OTHER POST-EMPLOYMENT BENEFITS IN THE SPOTLIGHT

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AGENDA

- GASB Accounting Standards Nos. 74/75
  - Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans
  - Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions
- Michigan Public Law (PA) 530 of 2016 (HB 6075)
  - Amendment to Act 314 of 1965, Public Employee Retirement System Investment Act
OVERVIEW

- Over 600 local Michigan governments offer OPEB benefits
- $10.1 billion unfunded OPEB liabilities
- Increased transparency
  - Net OPEB liability reflected on balance sheet for FY 2017/18
  - Michigan-mandated disclosures for OPEB related to retirement systems

Source: Report
GASB Nos. 74 and 75
## OVERVIEW

<table>
<thead>
<tr>
<th>Effective Date</th>
<th>GASB 74 Plan Accounting</th>
<th>FY after 6/15/2016</th>
<th>GASB 75 Employer Accounting</th>
<th>FY after 6/15/2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Replaces</td>
<td>GASB 43</td>
<td></td>
<td>GASB 45</td>
<td></td>
</tr>
<tr>
<td>Pension “sibling”</td>
<td>GASB 67</td>
<td></td>
<td>GASB 68</td>
<td></td>
</tr>
</tbody>
</table>
KEY CHANGES

- Net OPEB obligation reflected in net position
- Discount rate determination
- Decouples expense from funding
- Mandated actuarial cost method
- Significantly increased disclosure requirements
## PENSIONS VS. OPEB ACCOUNTING STANDARDS

<table>
<thead>
<tr>
<th></th>
<th>Pensions</th>
<th>OPEB</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Plan type</strong></td>
<td>Multiple and single employer</td>
<td>Typically, single employer</td>
</tr>
<tr>
<td><strong>Documentation</strong></td>
<td>Formal plan documentation</td>
<td>More informal “Substantive plan” evolving over time</td>
</tr>
<tr>
<td><strong>Governance</strong></td>
<td>Independent, stand-alone entity</td>
<td>Employer</td>
</tr>
<tr>
<td><strong>Pace of change</strong></td>
<td>Infrequent</td>
<td>Frequent</td>
</tr>
<tr>
<td><strong>Accounting</strong></td>
<td>Trust focused</td>
<td>Often non-trusted</td>
</tr>
<tr>
<td><strong>Audit</strong></td>
<td>Trust focused</td>
<td>Significant focus on employer</td>
</tr>
<tr>
<td><strong>Benefit levels</strong></td>
<td>Salary-related</td>
<td>Level benefit means more valuable</td>
</tr>
<tr>
<td></td>
<td></td>
<td>to lower, mid-paid employees</td>
</tr>
<tr>
<td><strong>Benefit taxability</strong></td>
<td>Ordinary income</td>
<td>Not currently taxed</td>
</tr>
<tr>
<td>(Federal)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Funding</strong></td>
<td>Mandated</td>
<td>Not mandated (yet)</td>
</tr>
</tbody>
</table>
OPEB Trust and Funding Considerations
QUALIFYING TRUST
Requirements

- Contributions are irrevocable
- OPEB plan assets for exclusive benefit of plan members
- OPEB plan assets legally protected from creditors of the employer, nonemployer contributing entities, plan administrators and plan members
- Qualifying trusts commonly seen in practice
  - Integral part trusts
  - Voluntary Employees Beneficiary Association (VEBA)
  - Section 401(h) trust

1 GASB 75, paragraph 4
QUALIFYING TRUST

- Does not qualify
  - Pay-as-you-go (PayGo)
  - Informal set asides within general fund
  - Secondary/stabilization trusts

- Potentially qualifying
  - Multifunction trust (e.g., active employee/OPEB)
    - May qualify if OPEB/non-OPEB assets partitioned
      - Partitioned OPEB assets must meet qualifying trust requirements
DISCOUNT RATE SELECTION¹
Single Rate Used to Determine Total OPEB Obligation

- Expected rate of return on OPEB plan investments, to the extent that:
  - Fiduciary net position projected to be sufficient to make projected benefit payments, **and**
    - Based on cash flow projections
  - Investment strategy in place to achieve that return

- To extent conditions above not met:
  - Yield/index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher
    - This is the PayGo discount rate

¹ GASB 75, Paragraph 36
DISCOUNT RATE SELECTION

Bond Buyer GO 20-Bond Municipal Bond Index

Value as of 7/20/2017 is 3.51%
Source: St. Louis Federal Reserve and Bond Buyer
DISCOUNT RATE SELECTION\(^1\)
Impact of Discount Rate\(^1\)

- Rule of thumb
  - 100 basis point \textit{increase} in the discount rate
  - 10% to 15\% \textit{decrease} in Total OPEB Obligation

- Example:
  - 3.50\% PayGo discount rate: $100 million Total OPEB Obligation
  - 6.50\% qualifying trust discount rate: $55 to $70 million Total OPEB Obligation

\(^1\) GASB 75, Paragraph 36
DISCOUNT RATE SELECTION

Impact of Discount Rate

- Cash flow projections determine the single, blended discount rate based on
  - Expected return on plan assets, and
  - 20-year municipal bond rate
- Future cash flows of employer contributions
  - Professional judgement if a formal written policy, statute or contract exists regarding contributions
  - Otherwise, projected contributions are limited to the average contributions of the prior five (5) years

1 GASB 75, Paragraph 37 to 39
MICHIGAN SPECIFIC

- HB 6075
- Responsible Retirement Reform Report
(PA) 530 OF 2016 (HB 6075)
AMENDS ACT 314 OF 1965, PUBLIC EMPLOYEE RETIREMENT SYSTEM INVESTMENT ACT

- Reporting requirements of Act 314 apply to “public employee retirement systems”
  - Employers may wish to confer with counsel regarding applicability, if any, to OPEB not part of a retirement system

- Expanded disclosure

- Provide summary annual report (SAR) to MI Department of Treasury (DOT)

- Requires DOT to post SAR summary on its website, including net pension/OPEB obligation

- Requires local system with a funded status below 60% to post on its website what steps, if any, it may take to decrease its unfunded actuarial liabilities
Unfunded local OPEB liabilities ($10 billion) exceed pension liabilities ($7 billion)$^{1}$

- $13 billion in liabilities, $3 billion in assets, 340 local government units
- $160 million in OPEB bonds

Four main recommendations

- Greater reporting and transparency
- Creation of local pension/OPEB stress test system
- Creation of a new Municipality Stability Board (MSB)
- Minimum funding requirements to pay OPEB normal costs for new employees

$^{1}$ As of FY 2015. Underlying assumptions not disclosed.
CLOSING THOUGHTS
Full vs. Partial vs. PayGo Considerations

- Volatility is inescapable
  - Funded: capital market volatility, assets reported at market value (no smoothing)
  - Unfunded: changes in municipal bond index
- Ultimate long-term cost of plan
  - Investment earning approximately 61% of all public pension revenues
  - PayGo costs will ultimately exceed funded costs
- Balance sheet impact
- Intergenerational equity
- Securing the benefit

1 National Association of State Retirement Administrators, July 19, 2017