

MFP COMMITTEE #1
November 27, 2006

MEMORANDUM

November 22, 2006

TO: Management and Fiscal Policy Committee

FROM: Stephen B. Farber, Council Staff Director *SBF*

SUBJECT: Update – GASB Statement on Other Post-Employment Benefits (OPEB)

This update deals with the response of County agencies to Governmental Accounting Standards Board (GASB) Statement 45, Financial Reporting for Other Post-employment Benefits (OPEB). The benefits involved are chiefly retiree health and life insurance benefits, as distinct from pensions.

Starting in FY08, jurisdictions with more than \$100 million in annual revenue must disclose their liability for OPEB. Most governments now fund these benefits on a pay-as-you-go basis to cover the annual expense for current retirees. The accrual standard in GASB 45 requires disclosure as well of the expense for employees who may one day be entitled to a benefit.

GASB 45 does not require funding the accrued expense, but credit rating agencies expect that AAA jurisdictions like the County will do so. Full pre-funding for the four tax-supported agencies would cost \$240.0 million in FY08. Ramping up to full funding over a five-year period would cost \$31.9 million in FY08 above the pay-as-you-go expense and a somewhat larger increment each year until full funding is achieved in FY12.

The focus of this update is on the November 13, 2006 report of the Multi-Agency OPEB Work Group on ©A-G. The Committee will hear from representatives of the four tax-supported agencies – County Government, MCPS, Montgomery College, and M-NCPPC, and also from WSSC – and from its consultant on this issue, Thomas Lowman of Bolton Partners, Inc. His comments on the report are on ©H-K.

Previous Work by the Committee and County Agencies

Starting in February 2003, when GASB issued exposure drafts, the Committee and the agencies were among the first state and local officials to address this issue. At the Committee's request, the agencies' finance, budget, benefits, and legal staff met three times in 2003 to develop a common understanding of relevant questions. They also took an important step by obtaining valuations of their retiree group insurance obligations as of July 1, 2003.

On November 28, 2005, the Committee reviewed the agencies' further progress and agreed that the agencies should:

- Update the actuarial valuations as of July 1, 2006.
- Create a trust – perhaps effective July 1, 2007 – if the agency has not already done so.
- Assess the costs and benefits of different pre-funding options and make specific recommendations on the extent, timing, and phasing of pre-funding.
- Assess the full range of options for limiting liability, including collective bargaining implications that may vary by agency.
- Use consultant assistance for these tasks that can draw on the growing body of experience from other jurisdictions.
- Provide updates to the Committee at least twice in 2006 – for example, in June and November – and regularly in 2007 until implementation begins on July 1, 2007.
- Design and implement a communications plan to keep agencies, employees, and the public informed of developments on this issue.

June 2006 Agency Updates

On June 26, 2006 the Committee received an update on the agencies' work. See ©1-12. Mr. Firestine's memo on ©1-5 outlines the efforts of County Government as of that date. These include developing a project timeline, formalizing a Multi-Agency OPEB Work Group, preparing for an updated actuarial valuation, and participating in the MDGFOA Affinity Group.

Mr. Bowers' letter on ©6-7, Mr. Campbell's letter on ©8-9, Ms. Barney's memo on ©10-11, and Mr. Traber's memo on ©12 discuss their agencies' work as of late June 2006 on updated actuarial valuations, trusts, and other issues.

Further Background Information

For the benefit of readers who have not followed day-to-day developments on this matter, this packet also contains three pieces from the last two Committee update packets that provide excellent background information:

- On ©13-16, a November 23, 2005 *Wall Street Journal* summary of efforts that some governments have already made, ranging from attempts to limit or even eliminate retiree health benefits to the issuance of "OPEB bonds".
- On ©17-21, a June 2005 special report by Fitch Ratings on the credit implications of GASB Statement 45.

- On ©22-27, a July 2005 special comment by Moody's Investors Service that addresses a broad range of funding issues.

Two additional articles provide further important background information:

- On ©28-32, a December 1, 2005 *New York Times* review of how the city of Duluth, Minnesota, the State of Alaska, and other jurisdictions are addressing this issue.
- On ©33-35, a January 30, 2006 *Washington Post* review of how this issue affects state and local governments in this region.

An especially useful reference document is the November 2006 report of Anne Arundel County's GASB45 Task Force. The following key excerpts from this report are attached:

- On ©36-37, a discussion of alternative trust funding vehicles.
- On ©38-48, a detailed review of options for addressing the County's OPEB liability.
- On ©49-50, a useful glossary of terms.
- On ©51, a January 1, 2006 bulletin on the County's revised policy on employee eligibility for retiree health benefits, including a minimum of 15 years of credited pension service.

Multi-Agency OPEB Work Group Report

The Work Group report on ©A-G reflects the significant progress the agencies have made on the issues identified by the Committee (see page 2). Agency representatives, together with Mr. Lowman, will discuss these issues point by point. His comments are on ©H-K. Key items in the Work Group report and Mr. Lowman's comments include the following:

- The tax-supported agencies all have actuarial valuations as of July 1, 2006. (WSSC's valuation is as of June 2005 and is being updated.) The Annual Required Contribution (ARC) for the tax-supported agencies is \$240.0 million. The Actuarial Accrued Liability (AAL) is \$2.6 billion. Both figures significantly exceed those developed in the valuations of three years ago. Mr. Lowman accepts these figures.
- The FY08 budget impact of a five-year phase-in approach for the tax-supported agencies is \$31.9 million plus \$7.0 million for increased pay-as-you-go costs. For details see ©C-E. Mr. Lowman supports the five-year phase-in approach and says that he understands and supports the methodology outlined on ©C-E.
- M-NCPPC has a trust in place. The other agencies plan to establish one by July 1, 2007. See ©F-G. Mr. Lowman raises questions about the purpose, limits, and number of trusts. See ©I-J. See also the excerpt from the Anne Arundel report on ©36-37.

- The agencies have started to examine options for limiting liability, including collective bargaining implications that vary by agency. See ©F-G. Mr. Lowman notes that some other jurisdictions have done more specific work in this area. See, for example, the excerpts from the Anne Arundel report on ©38-48 and ©51. He also suggests that agencies' benefits be harmonized to a greater extent. Some of the current differences among agencies are clear from the descriptions on ©F-G.
- The agencies continue to work on these issues with their actuarial consultants. Mr. Lowman notes that by July 2007 much more information about trusts and options for limiting liability will be available from other jurisdictions.
- The agencies have focused on the work outlined above and have not yet addressed the Committee's request that they "design and implement a communications plan to keep agencies, employees, and the public informed of developments on this issue." Mr. Lowman notes that "it will be important to share this information and what it means."

Next Steps

At least two follow-up Committee meetings with the agencies before the July 1, 2007 effective date of GASB 45 would be useful – perhaps one in early March and one in mid-June. These meetings should focus on the following questions:

- Have the agency budgets all included the FY08 phase-in expense outlined above?
- Will trusts be in place at all agencies on July 1? How have the agencies resolved the issues about trusts raised by Mr. Lowman on ©I-J?
- What further progress have the agencies made in exploring options for limiting liability, as outlined on the top of this page?
- What progress have the agencies made in developing a communications plan, as outlined above? The prompt involvement of the Interagency Public Information Working Group (IPIWG) will be important in this regard.

MEMORANDUM

November 13, 2006

TO: Management and Fiscal Policy Committee
FROM: Multi-Agency OPEB Work Group
SUBJECT: Update for November 27, 2006 MFP Committee Meeting

The purpose of this memorandum is to provide an update of County agencies' activities related to implementation of Governmental Accounting Standards Board (GASB) Statement 45, Financial Reporting for Other Post-employment Benefits (OPEB).

At the June 26, 2006 Management and Fiscal Policy Committee meeting on this subject, the Committee identified areas it would like to be updated on periodically. The areas identified and the current status of progress in those areas is covered below.

Status Report

- Update the actuarial valuations as of July 1, 2006, three years later than the current valuations.

Attachment A provides a summary of the updated actuarial valuation results for the tax-supported agencies. WSSC valuation results are as of June 2005 and an updated valuation is being prepared.

The updated results show that, assuming pre-funding, the Annual Required Contribution (ARC) for the tax-supported agencies is \$240.0 million and the Actuarial Accrued Liability (AAL) is \$2.6 billion. In the 2003 valuation, the pre-funding ARC was \$190.5 million and the AAL was \$1.8 billion.

- Assess the costs and benefits of different pre-funding options and make specific recommendations on the extent, timing, and phasing of pre-funding.

Attachment A displays the budgetary impact of a five-year phase-in approach. The rating agencies have indicated that a phased-in approach is acceptable. While they have not specifically indicated the acceptable time frame, recent statements from the rating agencies focus on a five year period.

Assuming a five-year phase-in approach, the budgetary impact in FY08 for the tax-supported agencies would be \$38.9 million. This includes \$31.9 million to meet the OPEB phase-in obligation and \$7.0 million related to increased retiree benefit costs.

(A)

- Create a trust – perhaps effective July 1, 2007 – if the agency has not already done so.

Attachment B provides an update for each agency on the work related to establishing OPEB trusts.

M-NCPPC already has a trust in place. All other agencies are working with legal counsel to have a trust established effective July 1, 2007.

- Assess the full range of options for limiting liability, including collective bargaining implications that may vary by agency.

Attachment B provides an update for each agency on the work related to exploring options for limiting liability.

- Use consultant assistance for the tasks that can draw on the growing body of experience from other jurisdictions.

The agencies continue to work with their actuaries, each of which are providing OPEB consulting and related actuarial services to a number of governments, to address the requirements and options associated with implementation of the OPEB standards. The Council's consultant, Mr. Tom Lowman, attended the last meeting of the multi-agency OPEB work group and has been sharing his experiences with other jurisdictions. Several conferences held in Maryland recently by statewide groups like the Maryland Government Finance Officers Association, and by various actuarial, accounting, law, and investment banking firms have addressed and presented examples of activities going on in jurisdictions in Maryland and around the country related to plan design changes.

- Design and implement a communications plan to keep agencies, employees, and the public informed of developments on this issue.

Agencies are currently focusing their work on developing the specific facts related to GASB 45. Once the factual foundation is developed, it can serve as the basis for communication with employees and the public.

Representatives from each agency will be present at the November 27, 2006 Committee meeting to answer questions about the material provided.

Attachments

OPEB
Actuarial Valuation Results and Key Assumptions
MFP Committee Meeting - November 27, 2006

Results - Incremental Cash Required for FY08:												
Full Prefunding (ARC):												
Normal PayGo increase - FY07 -> FY08 ⁽⁹⁾	\$	1,480,790	\$	4,997,418	\$	180,000	\$	320,550	\$	6,978,758	\$	-
Additional cash required to fund ARC		70,100,000		80,300,000		3,032,000		6,052,500		159,484,500		9,712,000
Total additional cash required	\$	<u>71,580,790</u>	\$	<u>85,297,418</u>	\$	<u>3,212,000</u>	\$	<u>6,373,050</u>	\$	<u>166,463,258</u>	\$	<u>9,712,000</u>
5-yr Phase-in Above PayGo - First Year:												
Normal PayGo increase - FY07 -> FY08 ⁽⁹⁾	\$	1,480,790	\$	4,997,418	\$	180,000	\$	320,550	\$	6,978,758	\$	-
1/5 phase in to the ARC		14,020,000		16,060,000		606,400		1,210,500		31,896,900		1,942,400
Total	\$	<u>15,500,790</u>	\$	<u>21,057,418</u>	\$	<u>786,400</u>	\$	<u>1,531,050</u>	\$	<u>38,875,658</u>	\$	<u>1,942,400</u>
ARC as % of PayGo ⁽⁵⁾												
Actuarial Accrued Liability (AAL) ⁽⁶⁾	\$1,100,530,000		3.18		2.87		2.21		3.16		2.03	
Assumptions												
Discount Rate, assuming Full Prefunding ⁽¹⁾	8%		7.50% ⁽²⁾		7.50% ⁽²⁾		8%		7.50% ⁽²⁾		8%	
Actuarial Method	Projected Unit Credit Cost		Projected Unit Credit Cost		Projected Unit Credit Cost		Projected Unit Credit Cost		Projected Unit Credit Cost		Projected Unit Credit Cost	
Amortization Method	Level % of Pay		Level % of Pay		Level % of Pay		Level % of Pay		Level % of Pay		Level %	
Medical Cost Trend Rate (post 65)	10% -> 5%		10% -> 5.25% ⁽⁸⁾		10% -> 5%		10% -> 5%		10% -> 5%		13% -> 5.5% ⁽⁴⁾	

NOTES:

Council Policy Action

(1) Under a multi-year phase-in scenario, use of discount rate higher than operating investment rate (~ 4%) for accounting and budgeting purposes assumes that the County Council will have an adopted written policy of its intent to phase-in full funding of the incremental difference between PayGo and the ARC on an amortized even basis over a specific number of years (i.e., 5) beginning in FY08. Absent such a policy, County agencies would be required to record OPEB liabilities in their financial statement of almost twice as much as liabilities required with such a policy.

Differences Between Agencies

- (2) Agency rate is lower than County rate, since agency has used a rate consistent with its pension plan, which is lower than County's pension plan rate.
 (3) WSSC valuation is as of June 2005, prepared in March 2006; updated valuation not yet prepared.
 (4) WSSC used Level Dollar amortization method, which would result in higher costs than the Level % of Pay method.

Other

- (5) PayGo for this calculation includes Implicit Rate Subsidy Per Bolton Partners, Inc. 7/19/2006 GASB45 Survey range of ratio for 8 Maryland counties is 2.96 - 4.07. State of MD is about 3.2.
 (6) AAL is based on full prefunding.
 (7) M-NCPPC valuation is for Montgomery and Prince George's Counties combined. This analysis assumes 45% relates to Montgomery County.
 (8) MCPS medical cost trend represents an average across medical and prescription.
 (9) Assumes there will be a policy decision at the agency level to dedicate Medicare Part D subsidies to fund OPEB costs.

OPEB
Full Prefunding Calculation - and Assumed Sources of Full Funding of the ARC

Full Prefunding Calculation	Ref	County	MCPS	College	M-NCPPC - (PG & MC)	Mont City Portion of M-NCPPC (1)	Subtotal Tax-Supported Agencies	WSSC (8)
Full Prefunding (ARC) (4)	A	\$ 102,320,000	\$123,300,000	\$ 5,532,000	\$19,669,000	\$ 8,851,050	\$ 240,003,050	\$ 19,112,000
Less: FY08 benefit payments (4) (F&G)	B	26,720,000	43,000,000	2,500,000	4,919,000	2,213,550	74,433,550	9,400,000
Less: Implicit Rate subsidy	E	5,500,000	(4)	(6)	(4)	585,000	6,085,000	(8)
Equals: Additional FY08 funding required for ARC	C	\$ 70,100,000	\$ 80,300,000	\$ 3,032,000	\$ 1,300,000	\$ 6,052,500	\$ 159,484,500	\$ 9,712,000
Anticipated Funding Sources for Additional FY08 Benefits:								
FY08 Benefit Payments	B	\$ 26,720,000	\$ 43,000,000	\$ 2,500,000		\$ 2,213,550	\$ 74,433,550	\$ 9,400,000
Less amount to be funded by:								
Medicare Part D subsidy (2)	D	730,000	(4) 2,900,000	(6) 150,000	(4) \$ 300,000	(4) 135,000	3,915,000	(8) -
Equals total employer cash required		25,990,000	40,100,000	2,350,000		2,078,550	70,518,550	9,400,000
Less: Approved FY07 PayGo (5)	F	24,509,210	(3) 35,102,582	2,170,000		1,758,000	63,539,792	(7) 9,400,000
Equals additional FY08 cash required for FY08 Benefits	G	\$ 1,480,790	\$ 4,997,418	\$ 180,000		\$ 320,550	\$ 6,978,758	\$ -
Proof of FY08 ARC by Funding Source								
Medicare Part D subsidy (2)	D	\$ 730,000	\$ 2,900,000	\$ 150,000		\$ 135,000	\$ 3,915,000	(8) \$ -
Implicit Rate Subsidy	E	5,500,000	-	-		585,000	6,085,000	(8) -
FY07 PayGo	F	24,509,210	35,102,582	2,170,000		1,758,000	63,539,792	(7) 9,400,000
Additional Cash Required for FY08 Benefits	G	1,480,790	4,997,418	180,000		320,550	6,978,758	-
Additional Funding for the ARC	C	70,100,000	80,300,000	3,032,000		6,052,500	159,484,500	9,712,000
Total - FY08 ARC	A	\$ 102,320,000	\$123,300,000	\$ 5,532,000		\$ 8,851,050	\$ 240,003,050	\$ 19,112,000

NOTES:

- (1) M-NCPPC valuation is for total plan, which includes Montgomery and Prince George's employees/costs. Per M-NCPPC, Montgomery County portion is approximately 45%. ARC amounts and benefit payments per the actuary, under full prefunding scenario, have been adjusted in this column to reflect 45% of amount in the actuarial valuation.
- (2) Assumes there will be a policy decision at the agency level to dedicate Medicare Part D subsidies to fund OPEB costs.
- (3) County FY07 approved PayGo includes \$23,924,080 NDA appropriation, plus \$585k projected participating agency contributions, for total of \$24,509,210.
- (4) Source: Actuarial 5-yr calculations and accompanying schedule(s).
- (5) Source: Council (Sherer/Farber) spreadsheet labelled "Tax Supported Salaries and Benefits by Agency" - FY07 amounts.
- (6) Source: MCPS.
- (7) WSSC benefit payments represent payments for FY06. Valuation to be updated.
- (8) WSSC information not yet available.
- (9) WSSC valuation is as of June 2005, prepared in March 2006; updated valuation not yet prepared.
- (10) MCC FY08 expected benefit payments provided by MCC rather than projected amount per valuation, which appears understated.

(P)

OPEB
5 Year Phase-In Calculation - and Assumed Sources of Funding

5-Year Phase-In Calculation	Ref	County	MCPS	College	M-NCPPC - (PG & MC)	Mont City Portion of M-NCPPC ⁽¹⁾	Subtotal Tax-Supported Agencies	WSSC ⁽⁵⁾
Full Prefunding (ARC)								
Less: FY08 benefit payments (B&C)		\$ 102,320,000	\$ 123,300,000	\$ 5,532,000	\$ 19,669,000	\$ 8,851,050	\$ 240,003,050	\$ 19,112,000
Less: Implicit Rate subsidy		26,720,000	43,000,000	2,500,000	4,919,000	2,213,550	74,433,550	9,400,000
Equals: Additional FY08 funding required for ARC		5,500,000	-	-	1,300,000	585,000	6,085,000	-
		\$ 70,100,000	\$ 80,300,000	\$ 3,032,000		\$ 6,052,500	\$ 159,484,500	\$ 9,712,000
1/5 Phase-In Amount	A	\$ 14,020,000	\$ 16,060,000	\$ 606,400		\$ 1,210,500	\$ 31,896,900	\$ 1,942,400

FY08 Total Contribution Towards ARC by Funding Source

Medicare Part D subsidy ⁽²⁾		\$ 730,000	\$ 2,900,000	\$ 150,000	\$ 135,000	\$ 3,915,000	\$ -	(4)
Implicit Rate Subsidy		5,500,000	-	-	585,000	6,085,000	-	(4)
FY07 PayGo	B	24,509,210	35,102,582	2,170,000	1,758,000	63,539,792	9,400,000	(3)
Additional Cash Required for FY08 Benefits	C	1,480,790	4,997,418	180,000	320,550	6,978,758	-	
Additional Funding for the ARC	A	14,020,000	16,060,000	606,400	1,210,500	31,896,900	1,942,400	
Total - FY08 ARC		\$ 46,240,000	\$ 59,060,000	\$ 3,106,400	\$ 4,009,050	\$ 112,415,450	\$ 11,342,400	

NOTES:

- (1) M-NCPPC valuation is for total plan, which includes Montgomery and Prince George's employees/costs. Per AI M-NCPPC, Montgomery County portion is approximately 45%. ARC amounts and benefit payments per the actuary, under full prefunding scenario, have been adjusted in this column to reflect 45% of amount in the actuarial valuation.
- (2) Assumes there will be a policy decision at the agency level to dedicate Medicare Part D subsidies to fund OPEB costs.
- (3) WSSC benefit payments represent payments for FY06. Valuation to be updated.
- (4) WSSC information not yet available.
- (5) WSSC valuation is as of June 2005, prepared in March 2006; updated valuation not yet prepared.

Status of OPEB Trust Establishment and Plan Design Change Considerations

Agency	Trust Establishment	Plan Design Change Considerations
County	<p>The County is currently in the early stages of legal work in establishing a trust. Discussions have been held addressing the options involved, and the Office of the County Attorney is identifying policy decisions to be made, including the scope of activity/contributions to be included in the trust. Parallel work has been initiated to start work on drafting the trust documents. The County anticipates creation of legislation and a separate trust document, similar to the approach used in establishing the Deferred Compensation Plan. The County intends for the trust to be effective July 1, 2007.</p>	<p>The County has begun work with our actuary to develop short and long-term plan design strategies, and to cost out the savings associated with such strategies. For the majority of our employees, the implementation of specific strategies could be subject to collective bargaining. Regarding benefits for represented employees, those benefits would be the subject of collective bargaining.</p>
MCPS	<p>MCPS is working with our attorney to have the legal structure for the trust in place for July 1, 2007. We anticipate having the trust investment policy and oversight parallel our pension trust.</p>	<p>MCPS made significant changes to the benefit plan offered to retirees in 2002. Retirees pay 36 percent of the plan cost while MCPS pays 64 percent. MCPS mandates that Medicare eligible retirees enroll in Medicare, and are covered by a Medicare supplement plan or an HMO. The point-of-service plans are not available to Medicare eligible retirees. MCPS changed its prescription drug plan in 2002. Co-pays were increased, and use of generic drugs and mail order pharmacy for purchasing maintenance medications was made mandatory.</p> <p>MCPS is working with the unions and retiree association to review plan design in the context of the GASB funding challenge.</p>

(71)

Status of OPEB Trust Establishment and Plan Design Change Considerations

College	The College has evaluated the various options available and we are in the preliminary phases of establishing a trust. The trust will not be established until July 1, 2007.	The College is evaluating ways to change the eligibility criteria for retiree group insurance benefits (i.e., make it more restrictive). Currently, employees that have worked 5 years are eligible for retiree group insurance; the College contributes 40% of the premium and the retirees contribute 60% of the premium. Employees that have 10 years of service or more are eligible for retiree group insurance, where the College contributes 60% of the cost of the premium and the retiree pays 40% of the premium.
M-NCPPC	M-NCPPC has a trust in place with a balance of approximately \$130,000. There are no changes in this trust anticipated.	M-NCPPC had a study of Retirement Health Insurance benefits done in June 2006 by Aon Consulting. This study compared benefits of the Commission with Montgomery and Prince George's County Governments, Montgomery County Public Schools, Montgomery College and Washington Suburban Sanitary Commission. Based on that study, a Commission committee is reviewing possible plan design changes. However any proposed changes must first be reviewed and approved by the Commission. Amendments that legal counsel determines fall within the scope of collective bargaining will then need to be agreed upon with respective union representatives.
WSSC	Outside Counsel has advised that WSSC has the legal authority to establish a trust and the Commission plans on doing so for FY08.	Many jurisdictions are looking at revising their plans to pro-rate the employer subsidy based upon years of service at time of retirement. The Commission has already implemented such a cost sharing formula for retiree health, with 20 years of service required to receive the full employer subsidy. Also, several years ago, the Commission reduced the employer subsidy for all health plans from 85% to 80%. Additionally, the cost sharing percentage for the Point-of-Service plan, in which most retirees participate, was further reduced to 78%. We have also increased co-pays in recent years and continue to annually review plan design for further cost containment.

MEMORANDUM

DATE: November 20, 2006
TO: Management and Fiscal Policy Committee
FROM: Thomas Lowman, Bolton Partners, Inc.
SUBJECT: Comments on the Multi-Agency OPEB Work Group Report

Background:

As you know, there is a new accounting standard (GASB 45) for employer provided retiree health and life insurance benefits. This standard will apply for the first time in FY2008. The standard includes a change from determining plan expense on a "pay-as-you-go" cash basis to an accrual standard. Under an accrual standard there is not only an expense for current retirees but also for employees who may one day be entitled to a benefit. The exact amount of the higher expense will depend on whether or not this extra expense is funded during an employee's career. Whether or not additional cash payments are made by the County, the increase in the expense from an accounting perspective is very large (e.g. no less than \$159 million in FY08 for County tax-supported agencies).

Other large counties in Maryland also have material increases in their expenses for FY08. The State of Maryland estimated an increase of over \$1 billion in its annual expense for State employees. Public employees in Maryland generally have better benefits than employees in other states outside of the northeastern part of the country. In Virginia, some of the counties in Northern Virginia have benefits comparable to those offered in Montgomery County but as you move away from the DC area the expenses may be only 20% of what they are in Maryland on a per-capita basis. In some states many jurisdictions offer no retiree health or life insurance benefits.

We have reviewed various documents provided by the Multi-Agency OPEB Work Group and attended their recent meeting. This includes a review of their November 13, 2006 memorandum and the accompanying documents. That memo addressed areas on which the MFP Committee asked them to comment. Below are our comments on each of these seven areas requested by the MFP Committee, taking into account information presented by the Work Group:

Update the actuarial valuations as of July 1, 2006, three years later than the current valuations. This will allow adjustments for those current cost figures and for changes such as the inception of the new Medicare Part D prescription drug benefit.

As stated in the November 13th memo, all of the valuations have been updated and (except for WSSC) all are as of June 30, 2006. These 2006 valuations can serve as the basis for the FY08 expense determination. Overall, the increases seem to be about 30%. Since the 2003 valuations showed the equivalent of FY04 results, this 30% increase can be thought of as 7.5%/year. We would note that the percentage increase for the County government alone was higher. Overall, the increase seems reasonable given the increase in health insurance cost. Our expectation is that once the expense begins to be fully prefunded, the percentage increases in the expense will not be as high but will remain highly dependent on the increase in age adjusted per-person health care cost.

(H)

These new numbers reflect Medicare Part D. However, the impact of Medicare Part D is not material. As the County drug plans are currently designed (similar to the design in most counties), the accounting rules do not let us anticipate the continuation of the Medicare reimbursement.

Assess the cost and benefits of different pre-funding options and make specific recommendations on the extent, timing, and phasing of pre-funding.

The Multi-Agency OPEB Work Group is proposing to eventually fund the full accrual expense for these benefits. They are proposing to do this over a five-year period starting with FY08. We support the five-year approach and expect many other Maryland counties to do the same. Some entities with smaller increases in expense are expected to immediately fund the increase. We have reviewed the details of the three page summary on Attachment A to the November 13th Memorandum and understand the methodology and support it.

For FY08 the increased budget request for tax-supported agencies includes \$6,978,758 that would have been requested under the existing pay-as-you-go approach plus \$31,896,900 as the first 20% installment under the 5-year phase-in. For each of the following four years you should expect increases of \$31,896,900 plus something approximating normal increases in the Annual Required Contribution (ARC). For tax-supported agencies the ARC (if fully funded) for FY08 is \$240 million and annual increase in the ARC might range between \$8 million and \$24 million per year depending on health care cost increases above what was assumed in the valuations.

While something of a detail, it should be understood that during this five-year period the difference between the annual expense and the cash contribution will show up as an unfunded liability. This unfunded liability will exist even after the five-year period is over. Also, the expense calculated during the first five years will be higher than it would be if full funding of the ARC started in FY08. While all of these things are true, they should not be a material concern and we mention them only so that you are not surprised later.

Create a trust – perhaps effective July 1, 2007 – if the agency has not already done so. As Mr. Firestine noted, the advantage is a higher rate of investment return, on an actual and actuarial basis, and thus a lower annual required contribution in FY08.

We have read attachment B to the November 13th memorandum. As a general matter this is an administrative issue for each agency to deal with. I have shared some detailed thoughts with members of the Multi-Agency OPEB Work Group that involve issues they should consider. The issues that could be discussed at the Council level include:

1. Understanding the purpose of the trust and limits on its contractual significance: We believe that the purpose of the trust is to collect and invest funds to cover future potential employer obligations for the retiree benefits covered under GASB45. As such, the set aside funds will reduce the current employer expense (ARC). Others may wish to view the trust like the pension fund and have it collect both employer and employee/retiree funds. We want to be sure that this trust in no way increases the local government's obligation to provide benefits nor restricts its rights to change benefits. For this reason, we also would be concerned if any employee contributions were added to the fund. There may also be a concern if retiree funds are added to the trust. The role of employees in the trust could be discussed.

(1)

2. Should MCPS have its own trust fund or be combined with the County? In most other Maryland counties, school boards do not currently manage retirement funds and it is likely that some of these county governments and their schools will combine funds at least for investment purposes. Since MCPS does currently manage a large retirement fund, we have no objection to this being managed separately, which appears to be the direction being taken. We have discussed whether the amounts budgeted for funding these obligations can be redirected for other uses. We have been told that there are restrictions on how parts of the budget can be spent as well as political problems if these funds are not spent as intended. We would still suggest that this be at least briefly discussed at the meeting.

Assess the full range of options for limiting liability, including collective bargaining implications that may vary by agency.

We read the description of "Plan Design Change Considerations" in Attachment B to the November 13th Memorandum. It appears that most of the agencies are looking at possible changes to the benefits.

Many other counties in Maryland (including Howard, Frederick, Baltimore and Anne Arundel) have a list of several dozen potential changes that could be made and their impact on the employer's expense (and sometimes the retirees' cost). While I would describe these other counties as further along in their review process, most are not committed to making any changes. Many will likely wait until mid to late 2007 to decide on benefit changes. Only Baltimore County has been vocal about their need for material changes. It remains to be seen what the new GASB rules will do to plans in Maryland and what it will take to be competitive in the market place in the future.

We would recommend that consideration be given to try to make the benefits more similar in all of the agencies. Even the agencies with lower than average benefits have features that are very generous compared to other agencies. Some of these differences do not seem to have a purpose that would outweigh their cost.

If we look outside of Maryland or in the private sector, we see more examples of benefit changes in response to increasing health care expenses. In the private sector we also see a trend to reduce retirement benefits in order to maintain employee health care benefits which are more appreciated by employees and have better tax advantages.

We are not totally clear on the collective bargaining limitations in the various Montgomery County agencies and would note that in most other jurisdictions these benefits are not subject to collective bargaining.

Use consultant assistance for these tasks that can draw on the growing body of experience from other jurisdictions.

The November 13th memo from the Multi-Agency OPEB Work Group summarized what has been done. We know that the benefits offered vary widely between counties and between agencies within most counties. Given the level of benefits that are offered by the Montgomery County agencies, we know that the basic actuarial assumptions and methods used by the County

agencies are similar to those used elsewhere. This includes an assumption that the rate of increase in health care cost will slow down (which may or may not happen).

Many jurisdictions are watching to see how others react to the new rules and the higher expense. We expect that more will be known about how much others will prefund as we get closer to the final FY08 budget decisions. We recommend that this be tracked as we get closer to the Spring of next year.

As we get closer to July 2007, more trust documents will be written. We suggest looking at how others are setting up their trusts.

As we get to the end of 2007 it might be appropriate to look at benefit changes that others decide to make.

Anne Arundel County recently released their GASB45 report and Howard County may release a report early next year. We will share these documents and other documents if and when they become public.

Provide updates to the Committee at least twice in 2006 – for example, in June and November – and regularly in 2007 until implementation begins on July 1, 2007.

Our comments on the prior question outline some of the non-routine issues to be followed up on through at least the end of 2007.

Design and implement a communications plan to keep agencies, employees, and the public informed of developments on this issue.

We understand that since the revised expense calculations were only recently completed, the attention of the agencies has not been on these activities. It will be important to share this information and what it means. For example, if retirement ages under the retirement plan were to be lowered, there now will be an immediate impact on the retiree medical expense that may need to be factored into the bargaining process and fiscal impact statement. Also, the establishment of trusts will bring with them a discussion of roles and flow of funds.

(K)



DEPARTMENT OF FINANCE


Douglas M. Duncan
County Executive

Timothy L. Firestine
Director

MEMORANDUM

June 15, 2006

TO: Stephen B. Farber, Council Staff Director
Montgomery County Council

FROM: Timothy L. Firestine, Director
Department of Finance 

SUBJECT: OPEB Update

The purpose of this letter is to respond to your request for an update on the County Government's activities related to GASB Statement 45, Financial Reporting for Other Post-employment Benefits (OPEB).

In order to assure timely implementation and coordination, the Department of Finance has created a project timeline that includes tasks and milestones related to the administrative aspects of the OPEB project. The major task categories include actuarial valuation process, trust creation, budgeting/funding, plan design options/considerations, accounting, and coordination/communication. The steps necessary for completing each major task are identified and the timeline for completing those steps is mapped. A copy of the project timeline is attached.

In addition to creating the project timeline, an internal County Government workgroup was formalized. The work group includes representatives from the Department of Finance, Office of Human Resources, Office of Management and Budget, and Office of the County Attorney. The work group has met several times since the November MFP Committee meeting. The work group has focused its agendas on ensuring the completeness of, approving, and periodically updating the project timeline, organizing work related to updating the actuarial valuation, identifying issues for legal consideration, and identifying opportunities for County multi-agency coordination and collaboration. The workgroup has also actively participated in the MDGFOA OPEB Affinity Group, through which we share information between other local Phase I governments (those required to implement by the same deadline as the County agencies) on approach, issues, and internal progress toward implementation. Another focus of this work group has been to stay abreast of clarifying guidance being issued by GASB and to work to determine its impact on the County's efforts.



Office of the Director

1

In response to your request for information on progress related to the steps identified at the MFP meeting last November, the most substantial progress relates to updating the actuarial valuation. The County has selected an actuary to provide the OPEB valuation and held initial discussions to identify the scope of an initial updated valuation and identify issues that have required follow-up. For example, issues arose during the planning processes that have required additional clarification from GASB. As part of planning for the valuation, the workgroup has identified scenario options that are being incorporated into the valuation process, such as alternative funding phase-in options and alternative actuarial assumptions and methodologies. The updated valuation will also include expanded information beyond that included in the original valuation, such as a breakout of the annual required contribution attributable to County government, as plan sponsor employer, vs. the other agencies that participate in the County plan. The County is currently working with the actuary to finalize the assumptions the actuary is using in the valuation. It is expected that the updated valuation will be available later this summer. This timing is currently several months later than the originally planned goal; however, the workgroup is working with the actuary to identify opportunities for work relating to plan design and legal considerations to be conducted simultaneously, rather than sequentially, over the summer.

Also, to continue the interagency coordination on this subject you started several years ago, a multi-agency OPEB workgroup has been formalized. This group met a few weeks ago and was attended by 12 representatives from the various agencies of the County. The objectives covered at this first meeting included:

- Communicating agencies' status and planned next steps;
- Identifying information needed for FY 08 and multi-year fiscal planning/budgeting;
- Identifying opportunities for comparability of data based on consistency of valuation assumptions; and,
- Identifying next steps, including multi-agency coordination.

As I'm sure you will see from the responses from the various agencies to your request for an update for the MFP Committee meeting, most agencies have been working on updating their actuarial valuations. One of the results of the recently held meeting was to identify areas where agencies could try and achieve consistencies in the assumptions and funding scenarios incorporated into its updated valuations, and to start to identify areas where there may be valid reasons for inconsistencies. The group plans on meeting again in late August to start to review agencies' updated valuations from a fiscal planning perspective, and further identify those areas where there are valid reasons for different assumptions used across the agencies.

Page Three
Stephen B. Farber
June 15, 2006

The County looks forward to working with the Council on this topic of significant impact to state and local governments, and suggests that future updates to the Council be accomplished in a single multi-agency report coordinated through the Workgroup.

Attachment

ID	Task Name	Duration	Start	Finish
1				
2	Formal Trust	357 days?	Wed 3/1/06	Sat 6/30/07
3	Identify/Evaluate Options & Impact (not FY07)	65 days?	Wed 3/1/06	Tue 5/30/06
4	Staff Recommendations re Options	22 days?	Thu 6/1/06	Fri 6/30/06
5	Management Policy Recommendations	20 days?	Mon 7/3/06	Fri 7/28/06
6	Implement - create trust document (IA) (goal: 3/15 budget date)	167 days?	Tue 8/1/06	Tue 3/13/07
7	Implement - create/amend laws - County (goal: 3/15 budget date)	165 days?	Tue 8/1/06	Fri 3/9/07
8	Implement - create/amend laws - State (goal: FY07 legislative session)	64 days?	Thu 1/11/07	Tue 4/10/07
9	Deadline - trust to be in place if applicable (for FY08 effective yri)	0 days	Sat 6/30/07	Sat 6/30/07
10				
11	Budget/Funding	317 days?	Mon 3/27/06	Thu 5/31/07
12	Obtain updated baseline valuation (scope of report to be determined) - A	26 days?	Mon 3/27/06	Mon 5/1/06
13	Perform analysis over valuation (ie, non-tax supp rate impact) & options (ie, funding period)	22 days?	Tue 5/2/06	Wed 5/31/06
14	Obtain actuarial estimates re: cost/plan design options - B	94 days?	Mon 3/27/06	Tue 8/1/06
15	Staff Recommendations re Options	22 days?	Thu 6/1/06	Fri 6/30/06
16	Management Policy Recommendations	22 days?	Sun 7/2/06	Mon 7/31/06
17	Implement - Obtain ongoing assistance as needed - C	46 days?	Tue 8/1/06	Sun 10/1/06
18	Obtain updated actuarial valuations from other Council-funded/approved agencies - M	14 days?	Mon 8/14/06	Thu 8/31/06
19	Consider need for update for final FY06 valuation for budget planning purposes - D	45 days?	Mon 10/2/06	Wed 11/29/06
20	Implement - incorporate initial estimate to Budget Process and fiscal plan - FY08 - E	11 days?	Thu 11/30/06	Wed 12/13/06
21	Implement - Update budget estimates when FY06 valuation available	7 days?	Sun 10/1/06	Sat 10/7/06
22	Brief new CC and CE (part of budget process?) - G	22 days?	Fri 12/8/06	Fri 1/5/07
23	Development of FY08 Recommended Budget - pre new CE	80 days?	Fri 8/18/06	Fri 12/1/06
24	Development of FY08 Recommended Budget - post new CE	75 days?	Sat 12/2/06	Wed 3/14/07
25	Consideration by CE of Funding Options (part of budget process)	75 days?	Sat 12/2/06	Wed 3/14/07
26	Consideration by CE of Plan Design Options - I	75 days?	Sat 12/2/06	Wed 3/14/07
27	Deadline - FY08 CE Recommended Budget Published	0 days	Thu 3/15/07	Thu 3/15/07
28	Development of Final FY08 Budget Adopted by Council	54 days?	Mon 3/19/07	Wed 5/30/07
29	Est Deadline - FY08 Council Approved Budget	0 days	Thu 5/31/07	Thu 5/31/07
30				
31	Plan Design Options/Considerations	696 days?	Wed 3/1/06	Wed 10/8/08
32	Identify/Evaluate Options & Impact	65 days?	Wed 3/1/06	Tue 5/30/06
33	Obtain actuarial estimates re: cost/plan design options - B	94 days?	Mon 3/27/06	Tue 8/1/06
34	Determination of involvement/role of others (legal counsel, unions, etc)	65 days?	Wed 3/1/06	Tue 5/30/06
35	Normal annual plan design/redesign considerations & tie-in to GASB work	91 days?	Mon 5/1/06	Thu 8/31/06
36	Staff Recommendations re Options	22 days?	Thu 6/1/06	Fri 6/30/06
37	Initial Management Policy Recommendations	22 days?	Sun 7/2/06	Mon 7/31/06
38	Implement - Obtain ongoing assistance as needed - C	46 days?	Tue 8/1/06	Sun 10/1/06
39	FY08 annual rate-setting process	42 days?	Mon 8/14/06	Fri 10/6/06
40	Consideration by CE of Plan Design Options - I	75 days?	Sat 12/2/06	Wed 3/14/07
41	Obtain FY08 actuarial valuation - J	67 days?	Tue 7/1/08	Wed 10/1/08
42	Implement - Updated actuarial valuation	21 days?	Sat 12/2/06	Fri 12/29/06

ID	Task Name	Duration	Start	Finish
43	Implement - Incorporate to OHR contracting processes (assumes 1/1/08 effective date)	45 days?	Wed 8/1/07	Mon 10/1/07
44	Implement - Incorporate to future budgeting processes	165 days?	Thu 8/2/07	Sat 3/15/08
45	Implement - Incorporate final disclosures to FY08 F/S - K	5 days?	Thu 10/2/08	Wed 10/8/08
46	Future ongoing considerations??	1 day?	Wed 3/1/06	Wed 3/1/06
47				
48	Actuarial Valuations	678 days?	Mon 3/27/06	Wed 10/8/08
49	Conduct kickoff meeting with actuary and County	11 days?	Wed 3/29/06	Wed 4/12/06
50	Obtain updated baseline valuation (scope of report to be determined) - A	47 days?	Mon 3/27/06	Tue 5/30/06
51	Obtain actuarial estimates re: cost/plan design options - B	94 days?	Mon 3/27/06	Tue 8/1/06
52	Implement - Obtain ongoing assistance as needed - C	46 days?	Tue 8/1/06	Sun 10/1/06
53	Consider need for update for final FY06 valuation for budget planning purposes - D	45 days?	Tue 8/1/06	Sat 9/30/06
54	Implement - Incorporate initial estimate to Budget Process and fiscal plan - FY08 - E	11 days?	Sun 10/1/06	Thu 10/12/06
55	Obtain FY08 actuarial valuation - K	67 days?	Tue 7/1/08	Wed 10/1/08
56	Implement - Incorporate to financial statements (for FY08 from FY08?) - L	5 days?	Thu 10/2/08	Wed 10/8/08
57				
58	Accounting	583 days?	Thu 8/3/06	Wed 10/8/08
59	Determine F/S impact of trust and funding policy decisions	167 days?	Thu 8/3/06	Thu 3/15/07
60	Determine F/S impact of any creation or amendment to laws	185 days?	Thu 8/3/06	Tue 4/10/07
61	Implement - fund/general ledger changes	244 days?	Fri 8/4/06	Sat 6/30/07
62	Obtain FY08 actuarial valuation - K	67 days?	Tue 7/1/08	Wed 10/1/08
63	Implement - Incorporate final disclosures to FY08 F/S - L	5 days?	Thu 10/2/08	Wed 10/8/08
64				
65	Coordination/Communication	358 days?	Wed 3/1/06	Sat 6/30/07
66	Coordination/consultation with other Council-funded/approved agencies	291 days?	Wed 3/1/06	Fri 3/30/07
67	Planning (valuation timing, consistent funding assumptions, etc)	66 days?	Wed 3/1/06	Wed 5/31/06
68	Obtain updated actuarial valuations from other Council-funded/approved agencies - M	14 days?	Mon 8/14/06	Thu 8/31/06
69	Meet with Interagency OPEB Workgroup to review address results of updated valuations	15 days?	Mon 8/21/06	Fri 9/8/06
70	Periodic (estimated)	22 days?	Fri 12/1/06	Fri 12/29/06
71	Periodic (estimated)	22 days?	Thu 3/1/07	Fri 3/30/07
72	Participating agencies - planning - rates/budget & accounting - prelim est	45 days?	Tue 8/1/06	Sat 9/30/06
73	Participating agencies - update based on CE rec budget	22 days?	Fri 3/16/07	Sun 4/15/07
74	Participating agencies - update based on CC approved budget	22 days?	Fri 6/1/07	Sat 6/30/07
75	Departs - enterprise/int svc - planning - rates/budget & accounting	45 days?	Tue 8/1/06	Sat 9/30/06
76	Departs - enterprise/int svc - update for FY06 valuation - rates/budget & accounting	7 days?	Sun 10/1/06	Sat 10/7/06
77	Depts - enterprise/int svc - final impact based on CC approved budget	57 days?	Thu 3/15/07	Thu 5/31/07
78	Departments - as part of normal budget process??	124 days?	Sun 10/1/06	Thu 3/15/07
79	Others?	1 day?	Wed 3/1/06	Wed 3/1/06

(S)



850 Hungerford Drive * Rockville, Maryland * 20850-1747
Telephone (301) 279-3626

June 12, 2006

Mr. Steve Farber, Staff Director
Montgomery County Council
100 Maryland Avenue
Rockville, Maryland 20850

Dear Mr. Farber:

This letter is in response to your May 3, 2006, request for an update on the Governmental Accounting Standards Board (GASB) Statement Number 45, Financial Reporting for Other Post-employment Benefits (OPEB) which requires governmental agencies to disclose the liability for the cost of health benefits current employees and retirees will receive during retirement. This disclosure requirement was originally targeted for implementation in FY 2006; however, implementation has been delayed to FY 2008.

At the November 28, 2005, meeting of the County Council's Management and Fiscal Policy (MFP) Committee, it was agreed that several steps would be taken by County agencies over the coming months. We welcome the opportunity to update the MFP Committee on the status of these efforts.

The Montgomery County Public Schools (MCPS) is working with its actuary to prepare a new valuation, effective July 1, 2006. The valuation will include analysis of current demographics, plan design, and cost-sharing arrangements. MCPS has been working with other county and bi-county agencies to ensure there is consistency across agencies in methodology, process, timelines, and assumptions used. Agencies will consider common funding options and amortization methods, and will, to the extent possible, use a common approach for evaluating trend data. The agencies also are developing a plan to share data and report back to the MFP Committee.

The valuation also will look at the impact of the Medicare Part D prescription drug benefit that went into effect January 1, 2006. It should be noted that MCPS has opted to receive a subsidy from the Center for Medicare and Medicaid Services (CMS) as reimbursement for providing prescription drug benefits to Medicare eligible retirees. We have been advised that the GASB voted last week to finalize GASB's proposed technical bulletin, which will not allow MCPS to net out the subsidy payments and report reduced retiree medical liabilities when we adopt GASB Statement 45.

Finally, MCPS has begun discussions with legal counsel to explore options with respect to the possible need to establish a trust arrangement to manage funding our GASB liabilities.

Mr. Steve Farber

2

June 12, 2006

Montgomery County needs to address the issues of Other Post-employment Benefits funding as part of its overall financial planning. MCPS continues to work closely with the County Council and county agencies to address this issue cooperatively. MCPS staff will be present at the June 26, 2006, Management and Fiscal Policy Committee meeting.

Sincerely,



Larry A. Bowers
Chief Operating Officer

LAB:

Copy to:

Members of the County Council
Members of the Board of Education
Dr. Weast
Mrs. DeGraba
Mr. Doody
Mr. Girling
Dr. Spatz

(7)

June 7, 2006

Mr. Steve Farber
Montgomery County Council Staff Director
100 Maryland Avenue
Rockville, MD 20850

Dear Mr. Farber:

This letter is in response to your request of May 3, 2006 for an update on the Governmental Accounting Standards Board Statement Number 45, Financial Reporting for Other Post-employment Benefits (OPEB). This statement requires governmental agencies to disclose the liability for the cost of health benefits current employees and retirees will be eligible to receive during retirement. At the Management and Fiscal Policy Committee meeting in November 2005, it was agreed that the following steps appeared to make sense:

- Update the actuarial valuations as of July 1, 2006, three years later than the current valuations. This would allow adjustments for current cost figures and for changes such as the inception of the new Medicare Part D prescription drug benefit.
- Create a trust – perhaps effective July 1, 2007 – if the agency has not already done so. As Mr. Firestone notes, the advantage is a higher rate of investment return, on an actual and actuarial basis, and thus lower annual required contributions in FY08.
- Assess the costs and benefits of different pre-funding options and make specific recommendations on the extent, timing, and phasing of pre-funding.
- Assess the full range of options for limiting liability, including collective bargaining implications that may vary by agency.
- Use consulting assistance for these tasks that can draw on the growing body of experience from other jurisdictions. (Apart from the consultants used by the individual agencies, the Council has in the past received expert assistance on interagency health benefits issues from Bolton Partners.)
- Provide updates to the Committee at least twice in 2006 – for example, in June and November – and regularly in 2007 until implementation begins on July 1, 2007.
- Design and implement a communications plan to keep agencies, employees, and the public informed of developments on this issue.

As you are aware, the College had previously decided to comply with FAS106 beginning in FY94. As a result funds had been set aside to the extent possible until FY04. We have continued to have annual valuations to determine our accrued actuarial liability since then. We will be having a FAS106 calculation to determine our June 30, 2006 Accumulated Post-Retirement Benefit Obligation (OPBO) as well as an estimate of what our liability might be under GASB standards. We also have met with AON Consultants to discuss the implications of establishing a trust effective July 1, 2007. While there are still some questions to be answered, it appears there are many favorable aspects to be gained by the establishment of a trust for the GASB funding.

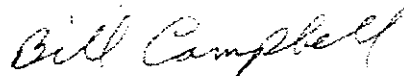
Mr. Steve Farber
Page 2

We continue to support the position that pre-funding to the greatest extent possible is the most prudent approach to take. In light of this expectation, the College hopes to be able to set aside some budgeted FY06 benefits funds that might be available as of June 30, 2006.

We also are reviewing our current retiree group insurance coverage eligibility requirements to determine what changes might be made to limit our future liability. We believe there are some options to consider. Our Office of Human Resources has been working with our consultants as well as participating in several informative educational opportunities on the implications and impact of GASB Statement 45. We also find the continued communication among all of the agencies benefits professionals to be extremely beneficial for assessing all aspects of the effect GASB 45 will have on all of us.

We look forward to our continued discussions and will be present at the June 26 worksession with the MFP Committee and our colleagues from the County-funded agencies.

Sincerely,



William E. Campbell
Executive Vice President
for Administrative and Fiscal Services


cc: Ms. Lawyer
Mr. Moore
Mr. Mullinix
Ms. von Bargaen

THE MARYLAND-NATIONAL CAPITAL PARK & PLANNING COMMISSION
Department of Finance, Office of Secretary-Treasurer

PCB06-35

June 14, 2006

TO: Management and Fiscal Policy Committee

FROM: Patricia Colihan Barney, Secretary-Treasurer 

SUBJECT: Update on M-NCPPC Other Post Employment Benefits (OPEB) –
response to GASB Statement No. 45

BACKGROUND: Per your request, this memo provides an update of the status of work related to implementing the Governmental Accounting Standards Board Statement Number 45, Financial Reporting for Other Post Employment Benefits. These benefits include medical, dental, and life insurance benefits at the Maryland-National Capital Park and Planning Commission.

One of the action items discussed at the November 2005 Management and Fiscal Policy Committee meeting related to the creation of a trust. The Commission established a 115 Trust in July of 1999. At the end of fiscal year 2005, after various contributions and withdrawals, the fund was almost depleted. The Commission decided to retain a small balance to keep the 115 Trust Fund open and ready to receive pre-funding contributions at a future date.

CURRENT STATUS: The Commission has been working with Aon Consulting to compare Commission OPEB with benefits offered by other governmental agencies. This study includes looking at alternatives offered to retirees by other agencies, examining possibilities of different levels of OPEB based on years of service, and benchmarking these various alternatives to estimate cost impacts. Commission Management is currently reviewing the consultant's report. Any proposed changes will be presented to the Commissioners in late fall.

Concurrently, we are pursuing the engagement of an actuary by riding a current contract. The selected actuary will perform a valuation as of July 1, 2006 to include the impact of Medicare Part D (if GASB's pending Technical Bulletin allows) and the requirement for consideration of implicit subsidies not included in the prior study. We will also look at

recording of a liability on the entity-wide financial statements of an amount equal to any unfunded required annual contribution beginning in fiscal year 2008. We are aware that the rating agencies will be looking for plans to be in place to address the pre-funding issue. It should be noted that the Prince George's County side of the Commission has factored in full annual pre-funding requirements in its long-term fiscal plan. The Commission will continue to work with the Montgomery County agencies to review a series of recommended strategies for pre-funding retiree medical.

The Commission's Finance Department has briefed the Commissioners on GASB Statement No. 45 so they will be informed as we move forward with both counties in determining how to establish a plan to address this issue. The Commission has not adopted a formal policy on pre-funding strategies. A series of recommendations will likely proceed to them after staff review of the Aon study.

V:\Update on MNCPPC OPEB-6_2006

WASHINGTON SUBURBAN SANITARY COMMISSION

Memorandum

TO: STEVE FARBER
MONTGOMERY COUNTY COUNCIL STAFF DIRECTOR

FROM: TOM TRABER
WSSC CHIEF FINANCIAL OFFICER

DATE: JUNE 13, 2006

SUBJECT: GASB 45 STATUS

Since last November, we have done the following with regards to implementing GASB 45:

- Our Commissioners were briefed on GASB 45 in February. This briefing was a high-level view of the pronouncement and its implications for WSSC and other governmental agencies.
- Aon prepared a June 30, 2005 actuarial valuation of OPEB in March. We are currently evaluating its results.
- A legal opinion as to whether WSSC can establish a trust under the current provisions of Article 29 of the Annotated Code of Maryland has been requested from outside counsel. If we do not have legislated authority, and the Commission determines that a trust is the appropriate vehicle for compliance, we would be submitting legislation in the upcoming legislative session.
- We have continued to participate with the Montgomery County Working Group in sharing information. It is very beneficial to have a feel for the specific plans that local agencies are making.
- Staff has also attended several briefings on GASB 45 by Aon, the Maryland Government Finance Officers' Association, and others.

Looking ahead, we anticipate having our implementation plan ready for Commissioner review by September and incorporating OPEB funding into the FY 2008 Spending Affordability process.

We look forward to continued participation with the Working Group and sharing our progress with the MFP Committee on June 26th.



November 23, 2005

State, Local Officials Face Looming Health-Care Tab

**Rule Requiring Disclosure
Of Obligations to Retirees
Could Force Painful Choices**

By DEBORAH SOLOMON
Staff Reporter of THE WALL STREET JOURNAL
November 23, 2005; Page A1

A looming accounting change is forcing state and local governments to fess up to something that's been lurking on their books for years: Many have made costly retirement health-care promises without planning how to pay for them.

Under a new accounting rule, governments soon must start recognizing their long-term obligations to pay for retirees' health benefits -- and, for the first time, publicly disclose what it would cost each year to fund that liability.

For many governments, the promised amount is likely to be sizeable enough to prompt big changes such as cutting retiree benefits, borrowing money and diverting tax dollars from other spending priorities -- or risk a credit-rating downgrade that could significantly boost borrowing costs. Estimates of obligations for some states range from \$500 million to as much as \$40 billion.

"This is going to be a big jolt to many state budgets, and this problem is one that is not immediately resolved," said Cecilia Januszkiewicz, secretary of Maryland's department of budget and management.

In many ways, the problem facing state and local governments mirrors that which has faced some companies, especially in labor-intensive, unionized industries such as autos and steel, which made big promises on pensions and health care that they ultimately couldn't afford to fund. Many governments are expected to respond in much the same way as corporations, which have slashed benefits since being forced in 1990 to recognize their retiree health-care obligations in financial statements.

But the dilemma for governments may be even thornier. Most states are legally required to provide some form of employee and retiree benefits for government workers, and changing or doing away with those benefits usually requires legislative action. While some local municipalities have more flexibility to change benefits, others must work through their state legislatures. In contrast, most public companies can easily trim benefits, especially those with weak or no union representation.

Cutting benefits for government workers is especially tough given that many employees are protected by strong unions that will challenge any such efforts. While unions representing workers in the private sector have lost significant clout, the municipal and

state unions remain quite strong. Additionally, while public companies can fall back on the Pension Benefit Guaranty Corp., which insures corporate pension funds, for some of the burden, governments have no such option.

So far, no state or local government has actually defaulted on any of its benefit plans. And the new rule doesn't require governments to set aside any money to fund the long-term obligations -- only to report what those obligations are.

But the change will shed new light on their long-term liabilities. And credit-ratings companies have told governments they expect the retiree health-care liability to be dealt with in some fashion. "We're looking to see that governments don't ignore it and look to control the growth of the obligation," said Richard Raphael, an analyst with Fitch Ratings.

How the ratings agencies respond will have big consequences for local and state governments, which borrow heavily from the public markets and need to maintain good ratings to keep borrowing rates low.

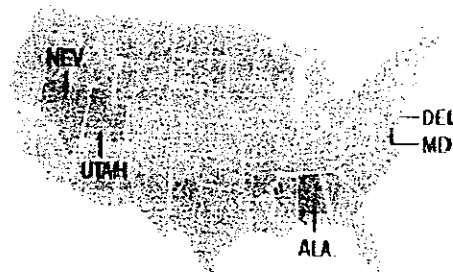
The accounting change will affect most big governments starting in fiscal 2008, which generally begins on July 1, 2007. It stems from a rule passed last year by the Government Accounting Standards Board, the independent advisory board that sets accounting standards for state and local governments.

With less than two years until the rule takes effect, governments already are scrambling to determine what they've promised to pay for retiree health care over the next 30 years -- and how to fund that liability. Until now, health-care benefits have been recorded on a pay-as-you-go basis, with budgets reflecting only the actual expense of benefits paid to employees and retirees each year.

Some already have gotten a taste of the bad news. Last month, Maryland disclosed a retiree-health-care liability of \$20 billion, and said it must put aside \$1.6 billion annually to fund the obligation. That's about 13% of the state's \$12 billion general fund and comes on top of the \$770 million Maryland shells out each year to pay for employee and retiree health-care benefits.

Scaling Back?

State and local governments are looking to curb escalating retiree health-care costs, which will come into view as the result of a pending accounting change. Here's a look at what several states are doing to respond to their long-term health-care liability:



Maryland	Alabama	Delaware	Nevada	Utah
ESTIMATED HEALTH-CARE LIABILITY:				
\$20.0 billion	10.9	3.0	1.75-4.40	0.54
ACTIONS TAKEN: Established a task force to explore ways to address health-care obligations	Increased health-care premiums for state employees who smoke; increased health-care costs for state employees who retire before 25 years of service	Committee established to review benefits unable to produce consensus around a single option or combination of options	Rejected a bill to end retiree health-care benefits for any state government employee hired after July 1, 2006	Passed legislation to end practice of allowing state employees to exchange eight hours of sick leave for one month's worth of retirement medical coverage

Source: Moody's Investors Service

Ms. Januszkiewicz said the \$20 billion obligation was much higher than the \$3 billion to \$5 billion officials had been anticipating, and will force the state to make some hard choices.

"When I got the

number I was in shock," said Ms. Januszkiewicz, adding that "there are a limited number of things we can do." A task force created by the state General Assembly earlier this year is examining the obligation and will make recommendations on how to deal with it.

The change comes at a time when many state and local governments already are struggling with other costs, such as fully funding their employee pension plans, which face shortfalls of as much as \$300 billion nationwide. Some are still recovering from the recession early this decade, which dented capital-gains and income taxes and caused a shortfall in revenue. In fiscal 2002, states suffered their steepest revenue drop since the Depression, said Mr. Raphael.

"States are coming off their worst fiscal crisis in decades," said Sujit CanagaRetna, a senior fiscal analyst with the Council of State Governments. "They're not really flush with funds and it's still a dire revenue picture as far as expenditures needed down the road."

Indeed, the situation is similar to the problems facing government-employee pension plans. Officials often promised big benefits but failed to set aside enough money to fund them, preferring during the 1990s to focus on outsized investment gains which eventually disappeared. The city of San Diego, for instance, is facing a \$1.1 billion pension shortfall in part because of agreements it made to sweeten benefits in exchange for reduced payments into the pension fund.

The problem has been years in the making. State and local governments began heavily expanding in the 1960s for a number of reasons, including the need for more schools as the Baby Boomers grew up and a heavier load of federal mandates, such as the 1965 Medicare law. As the number of employees grew, so did the cost of providing them benefits.

At the same time, the strength of public employees grew in tandem with the power of the American Federation of State, County and Municipal Employees, which represents public

workers. By the end of 1965, AFSCME had won collective-bargaining rights in several states, which translated into better and more generous benefits. And even with some recent cutbacks, costs are expected to swell over the next few years as the Baby Boomers begin to retire and collect both pension and health-care benefits.

For local officials, the latest dilemma could mean taking some politically unpopular stands. In Nevada, a proposal by Republican Gov. Kenny Guinn to discontinue retiree health-care benefits for any state government employee hired after July 1, 2006, ignited a firestorm.

The proposal was estimated to save the state \$500 million per year, but the state's employee union lobbied aggressively to scotch the legislation, and it failed in the Democratic-controlled state assembly. Nevada has estimated its retiree-health-care obligation to be as high as \$4.4 billion and says it will need to put aside about \$200 million annually to fund the liability.

Scott Mackenzie, executive director for the State of Nevada Employees Association, said unions understand that governments need to cut costs, but that ending benefits will turn people away from civil service, where robust benefits often make up for lower salaries.

"Government attracts people because they have a bit of a cushion there when they retire," said Mr. Mackenzie.

Other states have been unable to reach consensus on how to address the liability. A committee established earlier this year by Delaware Gov. Ruth Ann Minner, a Democrat, explored various ways to address the state's estimated \$3 billion obligation and the \$185 million it needs to set aside annually. The committee looked at a range of options, including reducing the state's agreement to pay 100% of health insurance for retirees, but was unable to agree on a plan. "Without exception, the options presented to the Committee included difficult and unavoidable policy trade-offs," the report concluded. "There are no straightforward 'win-win' solutions."

Some governments are opting to sell debt to finance their health-care obligation. For instance, Gainesville, Fla., issued bonds earlier this year to help finance its \$30.6 million liability.

Others are trimming benefits, despite the political ramifications. The city of Arlington, Texas, recently did away with retiree health benefits for any employee hired after 2006 and trimmed the percentage of health-care costs that the city covers. Arlington Chief Financial Officer Donna Swarb said the moves cut the city's health-care obligation to \$150 million from \$196 million. However, a more controversial plan to charge premiums based on age wasn't adopted and the city is still facing costs that Ms. Swarb called "unmanageable."

Alabama, Utah and Ohio also have taken steps to scale back benefits, including raising health-care premiums for retirees and increasing the length of time employees must work before being eligible for retiree health care.

Other states, such as California and New York, have yet to officially determine their liabilities but policy watchers and credit-ratings analysts expect those numbers will be significant. Some have predicted that California's obligation could be \$40 billion or more. The state controller's office has requested money from the governor and Legislature to perform an assessment of the liability.

Special Report

The Not So Golden Years Credit Implications of GASB 45

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The authors wish to thank finance department staff at Montgomery County, MD for sharing the results of a preliminary study of the county's OPEB liabilities, which provided valuable context to this report.

Related Research

- "Reversal of Fortune: The Rising Cost of Public Sector Pensions and Other Post-Employment Benefits," Sept. 18, 2003
- "Local Governments Pressured by Rising Employee Health Care Costs," Dec. 13, 2004

■ Summary

A new public sector accounting standard touches on three hot topics: skyrocketing health care costs, the ongoing national debate over retirement security, and the recent emphasis on greater financial disclosure. Governmental Accounting Standards Board (GASB) Statement No. 45 relates to other post-employment benefits (OPEB) — payments and services provided for retirees other than pensions. OPEB consist mainly of retiree health care benefits. GASB 45 applies the accounting methodology used for pension liabilities (GASB 27) to OPEB and is similar in concept to an accounting standard adopted for the private sector in the mid-1990s.

The new standard, to be implemented beginning in fiscal 2008 for many large governments, is timely given the aging demographics of the governmental work force. It also reflects the consistent efforts of the GASB to improve financial statement transparency and align public accounting more closely with that of the private sector.

GASB 45 does not increase costs of employment, but attempts to more fully reveal them by requiring governmental units to include future OPEB costs in their financial statements. Under current practice, nearly all governments pay only the cost of OPEB due in the current year, with no effort made to accumulate assets to offset future benefit costs. While not mandating funding, GASB 45 does establish a framework for prefunding of future costs.

Amounts required to prefund OPEB on an actuarially sound basis are likely to significantly exceed annual pay-as-you-go outlays for these benefits. Many actuaries believe, bolstered by preliminary studies done on behalf of a few proactive governments, that actuarially determined annual contributions could be five to 10 times higher than current expenses in many cases.

Fitch Ratings views GASB 45 as a positive step toward more fully illuminating governmental obligations to retirees, but acknowledges the inherent tension between allocating scarce resources toward critical government services today and meeting the funding requirements for retirement benefits that might not be due for decades. Fitch anticipates that governments will thoroughly review retiree benefit programs and that responses to OPEB funding challenges will vary considerably. However, Fitch expects many governments will approach GASB 45 in much the same way they responded to the adoption of pension system actuarial and accounting standards, by steadily ramping up annual contributions to actuarially determined levels, altering benefit plans, or taking other actions to ensure long-term plan solvency.

Credit Highlights

- Governmental Accounting Standards Board (GASB) Statement No. 45 will be the accepted accounting practice for governments as of its implementation dates. Failure to comply would prevent auditors from releasing a "clean" audit opinion.
- The switch to actuarial funding from a pay-as-you-go practice may have a sizable fiscal impact. However, Fitch Ratings believes that meeting actuarial funding requirements for other post-employment benefits (OPEB) will be a stabilizing factor and protective of credit over time.
- Fitch expects a wide range of unfunded liability positions to result as GASB 45 is implemented, reflecting the variability of benefits offered around the U.S. Annually required contributions are likely to place disparate burdens on the budgetary resources of state and local governments.
- 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.
- For issuers choosing to ramp up annual contributions to reach full funding of actuarially determined levels, Fitch recognizes that a rising net OPEB obligation in the short term may be a by-product. Such an increase, taken in the context of a sound OPEB funding plan, will not by itself affect credit ratings.
- Fitch does not expect OPEB plan funding ratios to reach the generally high levels of pension systems for many years, but steady progress toward reaching the actuarially determined annual contribution level will be critical to sound credit quality.
- Assumptions play a crucial role in calculating plan assets and liabilities. As actuarial standards for OPEB plans become clear, Fitch will review the underlying assumptions and will view negatively any that are overly aggressive. When applicable, assumptions should be consistent with those adopted for the plan sponsor's pension system.
- Fitch will view OPEB liabilities, like pensions, as soft liabilities that fluctuate based on assumptions and actual experience. 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.

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.

■ Implementation Schedule

GASB 45 will be phased in, beginning with the largest governments, effective:

- Fiscal periods beginning after Dec. 15, 2006 for governments with annual revenue greater than \$100 million.

- Fiscal periods beginning after Dec. 15, 2007 for governments with annual revenue between \$10 million and \$100 million.
- Fiscal periods beginning after Dec. 15, 2008 for governments with revenue under \$10 million.

■ Exploring GASB 45

GASB 45 furthers the effort to disclose the total cost of compensation earned by public sector employees. Some of this cost, specifically the salaries and related benefits of active workers, is already recognized on the statement of revenues, expenditures, and changes in fund balance (income statement) prepared annually. Similarly, the cost of pension benefits for current and retired workers is recognized through the implementation of GASB 27, which requires income statement recognition of annual employer contributions to pension systems and balance sheet recognition of net pension obligations (most often as a liability, but theoretically an asset). GASB 45 largely adopts the accounting and

actuarial valuation methodologies used for pensions, making minor adjustments to reflect the different nature of OPEB and the reality that very few governments have funded OPEB plans.

OPEB primarily relate to retiree health care, but can also include life insurance and other benefits. OPEB contributions by employers generally take the form of direct indemnity payments or full or partial cost-sharing of annual insurance premiums, but can also take the form of an implicit subsidy. This occurs when retirees pay a health insurance premium that is based on a larger risk pool, thereby benefiting from a lower premium rate than if they had to pay the full age-based premium.

Under GASB 45, governments providing benefits to more than 200 plan members are required to have an actuarial valuation of their OPEB plans done every two years. Most governments accessing the capital markets fall under this requirement. The OPEB plan is defined as whatever constitutes the "substantive plan," incorporating written and documented plan elements, as well as nondocumented elements that have been communicated and understood between the employer and employees. The actuarial valuation determines the actuarial present value of future liabilities — in essence, the amount that, if invested at the valuation date, would be sufficient to meet all liabilities, assuming embedded assumptions hold true.

From the actuarial valuation, an annually required contribution (ARC) is determined. The ARC is the portion allocated to the current year of the amount needed to pay both the normal costs (current and future benefits earned) and to amortize the unfunded liability (past benefits earned but not previously provided for). GASB 45 requires amortization of unfunded liabilities over a maximum of 30 years.

GASB 45 requires an accounting of a government's compliance in meeting its ARC. Contributions in an amount less than the ARC result in a net OPEB obligation, which is to be recorded as a liability on the governmentwide financial statements and full accrual-based fund statements. Only the employer's payments count toward the ARC; employee matching payments do not. The direct payment of benefits counts as a contribution toward the ARC. However, since nearly all plans will have some past service liability to amortize, simply continuing with pay-as-you-go funding is likely to result in rising net OPEB obligations.

Unlike GASB 27, which covers employer accounting for pensions, under GASB 45 there will be no net OPEB obligations reported at transition (unless a government volunteers to record one). Unfunded OPEB plan liabilities will be present as governments begin to implement the standard, but governments will be required to disclose their compliance in meeting the ARC only on a going-forward basis. The footnotes to the financial statements will include information on compliance in meeting ARCs, the cumulative net OPEB obligation, and the actuarial funding ratio of the OPEB plan (assuming a trust account is established).

■ OPEB Trust Funds

A critical element to making OPEB plans affordable and actuarially sound is GASB 45's requirement that, in order for actuaries to permit the use of a long-term investment return assumption, governments must set aside plan assets in an irrevocable trust. Funds accumulated or earmarked but held outside an irrevocable trust are limited to an investment return assumption consistent with general government investments, which are typically shorter in duration and lower in yield. Partially funded plans are required to use a blended rate, based on the proportion of contributions being used for asset accumulation versus payment of current benefits.

The ramifications for OPEB plan valuation are enormous, as long-term return assumptions are usually at least twice those of short-term investments. The higher the investment return assumption (discount rate), the lower the present value of future liabilities and the corresponding ARC will be.

Governments and actuaries are currently exploring different types of trust mechanisms, with no clear consensus emerging to date. Options include 401(h) accounts, voluntary employee benefit accounts, section 115 governmental trusts, and others. The type of trust account used may vary depending on the design of the OPEB plan. One consideration for governments may be weighing the financial benefits of establishing a trust against the legal and human resources management implications. Many governments reserve the right to unilaterally revoke OPEB. Establishing a trust fund may be seen as conferring a permanency to the benefit plan that might not be intended.

■ Role of Assumptions

As they do for pension systems, economic and demographic assumptions will play a critical role in

determining the magnitude of OPEB plan liabilities (and eventually, assets). Beyond the discount rate assumption discussed in the previous section, projections of health care costs and retirement rates and ages will be crucial to OPEB plans.

Health care costs have risen rapidly since the mid-1990s, with double-digit growth rates in some years. The pace of health care cost growth outstrips the salary and general inflation assumptions embedded in pension plan valuations, making OPEB liability growth potentially more volatile. Fitch expects initial variability in medical inflation assumptions, with actuaries making adjustments over time based on experience.

Retirement rate assumptions project how many plan members will leave active service and begin collecting OPEB during the valuation period. Studies have shown that the public sector work force is disproportionately made up of baby boomers, who are nearing retirement age. The pace at which they retire will have a significant effect on liability valuations and could even affect investment performance, as plan managers may have to adjust investment allocations to maintain liquidity sufficient to meet current benefit expenses. Retirement age is also important, given the existence of Medicare. In most cases, OPEB health care costs would be at least partially offset by Medicare. However, retirement age rules vary significantly among and within governments, with some plans having to carry OPEB for 10–15 years until Medicare eligibility is reached, and others facing much shorter exposure.

■ Implementation Issues

GASB 45 potentially creates legal, technical, and policy issues for the public sector.

Defining the “Substantive Plan”: Determining the precise definition of an OPEB plan is the task of the employer, in consultation with the actuary. Written documentation of the benefit plan may or may not accurately reflect the currently understood version of the plan. Employers have a financial interest in more narrowly defining the substantive plan, which may put them at odds with employee groups. Legal challenges or labor grievances can be envisioned.

Legal Status of OPEB: In many states and localities, pension benefits are constitutionally protected, statutorily defined, or otherwise codified. While OPEB may have the same status in some jurisdictions, many governments have greater administrative control over OPEB. If employers seek to modify or eliminate

OPEB for some workers or retirees, legal clarification may be required.

Medicare Part D: The implementation of the new prescription drug benefit under Medicare is under way and scheduled to go into effect Jan. 1, 2006. Integration with government OPEB plans will take time and will be complex. It is not clear at present whether this federal program will provide a financial benefit to or impose additional costs on state and local governments.

Labor Relations: Faced with potentially large costs to prefund OPEB plans, governments may seek concessions from active and retired employees. Conflicts could lead to work stoppages or recruitment and retention problems. Fitch expects such difficulties to appear in the more heavily unionized areas of the country.

■ Potential Funding Solutions

Governments will likely explore switching employees to a defined contribution system for OPEB. Once the government makes its scheduled contribution to employees or beneficiaries, all risk is transferred to the employee. While an attractive option for employers, it is likely achievable only for new hires, as existing beneficiaries have an interest in retaining the current system. Prolonged resistance by employee groups to defined contribution pension funding underscores this difficulty.

Governments facing large unfunded liabilities and steep ARCs may consider OPEB funding bonds. However, state laws are generally not explicit regarding issuing bonds for this purpose, creating a potential impediment to capital financing for OPEB. If legally allowable, OPEB funding bonds may be structured in the same manner as pension obligation bonds, which attempt to take advantage of the interest rate differential between taxable municipal bonds and the assumed investment return on plan assets. Bonds could be issued to fund all or a portion of a sponsor's unfunded OPEB liability, with the hope that the debt service on the bonds would be less than what the sponsor would otherwise have to pay in annual OPEB ARC costs over the long term.

Fitch believes that OPEB funding bonds, if used moderately and in conjunction with a prudent approach to investing the proceeds and other plan assets, can be a useful tool in asset-liability management. However, a failure to follow balanced and prudent investment practices could expose the plan sponsor to market losses.

Because a sponsor's unfunded OPEB liability will be factored into the rating, bond issuance would simply move the obligation from one part of the governmentwide or full accrual-based fund financial statements to another. However, Fitch notes that OPEB or pension funding bonds create a true debt, one which must be

paid on time and in full, rather than a softer liability that can be deferred or rescheduled from time to time during periods of fiscal stress. Consequently, issuing bonds to fund an OPEB plan could have a significant effect on financial flexibility over time.

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Other Post-Employment Benefits (OPEB)

New Accounting Requirements to Shed Light on Cost of State and Local Retiree Health Benefits; Funding Pressures Expected to Vary Widely

Summary

Just as U.S. local and state governments are emerging from one of the most difficult fiscal periods in recent memory, they face a new hurdle in the form of accrued retiree health-care liabilities. The costs associated with retiree health benefits, though they have been magnified by growth in healthcare spending, are not a new phenomenon. Governments in coming years will have to improve their measurement and disclosure of OPEB costs and liabilities under statements 43 and 45 of the Government Accounting Standards Board (GASB). For many state and local governments rated by Moody's, the rules will apply to fiscal years starting after Dec. 15, 2006. A wide range of previously unmeasured liabilities will be reported as a consequence, and the expected drive to address these liabilities will add to the fiscal pressures governments already face from programs such as public education, Medicaid, and employee pension funding.

Moody's does not anticipate that the liability disclosures will cause immediate rating adjustments on a broad scale. In fact, certain positive long-term effects seem likely to stem from the new requirements. This special comment describes the GASB statements and how they may affect the state and local government credit rating process. For municipal issuers, the credit impact of the new statements probably will depend on the following factors:

- The absolute size of unfunded actuarial accrued liability (UAAL) and UAAL size relative to key financial measures such as size of payroll, budget and tax base
- The plan for UAAL amortization as well as ongoing funding of new OPEB costs as incurred, on an accrual basis
- Actuarial assumptions, including discount and medical cost inflation rates, used to determine values of liability and pledged assets
- Retirement benefits promised to current workers and retirees as well as the ability (under contract or statute) to modify benefit offerings
- The impact of full funding on the issuer's financial flexibility and strength, based on measures such as debt or reserve levels
- The current credit assessment of the issuer and other factors affecting financial flexibility



NEW RULES ARE INTENDED TO IMPROVE DISCLOSURE OF PUBLIC PAYROLL COSTS

Statements 43 and 45 will improve disclosure of costs that, along with salaries, pension benefits and pre-retirement health insurance, make up government employees' total compensation package. Like pensions, OPEB are a form of deferred pay, part of an exchange of salaries and benefits for employees' service. Their costs to employers accrue over the period of employment, even though the benefits are not provided until later. GASB's new standards require governments to measure and report OPEB costs as they are incurred, during the employment period. This mandate will force significant changes in government practice. Most governments, by measuring as expense only the outlays associated with current retirees' OPEB, have failed to capture the accrued cost and liabilities of promising retirement benefits to active workers. The actuarial methods used to estimate the cost of OPEB will be similar to those already applied to pensions. Biennial actuarial valuations of OPEB assets and liabilities will be required under the new accounting rules for state and local governments with 200 or more benefit plan participants; smaller plans will have to conduct valuations every three years and in some cases may be able to use an alternative method not requiring use of an actuary.

OBLIGATIONS COVERED BY THE STANDARDS CONSIST PRIMARILY OF HEALTH INSURANCE

OPEB refers to retirement benefits besides pensions and early-retirement incentive (or termination) payments. These include various health-related benefits, as well as disability, life and long-term care insurance provided outside of defined-benefit pension plans. The largest component will be health insurance for which the employer pays some or all of retirees' premiums. The magnitude of this obligation will reflect the increases in prescription drug and other medical costs that have accounted for much of the recent growth in Medicaid, the joint state-federal health program for the poor.

GASB's new standards also require the inclusion in OPEB liability calculations of any implicit rate subsidy provided to retirees whose coverage is derived from a pool serving current employees (*see box*). It is because of this subsidy that even those state and local governments that do not explicitly pay part of their retirees' premium costs will likely have OPEB liabilities.

IMPLICIT RATE SUBSIDIES

A government's retirees in many cases are able to purchase health insurance at the same premium rate as current employees, based on the blending of premium rates that would apply to the two groups independently. The cost per participant of covering both groups together is higher than current employee coverage would be on its own, and not as high as the cost per participant in a group consisting solely of retirees. Because of this arrangement, retirees with blended rate health benefits are said to receive implicit rate subsidies. The new standards require measurement and reporting of the rate subsidy of retirees, even in situations where the retirees are required to pay 100% of their stated premiums.

The rules apply to state and local governments and to government-sponsored enterprises, as well as government-owned hospitals, universities, and utilities. Non-profit organizations are covered by standards issued by GASB's sister organization for the private sector, the Financial Accounting Standards Board (FASB). Statement 43 applies to financial reports prepared by health insurance or other OPEB plans, and 45 applies to the governments themselves.

STANDARDS ARE PART OF BROADER EFFORT TO IMPROVE ACCOUNTING FOR PENSIONS AND RELATED COSTS

The new accounting standards are part of a long-running effort in which GASB and FASB have mandated more disclosure of pension and other retirement benefit costs. FASB's Statement No. 81, issued in 1984, outlined disclosure practices for post-retirement health care and life-insurance benefits; Statement No. 87, in 1985, did the same for pension costs. Further clarification of OPEB cost reporting procedure followed when FASB issued Statement No. 106, in 1990. The same year, GASB published Statement No. 12, providing for disclosure of OPEB-related data in notes to governments' financial statements. These disclosures generally were to include the covered year's OPEB expense; the groups receiving (and the eligibility requirements for) the benefits; the respective contribution requirements for beneficiaries and employers; the statutory, contractual or other basis for the benefits, and a description of funding policy (either pay-as-you-go or paying in advance of future costs). Statement No. 12, which was intended as an interim measure, did not require the calculation of an actuarial accrued liability (AAL) or the recognition of current employees' accrued benefits. GASB in 1994 issued Statement No. 25 and Statement No. 27 to clarify how governments should report pension costs. Also at that time, it released Statement No. 26, providing interim guidance on financial reporting practices for post-employment healthcare plans administered by defined-benefit pension plans.

INCREASED BENEFIT PRE-FUNDING, OPEB-BOND ISSUANCE AMONG LIKELY GOVERNMENT RESPONSES

Under the new rules, a government will determine the annual required contribution (ARC) needed to amortize its actuarial liability (in no more than 30 years) and to cover the "normal cost" associated with services rendered by employees during the current year. The UAAL will appear in the notes to financial statements and in a required multi-year schedule of funding progress. But to the extent that a government in a given year fails to make the full ARC, that year's funding deficit will create (or add to) a liability called the net OPEB obligation, which will appear in the statement of net assets. The rules require calculation of an annual OPEB cost that differs from the ARC once this net obligation is recorded. This cost, which must be recognized as an expense in accrual-basis financial statements, will be derived from the ARC plus interest on the net OPEB obligation.

Because failure to pre-fund benefits will result in new balance-sheet liabilities, governments may begin to set aside assets for future OPEB obligations to an increasing extent. Moreover, the rules allow a higher assumed discount rate (and hence a lower present-value actuarial liability) for plans with assets set aside in a trust for OPEB obligations than for those with no (or insufficient) assets set aside. Governments may seek to address large, unfunded liabilities for retiree healthcare through the issuance of taxable bonds similar to pension-obligation bonds. An early example of this practice is the city of Gainesville, Florida, which has issued bonds to address a \$30.6 million liability in its self-insured Retiree Health Care Plan. The credit impact of borrowing to address a retiree health plan funding deficit will depend, as it does with pension-obligation bonds, on the extent to which the debt is part of a realistic plan to address these liabilities, and on its effect on the issuer's overall debt burden.

GOVERNMENTS HAVE BEGUN TO ADDRESS OPEB COST GROWTH

Some state governments, partly in response to the new standards, have already taken steps to reduce growth rates of their OPEB costs. Moody's expects this trend will continue, in part because improved OPEB information will encourage restraint in legislative debates and contract talks where benefits are determined. Alabama (rated Aa3 on watch for a possible upgrade) has enacted legislation increasing the premium payment obligation for various types of employees, including smokers and those who retire after a relatively short period of service. Ohio (Aa1) has modified its retiree health plan so that full coverage is available only to the employees with at least 30 years of service (see box).

OHIO'S APPROACH TO POST-EMPLOYMENT BENEFITS

Ohio is one of the few states that already have accumulated assets pledged to retiree health obligations. The Ohio Public Employees Retirement System (OPERS) oversees a \$1.1 billion healthcare fund, even so because of rapid growth in both medical costs and the number of covered retirees, the OPEB liability determined in 2003 that the healthcare fund would be used up in less than a dozen years. In September 2004, the trustees acted to restrain the fund's cost growth. They cut the minimum insurance premium coverage available to retirees with only 10 years of service to 50% for workers hired in 2002 or earlier, and to 25% for those hired later. For workers who retire with 30 years of service, however, 100% coverage was retained. The board also reduced spousal coverage and mandated increased contributions from active workers and employers. These actions are expected to extend the source of the healthcare fund to 18 years. Annual benefits and program adjustments will be reviewed periodically to maintain a balance between responsibilities of the system and its members.

Utah (Aaa) passed legislation this session to change its practice of providing retirees a month of health insurance for every day of unused sick leave. This policy, which was initiated when health insurance costs were substantially lower, will be modified so that the wages for each day of unused sick leave are placed in retiree health savings accounts, which retirees will then be able to use to purchase their own health coverage. The state still will have to address the liability accumulated through its existing policy, which remains in effect through the end of calendar year 2005. Other states that have taken steps to prepare for compliance with the new OPEB accounting rules include Delaware (rated Aaa), which in May of this year formed a committee to oversee an actuarial assessment of retiree health liabilities. In 2003, Delaware performed an actuarial analysis of its retiree health benefits using a preliminary version of the GASB standard. Georgia (rated Aaa), also in May, enacted a law creating the Georgia Retiree Health Benefit Fund to receive annual contributions based on the state's ARC.

Local governments also have begun to scale back retirement health-benefit offerings for new employees. After performing actuarial assessments of liabilities, Orlando, Florida (Aa2), and Arlington, Texas (Aa2), modified the percentages of employees' healthcare premiums that are covered, as well as length-of-service requirements for eligibility.

RETIREMENT HEALTH BENEFITS VARY WIDELY AMONG STATES AND LOCAL GOVERNMENTS

Retiree health benefits offered to public employees vary dramatically among state and local jurisdictions. States such as Iowa (Aa1) and Mississippi (Aa3) offer little or no health-care coverage to retired workers. Some, such as Wisconsin (Aa3) and Montana (Aa3), offer post-employment health insurance but require retirees to pay most of the cost. Still other states, such as California (A3), fully cover many retirees' health-insurance premiums as well as the majority of the premium costs for retirees' dependents. New Jersey covers retiree health insurance costs of local school teachers and college and university professors in addition to those of its regular employees. As a result, its OPEB expenditures for existing retirees already account for more than 3% of its general fund budget. A Kaiser Family Foundation survey of state governments found that in 2002, monthly premiums ranged from as little as \$105 per month for the Indiana (Aa1) Medicare complement plan to as much as \$668 per month in an indemnity-style plan provided by Alaska (Aa2).¹

State and local governments are further distinguished by benefit eligibility requirements, the legal measures that provide for the benefits, and the demographic characteristics of covered employee and retiree groups. As a result, there is likely to be great variation in the relative sizes of OPEB liabilities reported.

OPEB FUNDING STATUS WILL BECOME A MORE VISIBLE FACTOR IN CREDIT RATING PROCESS, SIMILAR TO PENSION OBLIGATIONS

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. While it will most closely resemble pension funding status, there are differences between the two types of obligations. OPEB obligations reflect medical cost trends, while those for pensions are based on salaries, over which a government's management has more control. On the other hand, retiree health benefits may be somewhat easier to modify than pensions, which may have stronger legal or contractual protection. Moody's views both OPEB and pension obligations as less binding than bonded debt, because they tend to allow some flexibility to alter the terms of the benefits (such as eligibility requirements), the assumptions used to derive the actuarial values of plan assets and liabilities, the liability amortization schedule, or other variables.

Moody's therefore 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. This practice is consistent with Moody's approach to municipal pension liabilities. Some governments provide post-retirement health benefits through pooled programs known as cost-sharing, multiple-employer plans. For these governments, the new standards will require reporting of OPEB payments in relation to the amount contractually mandated by their cost-sharing plans. Moody's may have to rely in these cases on the financial reports of the plans, rather than of the governments participating in them, for actuarial information on OPEB funding.

IMPORTANCE OF OPEB TO RATING PROCESS WILL DEPEND ON ISSUER'S OVERALL CREDIT STANDING

The extent to which OPEB funded status becomes an influential or decisive credit factor will depend on an issuer's current rating and how consistent its other attributes are with that rating. State and local governments' liabilities may be large in many cases, given the lack of prefunding in the past. For some issuers, it is possible that efforts to satisfy OPEB funding requirements will exacerbate fiscal pressure. Even so, Moody's does not anticipate that the disclosures required by the new rules will cause immediate and widespread rating adjustments. It is more likely that rating levels will be affected by observations of changes in OPEB funding measurements over time. Statistics such as the UAAL-to-covered payroll will be made available under the new rules, and Moody's expects to use these in the rating process. Plans for UAAL amortization, amortization periods, use of debt, and differences between actual and required contributions will also figure into the analysis, along with actuarial assumptions about medical costs and other variables key to estimating OPEB liabilities. Issuers' flexibility under relevant statutes or contracts to modify their post-employment health benefit offerings will likely be another focal point. Moody's also will monitor financial reserve, liquidity and debt levels that will be affected as issuers begin to set aside funds for OPEB. In general, a state or local government's effectiveness and initiative in OPEB liability management probably will influence our overall assessment of the government's management strength.

¹ Hoadley, Jack: "How States are Responding to the Challenge of Financing Health Care for Retirees"; The Henry J. Kaiser Family Foundation, September 2003.

LONGER-TERM IMPACT OF REPORTING REQUIREMENTS WILL BE LARGELY POSITIVE

Even though compliance with the new accounting rules is expected to exert financial stress and to bring to light previously unknown liabilities, Moody's expects the disclosure effects will be largely positive over the long term. As previously mentioned, the rules will require governments to disclose and record the full current cost of benefits provided to employees. Governments will have a strong incentive, though not an obligation, to set aside funds for benefit obligations as they are incurred, which is in keeping not only with accounting principles but also with prudent financial management. Any resulting fiscal strain is likely to be more than offset in most cases by the positive implications of management practice improvements under the accounting rules.

Until the release of audited reports subject to the standards, the lack of actuarially derived OPEB liability information limits Moody's ability to make a more detailed assessment of how these future costs will affect state and local government credit. Expenditures on current retirees' healthcare costs are already incorporated in the rating process. GASB's schedule for compliance with the new OPEB reporting rules is staggered, with smaller-revenue governments afforded additional time (see *Appendix I*). For states, the first financial reporting periods subject to Statement No. 45 will be those ending during calendar year 2008. A comprehensive overview of states' OPEB funding status is therefore not likely until early 2009, when published comprehensive annual financial reports covering fiscal 2008 become available. At that time, Moody's will focus on the OPEB factors listed earlier, including the UAAL, size relative to key financial indicators and the plan for UAAL amortization. Before compliant financial statements become available, Moody's may request information from issuers on various aspects of health plans and other retiree benefits that factor into OPEB liabilities (see *Appendix II*).

Appendix I

Effective Dates	
GASB 45	
Government Description	Effective Date
Tier 1 (annual revenues > \$100 mil)	Yrs Starting After 12/15/2006
Tier 2 (annual revenues > \$10 mil)	Yrs Starting After 12/15/2007
Tier 3 (annual revenues < \$10 mil) Yrs Starting After 12/15/2008	
GASB 43	
Plan Description	Effective Date
Tier 1 (annual revenues > \$100 mil)	Yrs Starting After 12/15/2005
Tier 2 (annual revenues > \$10 mil)	Yrs Starting After 12/15/2006
Tier 3 (annual revenues < \$10 mil) Yrs Starting After 12/15/2007	
*Tiers are based on first fiscal year ending after June 15, 1999, the same basis as applied to Statement No. 34	

Appendix II

Following are examples of questions Moody's will pose pending disclosure under the new rules:	
1) Has an actuarial assessment of OPEB liabilities been performed? If so, what were the results? Actuarial liability, actuarial value of assets, and funded ratio?	
2) What health care and other post-employment benefits subject to the standards are provided? What are the benefits, eligibility and payments?	
3) Describe the mechanisms (e.g., single employer or agent multiple employer defined benefit plans) through which benefits are provided.	
4) What legislative or other actions would be required to reduce the benefits?	
5) What is the total cost of retiree health and related benefits in the budget? How much has this sum increased in recent years, and what has accounted for that?	

Related Research

Special Comments:

GASB 34: What Does It Mean for the Rating Process?, December 2002 (#76862)

Moody's Perspective On Increased Pension Costs For California Local Governments, June 2003 (#78417)

Rating Methodology:

Moody's State Rating Methodology, November 2004 (#89135)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

December 11, 2005

The Next Retirement Time Bomb

By MILT FREUDENHEIM
and MARY WILLIAMS WALSH

SINCE 1983, the city of Duluth, Minn., has been promising free lifetime health care to all of its retired workers, their spouses and their children up to age 26. No one really knew how much it would cost. Three years ago, the city decided to find out.

It took an actuary about three months to identify all the past and current city workers who qualified for the benefits. She tallied their data by age, sex, previous insurance claims and other factors. Then she estimated how much it would cost to provide free lifetime care to such a group.

The total came to about \$178 million, or more than double the city's operating budget. And the bill was growing.

"Then we knew we were looking down the barrel of a pretty high-caliber weapon," said Gary Meier, Duluth's human resources manager, who attended the meeting where the actuary presented her findings.

Mayor Herb Bergson was more direct. "We can't pay for it," he said in a recent interview. "The city isn't going to function because it's just going to be in the health care business."

Duluth's doleful discovery is about to be repeated across the country. Thousands of government bodies, including states, cities, towns, school districts and water authorities, are in for the same kind of shock in the next year or so. For years, governments have been promising generous medical benefits to millions of schoolteachers, firefighters and other employees when they retire, yet experts say that virtually none of these governments have kept track of the mounting price tag. The usual practice is to budget for health care a year at a time, and to leave the rest for the future.

Off the government balance sheets - out of sight and out of mind - those obligations have been ballooning as health care costs have spiraled and as the baby-boom generation has approached retirement. And now the accounting rulemaker for the public sector, the Governmental Accounting Standards Board, says it is time for every government to do what Duluth has done: to come to grips with the total value of its promises, and to report it to their taxpayers and bondholders.

The board has issued a new accounting rule that will take effect in less than two years. It has not yet drawn much attention outside specialists' circles, but it threatens to propel radical cutbacks for government retirees and to open the way for powerful economic and social repercussions. Some experts are warning of tax increases, or of an eventual decline in the quality of public services. States, cities and agencies that do not move quickly enough may see their credit ratings fall. In the worst instances, a city might even be forced into bankruptcy if it could not deliver on its promises to retirees.

'It's not going to be pretty, and it's not the fault of the workers," said Mayor Bergson, himself a former police officer from Duluth's sister city of Superior, Wis. "The people here who've retired did earn their benefits."

The new accounting rule is to be phased in over three years, with all 50 states and hundreds of large cities and counties required to comply first. Those governments are beginning to do the necessary research to determine the current costs and the future obligations of their longstanding promises to help pay for retirees' health care. Local health plans vary widely and have to be analyzed one by one. No one is sure what the total will be, only that it will be big.

Stephen T. McElhaney, an actuary and principal at Mercer Human Resources, a benefits consulting firm that advises states and local governments, estimated that the national total could be \$1 trillion. "This is a huge liability," said Jan Lazar, an independent benefits consultant in Lansing, Mich. "If anybody understands it, they'll freak out."

Last spring, the state of Alaska was the scene of a showdown over retirement benefits that those involved said was a precursor of fights to come. Conservative lawmakers who supported scaling back traditional retiree health care and pension benefits squared off against union lobbyists, advocates for the elderly and the schools superintendent of Juneau, the state capital, who defended the current benefits.

After saying that Alaska's future combined obligations for pensions and retiree health care were underfunded by \$5.7 billion, Gov. Frank H. Murkowski called a special session of the Legislature and pushed through changes in pension and retirement health care benefits for new state employees. (The state Constitution forbids changing the benefits of current employees.)

Instead of having comprehensive, subsidized medical coverage, new public workers will have a high-deductible plan and health savings accounts. The changes cleared the State Senate and passed by a one-vote margin in the House.

Even the White House weighed in on the Alaska problem. Ruben Barrales, President Bush's director of intergovernmental affairs, lobbied wavering Republican legislators, arguing in favor of replacing pensions and traditional retiree health benefits with private savings accounts for new employees. Mr. Barrales noted that the president was seeking similar changes in Social Security, including a plan for private accounts.

The union that represents state employees in Alaska said the narrower benefits would make it harder to recruit qualified teachers and government workers. "They keep chiseling away" at school employees' pay and benefits, said Julia Black, a single mother and union activist who earns \$11 an hour as an aide in classes for disabled children in Juneau.

Actuaries say that about 5.5 million retired public employees have health benefits of some kind - and accountants joke that there are not enough actuaries in the country to do all the calculations necessary to estimate how much all these retirees have been promised.

Though it may seem strange after a decade of double-digit health cost inflation, hardly any public agencies have been tracking their programs' total costs, which must be paid out over many years. The promises seemed reasonable when they were initially made, officials say.

In Duluth, Mayor Bergson said the city actually offered free retiree health care as a cost-cutting measure back in 1983.

Message

At the time, Duluth was trying to get rid of another ballooning obligation to city workers: the value of unused sick leave and vacation days. Public workers then were in the habit of saving up this time over the course of their careers and cashing it in for a big payout upon retirement. Compared with the big obligations the city had to book for that unused time, substituting free retiree health care seemed cheap. "Basically, they traded one problem for another," Mayor Bergson said.

WITH some exceptions, most states and cities have set aside no money to pay for retiree medical benefits. Instead, they use the pay-as-you-go system - paying for former employees out of current revenue. Agencies did not have to estimate the total size of their commitment to retiree health care, so few did so.

Under the new accounting rule, local governments will still not have to set aside any money for those promises. But they will be required to lay out a theoretical framework for the funding of retiree health plans over the next 30 years, and to disclose what they are doing about it. If they fail to put money behind their promises to retirees, they may feel the unforgiving discipline of the financial markets. Their credit ratings may go down, making it harder and more expensive to sell bonds or otherwise borrow money.

Parry Young, a public finance director at Standard & Poor's, the credit rating agency, said his analysts look at total liabilities, including pension and now other "post-employment" obligations. Many governments, he added, have already been grappling with big deficits in their employee pension funds.

A few agencies are wrestling with the daunting task of estimating their total retiree health obligations and coming up with a way to slice it into a 30-year funding plan. They are finding that under the new method, the benefit costs for a particular year can be anywhere from 2 to 20 times the pay-as-you-go costs they have been showing on their books.

Maryland, for example, now spends about \$311 million annually on retiree health premiums. But when that state calculated the value of the retirement benefits it has promised to current employees, the total was \$20.4 billion. And the yearly cost will jump to \$1.9 billion under the new rule, according to an analysis for the state by actuaries at Aon Consulting, which advises companies on benefits.

That is because Maryland would not be recording just its insurance premiums as the year's expense, but instead would report the value of the coverage its employees have earned in that year as well as a portion of the \$20.4 billion they amassed in the past. After 30 years, the entire \$20.4 billion should be accounted for.

Michigan says it has made unfunded promises that are now valued at \$17 billion for teachers, part of a possible \$30 billion total for all public agency retirees. Other places that have done the math include the state of Alabama; the city of Arlington, Tex.; and the Los Angeles Unified School District. New York City has not yet completed an actuarial valuation of its many retiree benefit plans. But in its most recent financial statements, the city said it expected that the new rule would "result in significant additional expenses and liabilities being recorded" in the future.

The numbers can vary wildly by locality, depending on how rich its benefits are, what assumptions its actuary uses about future demographics and investment earnings, and that great unknown: the cost of health care 30 years in the future.

"Fifteen years ago, who would have projected 10 years of double-digit increases in health care costs?" said Frederick H. Nesbitt, executive director of the National Conference on Public Employee Retirement Systems, an advocacy group in Washington. Mr. Nesbitt pointed out that when the accounting rulemakers began requiring a similar change in financial reporting for companies in the 1990's, it was followed by a sharp decline in the retiree medical benefits provided by corporate America.

Today, only one in 20 companies still offers retiree benefits, according to Don Rueckert Jr., an Aon actuary. The rate

For large companies is less than one in three, down from more than 40 percent before the private-sector accounting change, according to Mercer Human Resource Consulting. General Motors and Ford are among the big companies that still offer retiree health benefits. But both automakers recently persuaded the United Automobile Workers union to accept certain reductions.

"We expect the same thing in the public sector, unless we help employers do the right thing," said John Abraham, deputy research director for the American Federation of Teachers.

The Governmental Accounting Standards Board, known by the acronym GASB (pronounced GAZ-bee), is a nonprofit organization based in Norwalk, Conn., and a sister to the Financial Accounting Standards Board that writes accounting rules for the private sector. Karl Johnson, the project manager for the retiree-benefits rule, said GASB began hearing from public employees' unions as soon as it issued a first draft of its new standard. The unions said that if governments were forced to disclose the cost of their plans, they would probably cut or drop them, just as companies have done.

Mr. Johnson said the accounting board had no interest in trying to reduce anyone's benefits, and no power to dictate local policy even if it wanted to. "Accounting is just trying to hold up a good mirror to what's happening," he said. "These are very expensive benefits."

Under the new rule - outlined in the board's Statement No. 45 in June 2004, and known widely as GASB 45 - large public governments and school boards with large health care obligations to retirees will have to start reporting their overall benefits cost in 2007 - either on Jan. 1 of that year or, for most big governments, on the start of the fiscal year beginning June 1, 2007. Smaller governments will start using the new method in the two years after that.

The change comes at a rough time for state and local governments. Spending on Medicaid and education has been spiraling, and Congress continues to cut federal taxes and shift burdens of governing away from Washington. In some areas, including parts of Michigan, governments are also suffering from the financial difficulties of important local industries. Max B. Sawicky, an economist at the Economic Policy Institute, a liberal research group in Washington, called the new requirement "another straw on the camel's back" for state and local governments already straining under their budget burdens.

Mr. Johnson said the accounting board had tried to issue the retiree health care rule 10 years ago, when the economic picture was rosier. It did succeed then in issuing an accounting standard for government pension plans, but before it could turn to the related issue of retiree health care, other urgent accounting issues crowded onto its agenda. The board finally cleared its decks and voted to address retiree benefits in 1999. Coming up with the new methodology took five years.

Now that it is here, "the general sense in the marketplace is that GASB 45 is going to lead to a watershed in public-sector health benefits," said Dallas L. Salisbury, president of the Employee Benefit Research Institute, a nonpartisan research center in Washington.

Indeed, the handful of states and cities that have already calculated their obligations to retirees have concluded they must also rein in the costs. Michigan, for example, with its possible \$30 billion in largely unfunded health care promises, is already considering legislation that would shift "a considerable amount of the cost for health insurance to the retiree," said Charles Agerstrand, a retirement consultant for the Michigan Education Association, a teachers union. The legislation would require teachers retiring after 20 years to pay 40 percent of their insurance premiums, as well as co-payments and deductibles, he said.

The pressure is greatest in places like Detroit, Flint and Lansing, where school systems offered especially rich benefits during the heyday of the auto plants, aiming to keep teachers from going to work in them. Away from those cities, retiree costs may be easier to manage. In the city of Cadillac, 100 miles north of Grand Rapids, government officials

said they felt no urgent need to cut benefits because they promised very little to begin with. Instead, Cadillac has started putting money aside to take care of future retirement benefits for its 85 employees, said Dale M. Walker, the city finance director.

Ohio is one of a few states to set aside significant amounts. Its public employee retirement system has been building a health care trust fund for years, so it has money today to cover at least part of its promises. With active workers contributing 4 percent of their salary, the trust fund has \$12 billion. Investment income from the fund pays most current retiree health costs, said Scott Streater, health care director of the Ohio Public Employee Retirement System. "It doesn't mean we can just rest," he said. "It is our belief that almost every state across the country is underfunded." He said his system plans to begin increasing the employee contributions next year.

In Duluth, Mayor Bergson grew quiet for a moment at the thought of a robust trust fund. "There was not a nickel set aside" in Duluth, he said. "The reason was, if you set money aside, you'd do less 'pretty projects.' Less bricks and mortar. Fewer streets. Fewer parks. So no one set the money aside. "If the city had set \$1 million aside every year for those 22 years" since the promise was made, he added, "we'd be in really good shape right now."

Mayor Bergson said his city intends to start setting aside money for the first time in 2006, but he is also trying to rein in the growth of new obligations. He raised to 20 from 3 the number of years that an employee must work for the city in order to qualify for retirement benefits.

He also imposed a hiring freeze and pledged not to lift it until Duluth could hire employees without promising them free lifetime health care. As the city has lost police officers, firefighters, an operator of its huge aerial lift bridge and other workers, the remaining employees have racked up more than \$2 million in overtime. But Mayor Bergson says that this is still cheaper than dealing with free retirement health care once the new accounting rule takes effect.

Most recently, he reached out for what may prove a political third rail: he took issue with the idea that once a public employee has retired, his benefits can never be reduced. This idea, as applied to pensions, is rooted in the constitutions of about 20 states, and unions argue that it also protects retiree health care.

Active employees in Duluth have had to start paying more for their health care under the city plan, Mayor Bergson said. If active workers must make concessions, he said, retired workers should make concessions, too. Otherwise, in relative terms, they are pulling ahead of the active work force.

"That's not a popular thing to say," Mayor Bergson said. "I'm getting kicked hard by retirees. I'm getting beat up by active employees. The people who are kicking me are the ones I'm trying to protect."

ATTEMPTS to balance the competing interests of retirees, active workers and taxpayers are building tension. Ross Eisenbrey, a former Clinton administration official who is now at the Economic Policy Institute, said that "when taxpayers wake up to these obligations, their first inclination is often to escape them or reduce them."

The problem is that people have counted on those benefits, and many have accepted lower salaries in exchange for better retirement benefits, said Teresa Ghilarducci, an economics professor at the University of Notre Dame. If they are close to retirement, said William R. Pryor, a firefighters' union official who is an elected board member of the Los Angeles County Employees Retirement Association, it may well be too late for them to make up for the loss with their own savings.

The clock is ticking. In Duluth, a city official approached the actuary who made the city's estimate in 2002 and asked her to refine and update her numbers because economic conditions had changed and the new accounting rule had been announced. This time the obligations worked out to \$280 million, a 57 percent increase in less than three years.

Costly Change Looming for Retiree Benefits

Rule Aims to Force Public Sector To Tally Future Health Spending

By Bill Turque
Washington Post Staff Writer
Monday, January 30, 2006; B01

State and local governments in the Washington region will soon be forced to show for the first time how much it will cost to provide health care benefits to their current and future retirees, a commitment with a price tag in the tens of billions.

The disclosures will be the result of a rule handed down in 2004 by the Governmental Accounting Standards Board (GASB), a little-known but influential private body formed to improve financial practices in the public sector. The rule, which takes effect at the end of this year, carries no legal weight. But the board's findings are closely watched by Wall Street and the bond rating agencies that assess the financial health of state and local governments.

That means the rule is likely to have far-reaching consequences, finance experts and local officials say. Governments, school boards and other public bodies throughout the country will be compelled to report what they owe retirees for health care over the next 30 years -- and to begin setting aside additional millions of dollars to pay for it.

It will take two to three years for the full effects of GASB 45, as the rule is known, to play out. But officials say it could lead to reduced benefits for retirees. Governments that don't have a plan for fully funding their obligations could have their bonds downgraded, limiting their ability to borrow at favorable rates and costing taxpayers millions in additional interest payments for new schools, roads and other capital improvements.

"It's a big deal, and it will have a big impact on our financial statements," said Gail Francis, deputy finance director for Prince George's County.

Parry Young, public finance director for Standard & Poor's Corp., said many governments will be able to absorb the effects of GASB 45 with relative ease. Some, he warned, especially those providing extensive health benefits, will face "painful decisions," forced to choose between funding critical services now and investing in needs that will have to be met decades down the road.

It is no secret that many states and localities face huge obligations -- above and beyond pensions -- to former employees, mainly in the form of medical coverage, including for prescription drugs, and life insurance. The long-term cost of these benefits, however, has traditionally been treated as a fiscal "don't ask, don't tell," missing from official financial statements.

Most jurisdictions cover such costs year to year on a "pay as you go" basis. Maryland, for example, will spend about \$300 million on health care in the fiscal year that ends June 30 for its 66,400 active employees, 55,600 retirees and their dependents. Fairfax County has budgeted about \$10 million for its 32,000 government and school employees and the 2,100 retirees enrolled in its health program.

Under GASB 45, governments have until July 1, 2007 (the beginning of fiscal 2008), to start carrying on their books the full cost of retiree health benefits over the next 30 years. They must also have a plan for meeting those obligations.

Some state and local governments have started to calculate what they owe, and the numbers are enormous: \$20 billion in Maryland, \$5 billion in Virginia (which offers workers more modest post-employment benefits), \$2 billion in Montgomery County and \$826 million in Fairfax. The District, which didn't assume responsibility for pension and health benefits from the federal government until 1997, faces a relatively tame \$509 million.

These figures are only snapshots, officials caution. As health care costs increase, so will the numbers. In 2000, for example, Maryland's "unfunded liability" for retiree health care was \$3 billion.

"The numbers start to get very large very quickly," Young said.

So quickly, finance experts say, that it will be virtually impossible for most jurisdictions to meet the requirements of GASB 45 under the pay-as-you-go method. Maryland, with one of the nation's more generous packages of health benefits, would have to increase its annual payments from \$300 million to \$1.9 billion.

Most jurisdictions are likely to "pre-fund" their obligations by placing money in a trust and letting it grow over time through returns on investments. Fairfax has set aside \$10 million. Last year, the District took \$138 million from its healthy \$1.2 billion surplus to begin meeting the GASB rule. In his proposed budget for fiscal 2007, Maryland Gov. Robert L. Ehrlich Jr. (R) includes \$100 million for compliance.

Some officials say the other probable consequence will be cuts in benefits. A Maryland task force that studied the issue concluded in its report last month that reduced benefits -- most likely for younger workers -- are all but inevitable.

"It will be very difficult for the state to sustain the current level of retiree benefits for all employees and retirees into the future," said the report by the panel, co-chaired by state Sen. Edward J. Kasemeyer (D-Baltimore County) and Del. Mary-Dulany James (D-Harford). The General Assembly is likely to appoint a commission to study the matter more closely, almost certainly kicking the whole politically sticky issue past the November elections.

Ehrlich administration officials said they are prepared to do what is necessary to comply with GASB 45 and maintain the state's top bond rating. "We are a Triple-A state, and we intend to keep that rating," said Cecilia Januszkiewicz, Maryland secretary of management and budget. "We'll have to decide what can and should be done."

Maryland state employees, smarting from steep increases in prescription drug co-payments last year, worry that GASB 45 will eventually prompt the kind of wholesale reduction in benefits that private sector workers began experiencing in the 1990s -- triggered, at least in part, by a similar change in accounting procedures.

"As public employees, we felt we would be immune from that," said Curtis Johnson, president of the American Federation of State, County and Municipal Employees Local 266. Johnson, an admissions coordinator at Spring Grove Hospital Center in Catonsville, Md., has 32 years of state service.

The current health plan, which pays between 50 and 90 percent of covered medical and hospital costs, depending on the package selected, costs Johnson \$90 a month from his annual salary of \$30,000. Much more than that would be a hardship, he said, especially as a retiree with a projected \$913 monthly pension.

"I'll be in a world of trouble," said Johnson, 53.

"We're infuriated that they would even consider it," said Royce Treadaway, 46, also a union leader and a market analyst for the Maryland Port Authority in Baltimore. Treadaway, who makes \$44,000 a year, said one of the attractive trade-offs of the comparatively low salaries in government service are benefits that are more secure than those in the private sector. Should that change, she said, it would be "degrading and appalling."

Gino Renne, president of United Food and Commercial Workers Local 1994, which represents about 6,000 Montgomery and Prince George's employees, said changes in accounting standards were used as "an excuse" by the private sector to cut benefits. Rather than focus on cuts, he said, the issue for state and local governments should be how to contain the growth of health care costs.

"All the parties have to be more creative," Renne said.

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What are the choices for and legal questions related to funding OPEB?

1. GASB 45 does not require or create a legal obligation for pre-funding. Indications are that, if OPEB are not funded on an actuarial basis, bond ratings may be affected. The County may continue to pay for OPEB on a Pay-Go basis, if it so desires.
2. OPEB Bonds are a pre-funding option.
 - Bond obligations would have to be within debt limitations of Article 25A, § 5(P) of the Maryland Code, Section 719 of the County Charter, and § 4-10-101 of the County Code, or would require modification of these limitations.
 - Does the pre-funding of OPEB make OPEB bonds “pension liability funding bonds” within Article 31, § 32 of the Maryland Code? (This applies to bonds funding a pension or retirement plan under which the County is obligated to pay retirement, disability, death, or other benefits.)
3. GASB 45 requires that any trust set up to fund OPEB obligations be irrevocable, be dedicated to providing benefits under the plan, and be protected from the creditors of the employer and plan administrator (like a pension trust).
 - Does funding in an irrevocable trust that is like a pension fund create a contractual or other property right to receive the benefits?
 - Changes to State law (Article 95, § 22F of the Maryland Code) defining “public funds”, setting fiduciary standards for their investment, and limiting investment options may be needed to exclude funds for OPEB. This would allow broader investment options for a greater return (as with pension funds).
 - The State could legislatively create a local government investment trust specifically for OPEB.
4. Three trust funding vehicles have been identified to the County thus far.

(Please note that the County’s Office of Law does not have expertise needed to identify all available investment vehicles or their attributes and consequences. This discussion of funding options is based on information that has been provided to the Working Committee by third parties. It is intended as an overview only. When and if the decision is made to use a trust as an investment tool, the Office of Law recommends obtaining the advice of experts in this area.)

- Section 401(h) Account
 - This has been described as a separate account within the pension account that is tracked separately. The assets may be combined with pension assets for investment purposes. It can be set up on an individual basis (defined contribution for each employee) or a pooled basis (defined benefit for each employee).

- The GASB 45 Annual Required Contribution may be greater than the annual contribution limit for this type of account under IRS law.
 - Employee contributions are permitted on a pre-tax basis.
- Voluntary Employees' Beneficiary Association ("VEBA") (Internal Revenue Code § 501(c)(9))
 - The trust is a separate entity from the pension plan, with its own plan and trust fund.
 - No limit to the amount of annual contributions.
 - Employee contributions are allowed only on an after-tax basis.
- Section 115 Trust
 - This is a trust established to provide an "essential governmental function."
 - No limit to the amount of annual contributions.
 - Employee contributions are allowed only on an after-tax basis.
- There are no restrictions on disbursements from any of the three types of trusts. A combination of trusts could be used to obtain tax benefits for participants and avoid the limitation of a Section 401(h) trust.

Defined Benefit Plans

What is it?

County law provides that, at the time of retirement, retirees may participate in the County's health care plan. At the current time, the County offers a defined benefit plan. The County contracts with plan providers for specific health care plans (currently, HMO, POS, and Triple Choice – combination POS and PPN). The plan is based on the defined benefits that are offered to employees. The County and the participants share in the costs of the plan based on percentages of cost. The County agrees to pay its percentage share, regardless of the cost of the plan.

What factors may affect the amount of the County's OPEB liability?

Cost Share

Obviously, if the County contributes less toward the cost of the health plan, the County's liability decreases. The percentages paid by the County and the participants could be adjusted based on the years of service and the employee group applicable to each participant in order to decrease the share paid by the County.

Plan Design

Over the years, the County has studied and adjusted the design of the health care plans offered in response to the rising cost of health care. There are countless combinations of plan attributes that can be changed and combined to affect the ultimate cost of the health care, including the types of plans offered, co-pays, out-of-pocket maximums, and limits on certain types of service. Some of the traditional approaches to reducing costs by changing plan design include increasing co-pays, increasing the employee portion of co-insurance levels and increasing deductibles and out of pocket maximums. The impact of increasing co-pays varies because the basic premise of this philosophy is to illustrate the differences in the costs associated with options in the plan provisions. For example, the average cost of a primary care visit and a specialist visit may have a differential in cost which can be addressed by setting appropriate split co-pays (co-pay for primary care physician visits, separate co-pay for specialist visits). Increasing co-insurance levels has a direct financial impact because this philosophy would facilitate the employee paying a higher percentage of the costs of certain services (ie employee pays 10% of inpatient visit instead of paying 0%). Increasing deductibles/out of pocket maximums means the employee would pay slightly more prior to accessing the certain levels of the benefit offering.

Plan offerings are part of the plan design. The County continues to evaluate the number of plans offered and the types of plans offered. These evaluations include physician network access, discounts and provider reimbursements. In addition, the County benchmarks these offerings against other public jurisdictions also taking into account retention and a shrinking workforce for recruiters.

Consumerism, disease management and wellness initiatives are examples of other approaches, which are being incorporated and evaluated in the market place. Health enhancements incorporate behavioral change programs with the leadership of case managers and emphasis is

placed on “preventive” care to alleviate more serious outcomes. These approaches encourage the employee to become a partner with the County with regards to health care. These philosophies increase the employee awareness of the total cost of health care and invite the employee to become better stewards of the monies spent and encourage them to become actively involved in maintaining a healthy lifestyle and making informed decisions to assist the County in reducing health care costs.

It is the consensus of the Task Force, in consultation with the actuaries, that it will be very difficult in today’s health care environment to decrease the overall cost of health care in this manner by any more than 5%. Therefore, such a change would reduce the ARC by about \$6 million (assuming a discount rate of 8% and a level percent of pay amortization). Alternatively, offering a single low cost HMO may result in more savings.

Eligibility Requirements

Another option may be to limit liability by limiting the persons eligible to receive the benefit. This may include only providing post-employment health benefits to employees who attain a certain level of County service, to employees who retire directly from County service, to retirees who attain a certain minimum and/or maximum age, to retirees only and not to their dependents, or to retirees and dependents but without survivor benefits for dependents.

Changes to such eligibility requirements could be based on the employee group applicable to each employee. For instance, the County has already instituted a new structure for eligibility for retirement benefits that applies to employees hired on or after January 1, 2006. This change was discussed on page 11 of this report.

Examples

The factors just identified can be combined and adjusted in a myriad of combinations and permutations. The following pages represent a suite of options to reduce the liability. It is impossible to present all of the possible combinations of factors and related changes. The evaluation and final determination of how to adjust and combine these factors, if at all, will be decided by the next Administration.

The reductions shown for any particular option cannot be added to the reductions associated with another option due to the possibility of duplication. Four specific combinations of options have been calculated whereby the actuaries have adjusted for any such duplication.

Pages 29 and 30 present the reductions in the Annual Required Contribution associated with each option. Pages 31 and 32 represent the reductions in the Normal Cost associated with the same suite of options. These four pages represent a scenario whereby an 8% discount rate is assumed. The scenarios whereby 6% and 4% discount rates are assumed are included in appendix C. While most of the options are self-explanatory, a few require additional explanation.

Hard and variable caps are based on an established published base rate upon which the cost share percentage is applied. While the published rate increases each year due to medical cost inflation, claims experience, plan design changes, etc., the base upon which the county cost share percentage is applied only goes up by the cap percentage. So, assuming the published rate base is \$100 and an 80-20 cost share applies, the employer pays \$80 and the employee pays \$20. Using a hard cap of 5%, if in the following year the published rate goes up 10% to \$110, the employer cost share percentage of 80% would apply to the base of \$105 (base rate plus 5%) yielding an employer contribution of \$84 and an employee share of \$26. The capped base is cumulative, so in year 3, the base rate would increase from \$105 to \$110.25. These options effectively shift all of the market risk onto the employee. If this type of option is chosen, a number of design details (e.g., the published rate used as the base, catch-up provisions in years where rates go up by less than the cap percentage, etc.) would need to be defined and might affect the savings shown. The option shown on the following tables assume the current published rate is used as the base rate.

The *minimum age options* assume that if an employee retires prior to reaching this age, they are ineligible to participate in the County's health plans at any point in time. The options which defer coverage until a certain age provide retirees with access to future coverage once they reach the specified minimum age.

It is also important to note that the reductions shown for each option or specific combination do not take into consideration potential behavioral changes which could impact the actual resultant reduction in cost. For instance, the option whereby a graduated scale is used would lessen the value of the benefit for those with fewer years of service. Therefore, the number of such eventual retirees that actually choose to participate in the plan may drop. This would increase the amount of actual reductions in cost. Another example would be in the options involving minimum years of service or minimum age. Given such a change, employees may remain employed longer than they otherwise would in order to meet the new threshold. This would decrease the amount of actual reductions in cost. When, and if, a specific option is chosen for FY2008, the actuaries will need to analyze these potential behavioral changes and incorporate them into the final valuation for FY2008.

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**Reductions in Annual Required Contribution (ARC)
at 8% Discount Rate and Level Percent of Pay Amortization**
(numbers expressed in millions)

Employee Group		County Pension Plans				
Factor	Option	Employee	Police	Fire	Det/Sheriff	Total
Baseline Cost (12.5% health care trend in 2006, end of year)		25.2	16.0	15.3	6.2	62.7
Current Retirees – under 65 and 65+						
Cost Share	Access only (100% share, implicit subsidy only)	-4.1	-3.4	-2.1	-0.7	-10.3
	Graduated Scale (e.g., 2.5% year, max at 75%)	info	info	info	info	0.0
	Hard Cap of 4%	-1.8	-1.4	-0.9	-0.3	-4.4
	Variable Cap based on CPI (3.5%)	-2.0	-1.6	-1.0	-0.3	-4.9
	Eliminate Implicit Subsidy	-1.8	-1.5	-0.9	-0.3	-4.5
	70%-30% Employer-Employee Share	-0.5	-0.4	-0.3	-0.1	-1.3
	60%-40% Employer-Employee Share	-1.0	-0.8	-0.5	-0.2	-2.5
	50%-50% Employer-Employee Share	-1.5	-1.2	-0.7	-0.2	-3.6
Term / Vested						
Cost Share	Access only (100% share, implicit subsidy only)	-0.3	N/A	N/A	0.0	-0.3
	Graduated Scale (e.g., 2.5% year, max at 75%)	info	N/A	N/A	info	0.0
Eligibility	Eliminate	-0.3	N/A	N/A	0.0	-0.3
	Retiree Only (no spouse or dependents)	info	N/A	N/A	info	0.0
Current Employees						
Cost Share	Access only (100% share, implicit subsidy only)	-14.0	-7.4	-8.2	-3.6	-33.2
	Graduated Scale (e.g., 2.5% year, max at 75%)	-6.0	-3.4	-4.1	-0.9	-14.4
	Hard Cap of 4%	-7.0	-3.9	-4.2	-1.8	-16.9
	Variable Cap based on CPI (3.5%)	-7.8	-4.4	-4.7	-2.0	-18.9
Eligibility	Eliminate	-19.1	-11.2	-12.2	-5.2	-47.7
	Eliminate Term Vesting	-0.3	0.0	0.0	-0.1	-0.4
	End Drug Benefits at Age 65	-6.8	-2.0	-2.3	-1.2	-12.3
	End All Benefits at Age 65	-12.5	-3.9	-4.5	-2.2	-23.1
	Retiree & Spouse Only (no dependents)	-1.1	-1.1	-1.1	-0.4	-3.7
	Retiree Only (no spouse or dependents)	-8.9	-5.9	-6.4	-2.4	-23.6
	Minimum of 10 Yrs of Service	-2.7	-0.2	-0.4	-1.2	-4.5
	Minimum of 15 Yrs of Service	-4.4	-0.8	-0.9	-2.4	-8.5
	Minimum of 20 Yrs of Service	-6.5	-2.0	-1.8	-3.3	-13.6
	Minimum Age of 50 years old	-0.6	-4.6	-3.9	-0.5	-9.6
	Minimum Age of 55 years old	-4.3	-9.9	-9.7	-3.5	-27.4
	Minimum Age of 60 years old	-6.4	-11.0	-12.1	-4.3	-33.8
	Minimum Age of 65 years old	-15.7	-11.1	-12.2	-5.2	-44.2
	Defer Coverage until Age of 55 years old	-0.6	-2.4	-2.2	-0.6	-5.8
	Defer Coverage until Age of 60 years old	-2.0	-4.4	-4.4	-1.4	-12.2
	Decrement of 5% per year if retiree participates at an age younger than age 65 (modeled after pension plan approach)	-1.5	-2.4	-2.4	-0.8	-7.1
Combo 1	Min. of 15 Yrs of Service & Graduated Scale	-10.4	-4.1	-4.9	-3.2	-22.6
Combo 2	Min. of 15 Yrs of Service, Graduated Scale & Variable Cap (3.5%)	-12.6	-5.9	-6.6	-3.7	-28.8
Combo 3	Min. of 15 Yrs of Service, Graduated Scale, Variable Cap (3.5%), and Min. Age of 55 yrs	-14.4	-10.6	-11.1	-4.8	-40.9
Combo 4	Min. of 15 Yrs of Service, Graduated Scale and Min. Age of 55 yrs	-12.6	-10.5	-10.8	-4.7	-38.6
All Employee Groups						
Plan Design	Changes to save 5%	-1.3	-0.8	-0.8	-0.3	-3.1

**Reductions in Annual Required Contribution (ARC)
at 8% Discount Rate and Level Percent of Pay Amortization**
(numbers expressed in millions)

Employee Group		County	Board of	Community	Public	Grand
Factor	Option	Total	Education	College	Libraries	Total
Baseline Cost (12.5% health care trend in 2006, end of year)		62.7	48.1	4.2	2.6	117.6
Current Retirees – under 65 and 65+						
Cost Share	Access only (100% share, implicit subsidy only)	-10.3	-18.0	-0.4	-0.4	-29.1
	Graduated Scale (e.g., 2.5% year, max at 75%)	0.0	info	info	info	0.0
	Hard Cap of 4%	-4.4	-6.0	-0.1	-0.2	-10.7
	Variable Cap based on CPI (3.5%)	-4.9	-6.6	-0.1	-0.2	-11.8
	Eliminate Implicit Subsidy	-4.5	0.0	-0.1	-0.1	-4.7
	70%-30% Employer-Employee Share	-1.3	-2.6	N/A	0.0	-3.9
	60%-40% Employer-Employee Share	-2.5	-5.3	N/A	-0.1	-7.9
	50%-50% Employer-Employee Share	-3.6	-7.9	N/A	-0.1	-11.6
Term / Vested						
Cost Share	Access only (100% share, implicit subsidy only)	-0.3	N/A	N/A	N/A	-0.3
	Graduated Scale (e.g., 2.5% year, max at 75%)	0.0	N/A	N/A	N/A	0.0
Eligibility	Eliminate	-0.3	N/A	N/A	N/A	-0.3
	Retiree Only (no spouse or dependents)	0.0	N/A	N/A	N/A	0.0
Current Employees						
Cost Share	Access only (100% share, implicit subsidy only)	-33.2	-30.1	-2.6	-1.6	-67.5
	Graduated Scale (e.g., 2.5% year, max at 75%)	-14.4	-4.2	N/A	-0.6	-19.2
	Hard Cap of 4%	-16.9	-14.1	-0.9	-0.7	-32.6
	Variable Cap based on CPI (3.5%)	-18.9	-15.8	-1.1	-0.8	-36.6
Eligibility	Eliminate	-47.7	-30.1	-3.7	-2.0	-83.5
	Eliminate Term Vesting	-0.4	N/A	N/A	0.0	-0.4
	End Drug Benefits at Age 65	-12.3	-13.0	-1.1	-0.8	-27.2
	End All Benefits at Age 65	-23.1	-20.6	-2.7	-1.4	-47.8
	Retiree & Spouse Only (no dependents)	-3.7	N/A	-0.1	0.0	-3.8
	Retiree Only (no spouse or dependents)	-23.6	-12.1	-1.4	-0.7	-37.8
	Minimum of 10 Yrs of Service	-4.5	N/A	N/A	-0.3	-4.8
	Minimum of 15 Yrs of Service	-8.5	N/A	-0.2	-0.6	-9.3
	Minimum of 20 Yrs of Service	-13.6	-4.8	-0.8	-0.9	-20.1
	Minimum Age of 50 years old	-9.6	N/A	0.0	0.0	-9.6
	Minimum Age of 55 years old	-27.4	N/A	0.0	-0.2	-27.6
	Minimum Age of 60 years old	-33.8	-6.2	-1.1	-0.4	-41.5
	Minimum Age of 65 years old	-44.2	-15.8	-2.5	-1.6	-64.1
	Defer Coverage until Age of 55 years old	-5.8	N/A	0.0	0.0	-5.8
	Defer Coverage until Age of 60 years old	-12.2	N/A	-0.2	-0.1	-12.5
	Decrement of 5% per year if retiree participates at an age younger than age 65 (modeled after pension plan approach)	-7.1	-4.6	-0.1	-0.1	-11.9
Combo 1	Min. of 15 Yrs of Service & Graduated Scale	-22.6	-4.2	-0.2	-1.2	-28.2
Combo 2	Min. of 15 Yrs of Service, Graduated Scale & Variable Cap (3.5%)	-28.8	-17.7	-1.3	-1.4	-49.2
Combo 3	Min. of 15 Yrs of Service, Graduated Scale, Variable Cap (3.5%), and Min. Age of 55 yrs	-40.9	-17.7	-1.3	-1.5	-61.4
Combo 4	Min. of 15 Yrs of Service, Graduated Scale and Min. Age of 55 yrs	-38.6	-4.2	-0.2	-1.3	-44.3
All Employee Groups						
Plan Design	Changes to save 5%	-3.1	-2.4	-0.2	-0.1	-5.9

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**Reductions in Normal Cost
at 8% Discount Rate**
(numbers expressed in millions)

Employee Group			County Pension Plans				
Factor	Option		Employee	Police	Juv	Dev/Sheriff	Total
Baseline Cost (12.5% health care trend in 2006, end of year)			9.8	5.2	5.1	3.0	23.1
Current Retirees – under 65 and 65+							
Cost Share	Access only (100% share, implicit subsidy only)		N/A	N/A	N/A	N/A	N/A
	Graduated Scale (e.g., 2.5% year, max at 75%)		N/A	N/A	N/A	N/A	N/A
	Hard Cap of 4%		N/A	N/A	N/A	N/A	N/A
	Variable Cap based on CPI (3.5%)		N/A	N/A	N/A	N/A	N/A
	Eliminate Implicit Subsidy		N/A	N/A	N/A	N/A	N/A
	70%-30% Employer-Employee Share		N/A	N/A	N/A	N/A	N/A
	60%-40% Employer-Employee Share		N/A	N/A	N/A	N/A	N/A
	50%-50% Employer-Employee Share		N/A	N/A	N/A	N/A	N/A
Term / Vested							
Cost Share	Access only (100% share, implicit subsidy only)		N/A	N/A	N/A	N/A	N/A
	Graduated Scale (e.g., 2.5% year, max at 75%)		N/A	N/A	N/A	N/A	N/A
Eligibility	Eliminate		N/A	N/A	N/A	N/A	N/A
	Retiree Only (no spouse or dependents)		N/A	N/A	N/A	N/A	N/A
Current Employees							
Cost Share	Access only (100% share, implicit subsidy only)		-7.2	-3.4	-3.4	-2.0	-16.0
	Graduated Scale (e.g., 2.5% year, max at 75%)		-2.6	-1.5	-1.5	-0.5	-6.1
	Hard Cap of 4%		-3.6	-1.9	-1.8	-1.0	-8.3
	Variable Cap based on CPI (3.5%)		-4.0	-2.1	-2.1	-1.2	-9.4
Eligibility	Eliminate		-9.8	-5.2	-5.1	-3.0	-23.1
	Eliminate Term Vesting		-0.2	0.0	0.0	-0.1	-0.3
	End Drug Benefits at Age 65		-3.6	-0.9	-0.9	-0.7	-6.1
	End All Benefits at Age 65		-6.6	-1.7	-1.7	-1.2	-11.2
	Retiree & Spouse Only (no dependents)		-0.5	-0.5	-0.5	-0.2	-1.7
	Retiree Only (no spouse or dependents)		-4.5	-2.7	-2.5	-1.4	-11.1
	Minimum of 10 Yrs of Service		-2.0	-0.1	-0.3	-0.8	-3.2
	Minimum of 15 Yrs of Service		-3.2	-0.4	-0.6	-1.5	-5.7
	Minimum of 20 Yrs of Service		-4.4	-1.1	-1.1	-2.0	-8.6
	Minimum Age of 50 years old		-0.3	-2.3	-1.9	-0.3	-4.8
	Minimum Age of 55 years old		-1.7	-4.8	-4.2	-2.0	-12.7
	Minimum Age of 60 years old		-2.7	-5.2	-5.1	-2.5	-15.5
	Minimum Age of 65 years old		-7.9	-5.2	-5.1	-3.0	-21.2
	Defer Coverage until Age of 55 years old		-0.3	-1.2	-1.0	-0.4	-2.9
	Defer Coverage until Age of 60 years old		-0.8	-2.1	-2.0	-0.8	-5.7
	Decrement of 5% per year if retiree participates at an age younger than age 65 (modeled after pension plan approach)		-0.7	-1.1	-1.1	-0.5	-3.4
Combo 1	Min. of 15 Yrs of Service & Graduated Scale		-5.8	-1.9	-2.0	-1.9	-11.6
Combo 2	Min. of 15 Yrs of Service, Graduated Scale & Variable Cap (3.5%)		-6.8	-2.7	-2.8	-2.2	-14.5
Combo 3	Min. of 15 Yrs of Service, Graduated Scale, Variable Cap (3.5%), and Min. Age of 55 yrs		-7.5	-5.0	-4.7	-2.8	-20.0
Combo 4	Min. of 15 Yrs of Service, Graduated Scale and Min. Age of 55 yrs		-6.6	-4.9	-4.6	-2.7	-18.8
All Employee Groups							
Plan Design	Changes to save 5%		-0.5	-0.3	-0.3	-0.2	-1.2

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**Reductions in Normal Cost
at 8% Discount Rate**
(numbers expressed in millions)

Employee Group		County	Board of	Community	Public	Grand
Factor	Option	Total	Education	College	Libraries	Total
Baseline Cost (12.5% health care trend in 2006, end of year)		23.1	9.8	1.7	1.1	35.7
Current Retirees – under 65 and 65+						
Cost Share	Access only (100% share, implicit subsidy only)	N/A	N/A	N/A	N/A	N/A
	Graduated Scale (e.g., 2.5% year, max at 75%)	N/A	N/A	N/A	N/A	N/A
	Hard Cap of 4%	N/A	N/A	N/A	N/A	N/A
	Variable Cap based on CPI (3.5%)	N/A	N/A	N/A	N/A	N/A
	Eliminate Implicit Subsidy	N/A	N/A	N/A	N/A	N/A
	70%-30% Employer-Employee Share	N/A	N/A	N/A	N/A	N/A
	60%-40% Employer-Employee Share	N/A	N/A	N/A	N/A	N/A
	50%-50% Employer-Employee Share	N/A	N/A	N/A	N/A	N/A
Term / Vested						
Cost Share	Access only (100% share, implicit subsidy only)	N/A	N/A	N/A	N/A	N/A
	Graduated Scale (e.g., 2.5% year, max at 75%)	N/A	N/A	N/A	N/A	N/A
Eligibility	Eliminate	N/A	N/A	N/A	N/A	N/A
	Retiree Only (no spouse or dependents)	N/A	N/A	N/A	N/A	N/A
Current Employees						
Cost Share	Access only (100% share, implicit subsidy only)	-16.0	-9.8	-1.2	-0.8	-27.8
	Graduated Scale (e.g., 2.5% year, max at 75%)	-6.1	-0.1	N/A	-0.3	-6.5
	Hard Cap of 4%	-8.3	-5.2	-0.4	-0.4	-14.3
	Variable Cap based on CPI (3.5%)	-9.4	-5.9	-0.5	-0.4	-16.2
Eligibility	Eliminate	-23.1	-9.8	-1.7	-1.1	-35.7
	Eliminate Term Vesting	-0.3	N/A	N/A	0.0	-0.3
	End Drug Benefits at Age 65	-6.1	-4.3	-0.5	-0.4	-11.3
	End All Benefits at Age 65	-11.2	-6.7	-1.2	-0.8	-19.9
	Retiree & Spouse Only (no dependents)	-1.7	N/A	-0.1	0.0	-1.8
	Retiree Only (no spouse or dependents)	-11.1	-3.9	-0.6	-0.4	-16.0
	Minimum of 10 Yrs of Service	-3.2	N/A	N/A	-0.2	-3.4
	Minimum of 15 Yrs of Service	-5.7	N/A	-0.1	-0.4	-6.2
	Minimum of 20 Yrs of Service	-8.6	-2.2	-0.5	-0.6	-11.9
	Minimum Age of 50 years old	-4.8	N/A	0.0	0.0	-4.8
	Minimum Age of 55 years old	-12.7	N/A	0.0	-0.1	-12.8
	Minimum Age of 60 years old	-15.5	-1.2	-0.5	-0.2	-17.4
	Minimum Age of 65 years old	-21.2	-4.9	-1.1	-0.8	-28.0
	Defer Coverage until Age of 55 years old	-2.9	N/A	0.0	0.0	-2.9
	Defer Coverage until Age of 60 years old	-5.7	N/A	-0.1	-0.1	-5.9
	Decrement of 5% per year if retiree participates at an age younger than age 65 (modeled after pension plan approach)	-3.4	0.0	-0.1	0.0	-3.5
Combo 1	Min. of 15 Yrs of Service & Graduated Scale	-11.6	-0.1	-0.1	-0.6	-12.4
Combo 2	Min. of 15 Yrs of Service, Graduated Scale & Variable Cap (3.5%)	-14.5	-5.5	-0.6	-0.8	-21.4
Combo 3	Min. of 15 Yrs of Service, Graduated Scale, Variable Cap (3.5%), and Min. Age of 55 yrs	-20.0	-5.5	-0.6	-0.8	-26.9
Combo 4	Min. of 15 Yrs of Service, Graduated Scale and Min. Age of 55 yrs	-18.8	-0.1	-0.1	-0.7	-19.7
All Employee Groups						
Plan Design	Changes to save 5%	-1.2	-0.5	-0.1	-0.1	-1.8

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Defined Contribution Plans

Another change that may be considered is to switch from a defined benefit plan to a defined contribution plan.

What is it?

Defined contribution plans involve the County providing a fixed dollar amount toward employee and retiree health care. The County's contribution can be defined in respect to an actual amount of dollars or a percentage of pay, with or without maximum dollars.

Defined contribution plans vary widely in design. The responsibility for selection of and payment for health care is generally shifted to the employee. The employer may provide access to the health plans or may require the participant to obtain the insurance in the market place. It should be noted that the administrative and distributive costs of individual policies are much greater than under group policies.

In the simplest form, and the form that has been most commonly used, **employers provide the plans and pay a fixed dollar amount to each participant for the health care.** This may be fixed as the cost of the lowest priced health care option or based on some other basis or calculation. If the employee wants to participate in a plan that offers more benefits, then the employee pays the difference out-of-pocket.

Some of these plans are also called "**cafeteria plans**," in which the employer provides a fixed amount of benefit dollars, and the employee purchases available benefits, like health care, disability insurance, and life insurance, with those dollars. The employee chooses how to spend those dollars and whether to contribute employee dollars based on factors important to the employee. With the cafeteria plan, the employer generally continues to make health care plans available to participants.

Another approach to defined contribution plans is called the **individual market approach**. The employer continues to make a defined contribution toward the benefits. The employee is responsible for obtaining insurance in the market place. It has been noted that, if a large number of employers adopt this approach, health insurance may be more portable. Employees would not have to change their health plan merely because they changed employers. They could continue to use the defined contribution toward the plan they obtained on their own in the market place.

Effects of Use of Defined Contribution Plans on GASB 45 Liability

Defined contribution plans can be used to fix the County's liability for employee and retiree health care. Many considerations go into calculating and choosing the County's contribution, however, rather than the County's contribution being based on an annual plan cost, the contribution would be under the control of the County. This would lead to more stability and predictability of the County's liability over time. It may also increase the employee and retiree share of the premium for certain plans.

In calculating the County's ARC, the trends in health care costs would not be as relevant to the increased cost to the County over time. The County could calculate its liability based not on

projected health care costs, but on an amount it is willing to contribute toward health care. That amount could increase over time based on projected increases in payroll costs or other price indices, and not necessarily on the rising cost of health care.

Account-Based Health Plans

Another option for funding health benefits for employees and retirees is the implementation of some type of account-based health plan. The County already offers one type of account-based plan, a Flexible Spending Account, to its employees. This allows employees to pay certain health care expenses not covered by insurance with pre-tax dollars deducted from pay and put into an account with an outside administrator. There are IRS limits on the amount that can be placed into the account, and funds that are not used during the plan year are lost by the employee.

There are other accounts that can be used to pay for health care expenses that are used in place of other defined benefit and defined contribution plans. The following summarizes some of the features of two of the available types of plans. It should be noted, however, that more detailed analysis and advice would be required to determine the tax qualifications and implications, as well as the eligibility requirements and all plan features.

Health Savings Accounts (“HSA”) are tax exempt accounts that are used to pay health care expenses. The HSAs are actually owned by the employee, and, therefore are portable between employers. Funds not used are not lost, but roll over for future use. At this time these accounts are not widely used, but it is anticipated that because of recent IRS rulings these accounts will become more common. To qualify for the tax exempt status, contributions to HSAs must be made while the participant is enrolled in a health plan with a high annual deductible. Deductions can be made at any time, even when the participant is no longer in the high deductible plan. Employers can contribute to the HSA, but the maximum contribution to a plan cannot exceed the plan deductible. Medicare beneficiaries are not permitted to contribute to HSAs, but they can make withdrawals for certain expenses. Individuals older than 55 can make limited “catch-up” contributions.

Health Reimbursement Arrangements (“HRA”) are employer funded health plans that reimburse employees for qualified medical expenses. A high deductible health plan can also be used, but is not required. If an HRA is offered with plans with high deductibles, it can be used to assist the employee with meeting that deductible. HRAs can also be used to allow employees to purchase benefits, including for long-term care and health care during retirement. HRAs are paper accounts only, and no expense is incurred by an employer until there is a claim. Unused “funds” can be rolled over for use in subsequent plan years. If an employee leaves employment, the employer is not required to make unused amounts available to the employee.

Like defined contribution plans, account-based plans may result in a somewhat more predictable and controllable future liability for the County. These account plans can be used in combination with certain defined benefit and defined contribution plans, again resulting in numerous possible combinations and resulting options.

The purpose for this section of the report is to identify the potential funding gaps, provide some context for the various funding options, and address the implications of doing nothing.

Identification of the Funding Gap

The difference between the total Annual Required Contribution (ARC) and the current “pay-as-you-go” funding for retiree health benefits is the initial funding gap. The chart below shows this calculation in total as well as for the County government itself and the three component units. Similar calculations can be made under the other two discount rate scenarios. The total ARC gap using a 6% discount rate is \$97.7 million, and using a 4% discount rate is \$137.2 million.

Identification of Initial Funding Gap Discount Rate of 8% (dollars expressed as millions)					
	County	Board of Education	Community College	Libraries	Total
Baseline					
Amortized AAL	\$39.7	\$38.3	\$2.5	\$1.5	\$82.0
Normal Cost	\$23.0	\$9.8	\$1.7	\$1.1	\$35.6
Total ARC	\$62.7	\$48.1	\$4.2	\$2.6	\$117.6
Pay-as-you-go	\$15.0	\$25.1	\$1.3	\$0.8	\$42.2
Total ARC Gap	\$47.7	\$23.0	\$2.9	\$1.8	\$75.4
% of whole	63%	31%	4%	2%	100%

This initial funding gap can be broken down into two different components as shown in the chart below. The “Amortized AAL Gap” represents that portion of the funding gap that is due to liabilities incurred over many years in the past. It can be thought of as a “backlog” of sorts. The “Normal Cost” component represents that portion of the funding gap that is attributable to the budget year in question (i.e., FY2008). This should be thought of as a “recurring” cost.

Two Components of Initial Funding Gap (dollars expressed as millions)			
Discount Rate	Amortized AAL	Normal Cost	Total ARC Gap
8%	\$39.8	\$35.6	\$75.4
6%	\$43.3	\$54.4	\$97.7
4%	\$48.2	\$89.0	\$137.2

County financial policy dictates that one-time funds should not be used to fund “recurring costs” such as the Normal Cost gap. However, it may be prudent to apply one-time funds to fund a “backlog” such as the Amortized AAL gap.

If none of the previously presented options to reduce the liability are chosen and the ARC is not otherwise reduced, then the final funding gap would be as shown on the previous page. If the ARC is reduced by some combination of options totaling \$75.4 million, then the final funding gap would be reduced to zero. If the ARC is reduced by some combination of options totaling half of the initial funding gap, then the final funding gap would be \$37.7 million.

Similarly, under the 6% discount rate scenario, the final funding gap would range from \$0 to \$97.7 million, with \$48.9 being the midpoint. And, under the 4% discount rate scenario, the final funding gap would range from \$0 to \$137.2 million, with \$68.6 million being the midpoint.

Putting the Final Funding Gap in Context

If options are sought to fund the final funding gap, they can be broken down into three broad categories: increasing revenues, decreasing expenditures, and other sources. While it's not within the scope of this report to make recommendations as to funding approaches, it is useful to view these possible final funding gaps in the context of specific areas within these three broad categories.

Increasing Revenues

- A one-cent increase in the property tax yields about \$5 million annually.
- A 25% increase in the income tax from 2.56% to 3.20% would be the maximum allowed under state law and would yield about \$80 million annually. This tax rate is comparable to Howard, Prince George's, and Montgomery Counties.
- A 10% increase in the income tax from 2.56% to 2.82% would yield about \$32 million annually and is comparable to the Baltimore County tax rate.
- A 5% increase in the income tax rate from 2.56% to 2.69% would yield about \$16 million annually.

Decreasing Expenditures

- One percent of all salaries (including component units, and FICA and pension where applicable) equals about \$7.3 million annually.
- In order to provide a departmental context for any potential changes in expenditure levels, a departmental breakdown of the FY2007 Approved General Fund operating budget is shown in Appendix D. Overall, the total ARC of \$117.6 million is approximately equal to 10% of the General Fund operating budget.

Accrual Accounting – A term used to describe the method of recognizing costs when economic events occur regardless of when cash will be needed to satisfy obligations.

Actuarial Accrued Liability (AAL) – This is the portion of the Total Present Value of Projected Benefits (TPV) attributable to service provided to date. For example, if an individual is expected to have 25 years of service upon retirement and has 10 years of service at the valuation date, the AAL is 10/25ths of the TPV. For someone that is already retired at the valuation date, the AAL is equal to the TPV.

Actuarial Present Value of Total Projected Benefits – This represents the total projected benefits to be paid to employees / retirees discounted back to current dollars.

Actuarial Valuation Date – This is the date as of which the actuarial evaluation is performed. The evaluation uses employer data as of this particular date to calculate liabilities, etc.

Actuarial Value of Assets (AVA) – The market value of assets that have been set aside exclusively for funding retiree healthcare. For plans that are not funded, the AVA = \$0.

Amortization Period – The time period used to amortize the Annual Required Contribution (ARC) related to past service costs.

Annual Required Contribution (ARC) – The annual contribution required to conform to GASB 45 standards and avoid a liability from appearing on the balance sheet. The ARC consists of two parts: (1) a payment against the previously unfunded actuarial accrued liability (UAAL) which is equal to the UAAL amortized over a set number of years (maximum allowed is 30 years), plus (2) the Normal Costs.

Blended Premium – A healthcare premium that does not take into account the age of the individuals covered, as when a single premium is used for both active and retired employees.

Governmental Accounting Standards Board (GASB) – GASB is a nationally established board that sets standards for accounting and reporting for State and local governments and their component units. Governments follow these standards in order to fairly present financial information and to receive an unqualified audit opinion on their annual financial statements.

Implicit Rate Subsidy – The de facto subsidy of retirees by permitting them to pay lower than age-adjusted premiums through the use of a single common or blended premium for both retirees and active employees.

Normal Service Costs – The portion of the Total Present Value of Projected Benefits (TPV) allocated to the current year (i.e., the amount attributable to services provided to date by current employees). For example, if an individual is expected to have 25 years of service upon retirement, this is 1/25th of the individual's TPV. There is no Normal Service Cost for retirees.

Other Post Employment Benefits (OPEB) – This term is used to describe any benefit (separate from a pension plan) offered to employees after employment is severed.

Past Service Costs – The portion of the Total Present Value (TPV) that relates to services rendered by employees in past years.

Pay as you go – A term to describe the method of recognizing costs as bills are due. This method is based on when cash will be needed to pay the bills. When used in reference to OPEB, this term refers to the actual costs incurred by the government to pay for retiree healthcare in a given fiscal year.

Total Present Value of Projected Benefits (TPV) – An amount calculated by actuarial methods to estimate the amount of benefits (in current dollars) both former and current employees will be paid during retirement. The calculation estimates the required future pay outs and then determines what those pay outs are valued in today's dollars. For an individual person, this would be the value of all benefits expected to be paid from the date of retirement until death discounted back to the valuation date.

Total Projected Benefits – An amount calculated by actuarial methods to estimate the amount of benefits both former and current employees will be paid during retirement.

Unfunded Actuarial Accrued Liability (UAAL) – This represents the amount of the AAL for which funds have not been set aside. It is calculated as the actuarial accrued liability (AAL) minus the actuarial value of assets (AVA). For plans that are not funded, the UAAL is equal to the AAL.

BULLETIN NO.: 05-04-13

**SUBJECT: Eligibility for Health Insurance
As A Retired County Employee**

December 31, 2006

[X] DEPARTMENT HEADS

[X] PLEASE POST UNTIL

DATE: January 1, 2006

**[] GENERAL DISTRIBUTION
TO ALL EMPLOYEES**

[X] PERSONNEL OFFICE

This policy supercedes all previous written policy statements and is effective January 1, 2006 unless otherwise indicated.

Policy:

1. Eligibility for Benefits

- a. Employees of the County government who are participants in the County Pension plan and were hired prior to January 1, 2006, are eligible to participate in the County-sponsored post employment health benefit programs upon their retirement.
- ✓ b. Employees hired or re-hired after January 1, 2006 must retire directly from Anne Arundel County Government and must have a minimum of 15 years of credited pension service as defined by Section 1-205 (a), Article 5 (old Article 7), Anne Arundel County Code to be eligible to participate in the County-sponsored post employment health benefit programs upon retirement.
- c. Dependents of a retiree will be eligible for coverage as long as the retiree is receiving pension payments. Survivors who continue to receive pension payments after the death of the retiree are eligible to continue coverage, but may not add additional dependents unless there was a prior dependent relationship between the original retiree and the covered dependent.
- d. Those employees of the Anne Arundel Economic Development Corporation who are participants in the County Pension Plan and who were hired prior to January 1, 2006 are eligible to participate in County-sponsored post employment health benefit programs upon retirement.