Other Post Employment Benefits

Auditor of Public Accounts
COMMONWEALTH OF VIRGINIA

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Outline

Other Post Employment Benefits (OPEB)

- Background
- Financial Reporting Requirements
- Bond Rating Agency Comments
- Commonwealth's OPEBs
  - – Description of benefit
  - – Accounting effect (expense and liability)
  - – Policy Questions

Background

- Governmental Accounting Standards Board issued two new accounting standards with requirements for Other Post Employment Benefits (OPEB)
- These are part of the compensation package that the Commonwealth, as an employer, offers for services received.

Background

- Post-employment benefits are a form of deferred compensation.
- Benefits are “earned” and obligations accrue during employment even though benefits are not taken until after employment.

Background

- The new standards require the cost of promised benefits to be recognized for financial reporting purposes during employment rather than after employment when the benefit is paid.
- The accrual-basis cost of benefits for a period is part of the total cost of government services for that period, *whether or not the employer chooses to fund it currently*.

Background

- Even if the benefits are not vested or guaranteed, or could potentially be amended or discontinued, they still must be accounted for as OPEB.
- An appropriation or consistent patterns of making payments in the past pursuant to an established funding policy are considered evidence of a formal commitment.

OPEB Actuarial Valuations
(in millions)

Benefit Plan	Unfunded Actuarial Liabilities	Annual Required Contribution	FY 08 Budget
Pre-Medicare Retiree Healthcare	$ 890.3	$107.4	$ 40.4
Line of Duty	98.6	9.8	10.0
Health Insurance Credit	601.1	49.1	43.8
Ret. Group Life Insurance	362.5	40.9	46.3
Long-term Disability	359.7	117.2	72.0
Total	$2,312.2	$324.4	$212.5

– Valuations as of June 30, 2006.
– Group Life is a cost sharing multiple employer plan. Total UAL is $739.7 million which is shared with localities based on participants (approximately 50/50)

Summary of Issues

- Fund with long-term, actuarially sound funding streams?
- Pursue alternative funding sources for plans that cover local employees?
- Change the benefits so the plans are less costly?
- Change benefits for new employees?
- Phase-in the actuarially required contribution?

Financial Reporting

- Reporting requirements must be implemented for the Commonwealth of Virginia for fiscal year 2008
- Recognize OPEB expense (actuarially required contribution - ARC)
- Report Net OPEB Obligation (i.e., difference between ARC and actual contributions) as a liability

Financial Reporting

- Footnote Disclosures:
  - Plan description
  - Funding policy
  - Contributions compared to OPEB expense
  - Change in net OPEB obligation
  - Funded status and actuarial assumptions

Independent Trust Funds

- If independent trust funds for the segregation and accumulation of plan assets are established and the annual required contribution (ARC) is fully funded, higher assumed rates of return (discount rates) on plan assets may be used in the actuarial valuation.
  - Higher assumed rates of return on plan assets reduces the Actuarial Accrued Liability e.g., VRS rate of return – 7.5%, Treasury rate of return – 3%

Independent Trust Funds

- If independent trusts are not established, the discount rate used in the actuarial valuation must be the general return rate on Commonwealth assets (i.e., Treasury rate).
- If independent trusts are established, but the ARC is not fully funded, the discount rate used in the actuarial valuations must be a blended rate, based on the proportion of contributions being used for asset accumulation versus payment of current benefits.

Independent Trust Funds

- Localities currently may not have the ability to create these types of trust funds
- The APA is currently working with their member organizations to develop a proposal for amending the Code of Virginia to allow them to create these funds

Bond Rating Impact – Fitch Quotes

- *Failure to make actuarially determined OPEB plan contributions will most likely result in rising net OPEB obligations, which like rising net pension obligations are a deferral of financial responsibility. Therefore, over time, a lack of substantive progress in funding and managing OPEB liabilities or a failure to develop a realistic plan to meet annual OPEB contributions could adversely affect an issuer's credit rating. Conversely, in Fitch's opinion, the prudent accumulation of assets in a trust account outside the general fund and well in advance of pay-as-you-go cost escalations can avoid or forestall liquidity problems or tax capacity concerns that might lead to credit deterioration.*

Bond Rating Impact – Fitch Quotes

- *Initially, Fitch's credit focus will be on understanding each issuer's liability and its plans for addressing it. Fitch also will review an entity's reasoning in developing its plan. An absence of action taken to fund OPEB liabilities or otherwise manage them will be viewed as a negative rating factor.*

Bond Rating Impact – Fitch Quotes

- *Reality dictates that an entity may opt to defer OPEB funding in times of budget stress. However, indefinite deferrals are damaging to credit quality. While not debt, pension and OPEB accumulated costs are legal or practical contractual commitments that form a portion of fixed costs. Long-term deferral of such obligations is a sign of fiscal stress that will be reflected in ratings.*

Bond Rating Impact – Moody's Quotes

- *Moody's does not anticipate that the liability disclosures will cause immediate rating adjustments on a broad scale.*
- *As governments and their retirement benefit plans begin issuing financial reports in compliance with the new rules, OPEB funding status will become more visible among the many attributes Moody's assesses in the municipal credit rating process.*

Bond Rating Impact – Moody's Quotes

- *Moody's will exclude OPEB liabilities from calculations of state or local debt burdens, but include them as a factor in the overall credit assessment of an issuer.*

Bond Rating Impact – Standard and Poor's Quotes

- *The new reporting may reveal cases in which the actuarial funding of postemployment health benefits would seriously strain operations, or, further, may uncover conditions under which employers are unable or unwilling to fulfill these obligations. In such cases, these liabilities may adversely affect the employer's creditworthiness. All Standard & Poor's rated employers will be monitored closely in terms of their reporting under GASB 45. Upon implementation of these new standards, we will include the new information as part of our ongoing analytical surveillance of ratings.*

Commonwealth OPEBs

- Pre-Medicare Retiree Healthcare – DHRM
- Line of Duty – DOA
- Retiree Health Insurance Credit – VRS
- Retiree Life Insurance – VRS
- Long-term disability – VRS

Pre-Medicare Retiree Healthcare

- Virginia has one health insurance program for both active employees and pre-Medicare retirees
  - Pre-Medicare retirees are former employees who are retired from state service but are not yet eligible for Medicare – typically 55-65 years of age

Pre-Medicare Retiree Healthcare

- During active employment the health insurance program requires payment of an employee-paid premium and an employer-paid premium
- After retirement the retiree premium is paid entirely by the retiree in an amount equal to the employee and employer premiums combined

Pre-Medicare Retiree Healthcare

- Premium rates for actives and pre-Medicare retirees are blended (i.e., one premium rate) even though actual claims experience shows retiree claims costs are higher
- Thus, even though pre-Medicare retirees pay their entire premium, the premium itself is subsidized by the premiums paid by/for active employees

Pre-Medicare Retiree Healthcare

- The implicit subsidy is the difference between retirees claims cost and amounts actually paid by retirees

Virginia Claims Experience vs. Contributions (single-coverage)

<table>
<tr><th>Age</th><th>Annual
Claims Cost</th><th>Annual
Contributions</th><th colspan="2">Annual
Implicit Subsidy</th></tr>
<tr><td>40-44</td><td>$2,761</td><td rowspan="5">While working:
$432 employee-paid
$4,080 employer-paid

After retirement:
$4,512 retiree-paid</td><td>$1,751</td><td rowspan="3">Paid by participant and employer</td></tr>
<tr><td>45-49</td><td>$3,592</td><td>$920</td></tr>
<tr><td>50-54</td><td>$4,388</td><td>$124</td></tr>
<tr><td>55-59</td><td>$4,860</td><td>$348</td><td rowspan="2">Received by participant</td></tr>
<tr><td>60-64</td><td>$6,637</td><td>$2,125</td></tr>
</table>

Pre-Medicare Retiree Healthcare

Key Preliminary Actuarial Results:

Discount Rate	Annual Required Contribution	Total Unfunded Liability
3%	$137.1 million	$1,403.3 million
7.5%	$107.4 million	$890.3 million

- ARC assumes current pre-Medicare retiree premium policy: full blended premium paid by retirees
- Approximately $40.4 million implicit subsidy already paid through active employee premiums (employer and employee-paid) that are higher than actual claims costs

Pre-Medicare Retiree Healthcare

- The ARC is to fund actuarially determined benefits earned by employees in the current year and to amortize the unfunded liability
- The portion in excess of the $40.4 million already funded must be accounted for as an expense and either set up as a liability or a contribution made to cover it
- Approximately $30.2 million is the GF share, $24.2 million is the NGF share, $7.6 million is employee share and $5.0 million is pre-Medicare retiree share

Pre-Medicare Retiree Healthcare

- Chapter 3 Item 461 O. establishes the Pre-Medicare Eligible Retiree Health Benefits Trust Fund
  - An independent trust administered by VRS
  - Currently would be funded only with share of existing (pay-as-you-go) health insurance premiums (blended retiree-paid premiums, implicit subsidy from actives)

Policy Issues

- Establish separate health care program and require retirees to pay full premium?
- Develop a less costly, less comprehensive plan for early retirees? Increase deductibles and co-pays?
- Create an early retiree health insurance premium credit program for retirees based on service levels similar to existing health insurance credit?

Policy Issues

- Fund with long-term, actuarially sound funding stream?
- Collect through a percentage of payroll?
- Phase-in ARC?
- Develop incentives to encourage employees to work more years?

Line of Duty

- Benefits for state/local public safety officers (police, fire, rescue)
- $100,000 death benefit and health insurance for surviving dependents
- Health insurance for disabled officers and dependents

Line of Duty

Key Preliminary Actuarial Results:

Discount Rate	Annual Required Contribution	Total Unfunded Liability
4%	$15.0 million	$183.4 million
7.5%	$9.8 million	$98.6 million

- $10 million already budgeted in FY 08
- The remainder of the ARC must be accounted for as an expense and either set up as a liability or a contribution made to cover it

Line of Duty

- Chapter 3 Item 262 B. establishes the Line of Duty Death and Health Benefits Trust Fund
- An independent trust administered by VRS
- Currently funded only with general fund (pay-as-you-go) appropriation

Policy Issues

- Fund with long-term, actuarially sound funding stream?
- Collect through percentage of payroll?
- Widen funding scope beyond State General Fund? – 60% of covered public safety officers are local employees
- Phase-in ARC?

Retiree Health Insurance Credit

- $4 per year of service paid to cover a portion of the monthly health insurance premium cost
- Given to retirees with a minimum of 15 years of VRS service (Chapter 622 removed cap for state employees)
- Already separate fund administered by VRS

Retiree Health Insurance Credit

Key Preliminary Actuarial Results:

Discount Rate	Annual Required Contribution	Total Unfunded Liability
3%	$65.1 million	$1.1 billion
7.5%	$49.1 million	$601.1 million

- $43.8 million already budgeted in FY 08
- The remainder of the ARC must be accounted for as an expense and either set up as a liability or a contribution made to cover it - $2.7 million GF share, $2.6 million NGF share

Policy Issues

- Fund with long-term, actuarially sound funding stream?
- Collect through percentage of payroll?
- Phase-in ARC?

Retiree Group Life Insurance

- Active Employees – double annual salary
- Retirees – 25% of active employee benefit (i.e., 50% of salary)
- Already separate fund administered by VRS

Retiree Group Life Insurance

Key Preliminary LOD Actuarial Results:

Discount Rate	Annual Required Contribution	Total Unfunded Liability
3%	$104.9 million	$1,144.0 million
7.5%	$40.9 million	$362.5 million

- **$46.3 million already budgeted in FY 08 (for retirees)**

Retiree Group Life Insurance

- FY 08 budget higher than ARC because VRS Board certified funding levels applied a different actuarial method than required under by GASB and Board certified funding was approved for FY 08

Policy Issues

- No issues at this time for Group Life because there is a sufficient funding stream in the budget

Long-term Disability

- 60% of salary following 180 days on short-term disability
- Long-term disability period counts towards retirement service credit
- Already separate fund administered by VRS

Long-term Disability

Key Preliminary LOD Actuarial Results:

Discount Rate	Annual Required Contribution	Total Unfunded Liability
3%	$151.0 million	$633.9 million
7.5%	$117.2 million	$359.7 million

- $72.0 million already budgeted in FY 08
- The remainder of the ARC must be accounted for as an expense and either set up as a liability or a contribution made to cover it; $22.5 million GF share, $22.7 million NGF share

Policy Issues

- Fund with long-term, actuarially sound funding stream?
- Collect through percentage of payroll?
- Close to fully funding the required contribution

OPEB Actuarial Valuations
(in millions)

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OPEB Actuarial Valuations
(in millions)

Benefit Plan	Required Contribution	FY 08 Budget	Additional Needed	GF Share	NGF Share
Pre-Medicare Retiree Healthcare	$107.4	$ 40.4	$67.0	$30.2	$24.4
Line of Duty	9.8	10.0	(.2)	(.2)	
Health Insurance Credit	49.1	43.8	5.3	2.7	2.6
Ret. Group Life Insurance	40.9	46.3	(5.3)	(2.7)	(2.6)
Long-term Disability	117.2	72.0	45.3	22.5	22.7
Total	$324.4	$212.5	$112.1	$52.5	$47.1

- Amounts are rounded
- Pre-Medicare retiree healthcare additional needed also has a $7.6 million employee share and $5.0 pre-Medicare retiree share

Summary of Issues

- Fund with long-term, actuarially sound funding streams?
- Pursue alternative funding sources for plans that cover local employees?
- Change the benefits so the plans are less costly?
- Change benefits for new employees?
- Phase-in ARC?

Questions?

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