



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*
- ▶ Michigan's "*Responsible Retirement Reform for Local Government Task Force*" Report (July 2017) ("Report")

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



A man with a friendly expression, wearing a blue and white checkered button-down shirt, is seated at a desk in an office. He is holding a pen in his right hand and writing on a document. The desk also has a computer keyboard and a mouse. In the background, there are office cubicles with glass partitions and white overhead cabinets. A semi-transparent blue banner is overlaid on the left side of the image, containing the text 'GASB Nos. 74 and 75'.

GASB Nos. 74 and 75

OVERVIEW

	GASB 74 Plan Accounting	GASB 75 Employer Accounting
Effective Date	FY after 6/15/2016	FY after 6/15/2017
Replaces	GASB 43	GASB 45
Pension "sibling"	GASB 67	GASB 68

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

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

A woman with dark hair, wearing a grey short-sleeved shirt, a red high-visibility safety vest, and blue nitrile gloves, is holding a clear glass Erlenmeyer flask containing a light-colored liquid. She is looking down at the flask with a focused expression. The background is an industrial facility with large white pipes, metal brackets, and a blurred overhead light fixture. A semi-transparent blue horizontal band is overlaid across the middle of the image, containing the title text.

OPEB Trust and Funding Considerations

QUALIFYING TRUST

Requirements¹

- ▶ 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



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

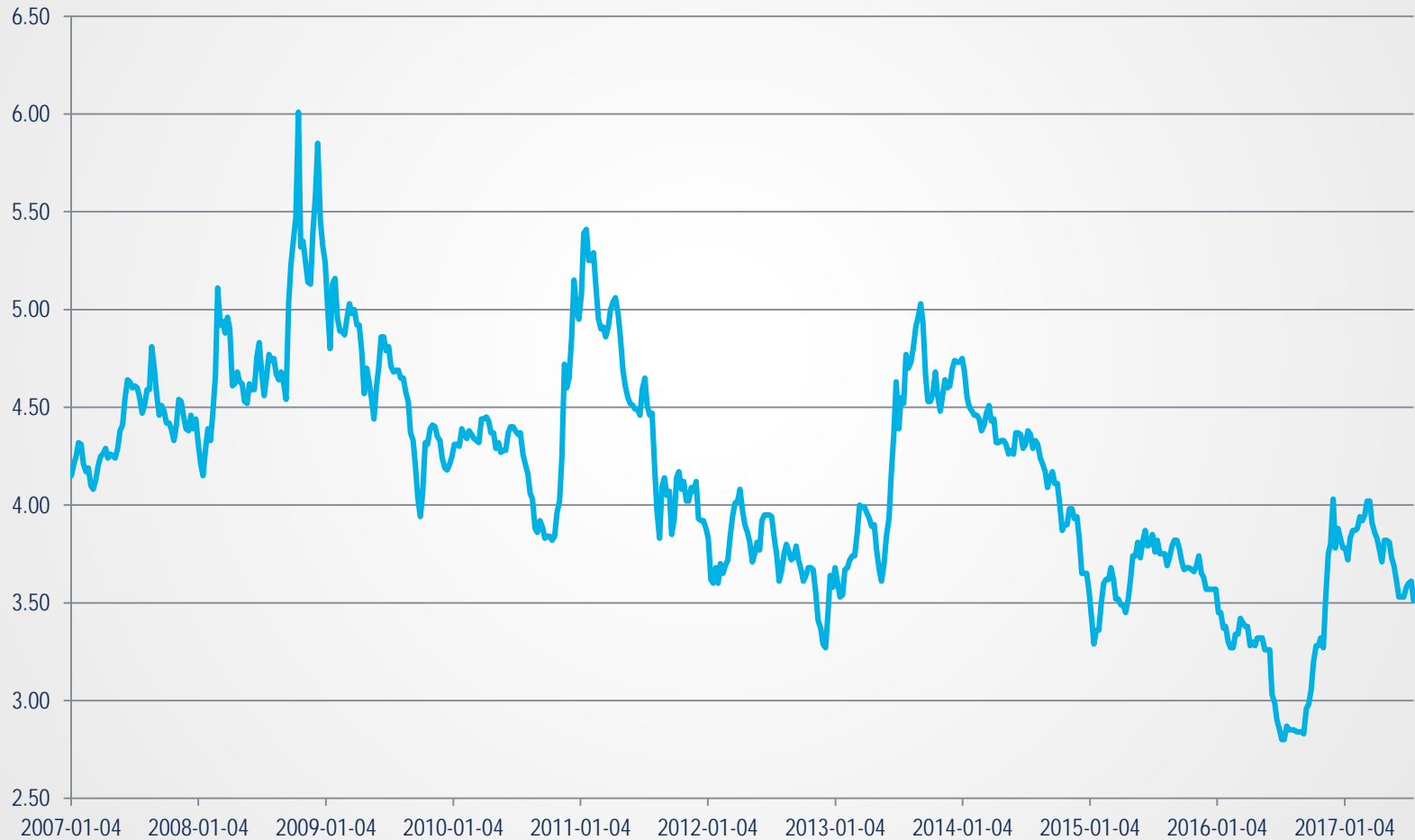
Single Rate Used to Determine Total OPEB Obligation

- ▶ 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



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 SELECTION¹

Impact of Discount Rate¹

- ▶ Rule of thumb
 - ▶ 100 basis point **increase** in the discount rate
 - ▶ 10% to 15% **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



DISCOUNT RATE SELECTION¹

Impact of Discount Rate¹

- ▶ 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



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



“RESPONSIBLE RETIREMENT REFORM FOR LOCAL GOVERNMENT TASK FORCE” REPORT

- ▶ Released July 18, 2017
- ▶ 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 revenues¹
 - ▶ 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