

**MEMORANDUM**

November 26, 2008

TO: Management and Fiscal Policy Committee

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

SUBJECT: Update – Retiree Health Benefits (OPEB)

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

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. Since then the Committee has received regular updates from the agencies' finance, budget, benefits, and legal staffs. The Committee's most recent review of OPEB issues was on May 9.

Members of the **Multi-Agency OPEB Work Group**, who have collaborated very effectively with each other and with the Committee over the past five years, will be present for this update. We will hear from Finance Department Chief Operating Officer Karen Hawkins, MCPS Chief Financial Officer Sue DeGraba, M-NCPPC Secretary-Treasurer Patricia Colihan Barney, Montgomery College Director of Financial Operations Ken Mullinix, and WSSC Chief Financial Officer Tom Traber and/or their colleagues. We will also hear from the Committee's actuarial consultant on this issue, Thomas Lowman of Bolton Partners, Inc.

**Background**

Starting in FY08, jurisdictions with more than \$100 million in annual revenue have had to disclose their liability for OPEB. Most governments have funded these benefits on a pay-as-you-go basis to cover the annual expense for current retirees. The accrual standard in GASB 45 also requires disclosure 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. Based on the four tax-supported agencies' 2006 actuarial valuations, full pre-funding of the annual required contribution (ARC) would have cost **\$240.0 million** in FY08. Of this amount, the **additional** cost, apart from the annual pay-as-you-go expense, would have been **\$159.5 million** in FY08.

On March 19, 2007 the Committee concurred with the Executive in recommending a five-year phase-in of this **additional** amount, starting with **\$31.9 million** in FY08. This cost was projected to rise by a larger increment in each of the next four years until it reached an estimated **\$187.7 million** in FY12. On April 10, 2007 the Council approved the Committee's recommendation in Resolution No. 16-87. See ©1-2. For a summary of FY08 OPEB costs by agency, see ©3.

On May 9, 2008 the Committee concurred with the Executive in recommending an eight-year funding schedule instead. For the tax-supported agencies combined, this change would have reduced the FY09 contribution from **\$70.9 million** to **\$55.2 million**. However, the Committee decided to adopt an alternative methodology on the discount rate used to assess the cost of the eight-year phase-in, as proposed by Mr. Lowman. This change reduced the FY09 contribution to **\$40.6 million**. On May 14, 2008 the Council approved the Committee's recommendation in Resolution No. 16-555. See ©4-5. For a summary of OPEB costs by agency for FY09-15 as projected then, see ©6.

#### **Multi-Agency OPEB Work Group Report (November 24, 2008)**

We asked the Work Group to focus its current report once again on five areas: the status of the agencies' OPEB trusts, communication plans, options for limiting liability; actuarial valuations; and lessons to date from the experience of other jurisdictions. The Work Group's report on ©7-21 reflects the agencies' continued progress on these issues. Agency representatives, together with Mr. Lowman, will discuss these issues point by point. Mr. Lowman's comments are on ©22-24.

To summarize, the report indicates on ©7-8 that all agencies have now established OPEB trusts, with structure and details varying from agency to agency. Communications plans are moving forward, as described on ©9 and in the information on agency web sites on ©16-21. The discussion of limiting liability on ©10-11 describes agency initiatives in this important area while noting the challenges involved.

The detailed discussion of actuarial valuations on ©11-15 notes that updated valuations (as of July 1, 2008, which will be used for the FY10 budget), are complete for M-NCPPC and the College and will soon be available for MCPS and MCG. (WSSC is not updating its valuation this year.) The report notes that over the past year the Work Group and their actuaries have undertaken a due diligence reevaluation of the processes and assumptions used in the multi-year phase-in analysis, including issues of timing, assumptions, and methodologies. The result, the Work Group believes, will be more consistent reporting across agencies and projections that are better aligned with budgetary calculations. As for lessons from the experience of other jurisdictions, the Work notes on ©15 that it continues to monitor developments elsewhere.

In his memo on ©22-24, Mr. Lowman notes his agreement with the Work Group's conclusions on methodology for actuarial valuations. He also points to recent limitations on retiree health benefits in Frederick County as another example of changes elsewhere that he has previously discussed, such as in St Mary's County and Baltimore County. See in particular his comments on ©23 on options for limiting liability, including a possible role for the Council.

Limiting liability is a challenging and sensitive topic, but the table on ©6 shows clearly why it cannot and will not go away. The table reflects the Council's decision last May 14 to approve an eight-year phase-in of the **additional** cost – not including the annual pay-as-you-go expense – to pre-fund the annual required contribution (ARC) for the agencies' retiree health benefits. The FY09 amount, **\$40.6 million**, is scheduled to rise to **\$66.2 million** in FY10 and rise steadily thereafter until it reaches **\$195.5 million** in FY15. (These numbers will change with updates to the actuarial valuations, including this year's.)

**In other words, pre-funding the agencies' retiree health benefits is on track to require a massive taxpayer contribution, growing to the range of \$200 million per year by 2015, above and beyond the annual pay-as-you-go expense.** This required amount will not be available for services to County residents, or for that matter for salaries for agency employees. The required contribution for FY10 – **\$66.2 million** as of last May – is **\$25.6 million** more than the contribution approved for FY09 – this at a time when the County faces a FY10 budget gap now estimated at **\$500 million**.

State and local governments nationwide – especially those like the County with excellent retiree health benefits – are facing this same funding problem. In last year's reports the Work Group included a list of generic scenarios to limit liability that are under review elsewhere. See ©25-26. (Another factor to consider, of course, is the possible impact of future changes in national health policy.)

For a provocative analysis of these issues, see the article on ©27-34 entitled "A Taxpayers' Benefits Bill of Rights". The article, from the October 2008 edition of *Governing* magazine's management letter, is by investment and public finance expert Girard Miller. Mr. Miller reviews the OPEB issue from the perspective of both employees and taxpayers. He uses what he calls "three fundamental concepts of retirement plan finance: necessity, sustainability, and sufficiency." These are the concepts with which policymakers in the County and nationwide must now start to grapple in earnest.

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Resolution No.:	16-87
Introduced:	March 27, 2007
Adopted:	April 10, 2007

**COUNTY COUNCIL  
FOR MONTGOMERY COUNTY, MARYLAND**

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By: County Council

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**SUBJECT:** Five-Year Funding Schedule for County Agencies' Annual Required Contribution for Other Post Employment Benefits (OPEB)

**Background**

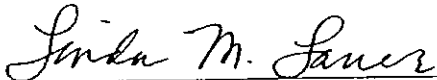
1. The Governmental Accounting Standards Board (GASB) has issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions*, which addresses how state and local governments should account for and report their costs and obligations related to Other Post Employment Benefits (OPEB).
2. County agencies (the County Government, Montgomery County Public Schools, Montgomery College, the Washington Suburban Sanitary Commission [WSSC], and the Maryland-National Capital Park and Planning Commission [M-NCPPC]) are required to disclose their OPEB liabilities in their financial statements, starting with the fiscal year beginning July 1, 2007 (FY 2008).
3. In November 2006 the County obtained actuarial valuation information addressing the extent of the County's liability to its retirees for Other Post Employment Benefits as of July 1, 2006. Other County agencies have also obtained, or are in the process of obtaining, similar actuarial valuations. The OPEB reports are subject to a number of actuarial and economic assumptions; these assumptions were generally similar to the assumptions used in evaluating the County agencies' pension fund liabilities.
4. Based on the assumptions and qualifications stated therein, the OPEB reports concluded that, assuming full prefunding, the FY 2008 annual required contribution (ARC) for the County, its tax supported agencies, and the Montgomery County portion of the M-NCPPC is \$240.0 million, and the related actuarial accrued liability (AAL) is \$2.6 billion. The most recent ARC for WSSC is \$19.1 million, and the related AAL is \$200 million.
5. The County has determined that a five-year phase in of the difference between the current pay-as-you-go amount and the ARC would be a responsible approach to pre-funding, and believes that such an approach is acceptable to the rating agencies, which will be evaluating the County's response to the GASB disclosure requirements and its approach to any obligations to current and future retirees for post-employment health and other non-pension benefits.
6. Should the County establish a separate OPEB trust, and should the County adopt a written policy of its intent to phase-in full funding of the difference between the pay-as-you-go contributions and the ARC on an amortized even basis over a five-year period, it would be appropriate for the County agencies to use, in their actuarial valuations, a discount rate higher than their operating investment rate for accounting and budgeting purposes. 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.

Action

The County Council for Montgomery County, Maryland approves the following resolution:

1. The Council is committed to the responsible fiscal management of the County agencies' Other Post Employment Benefit obligations and acknowledges that County agencies intend to establish one or more Trusts, on or before July 1, 2007 if possible, for such purposes.
2. It is the Council's policy intent to fund the difference between the OPEB pay-as-you-go contributions and the annual required contribution, for the tax supported agencies, on an amortized even basis over a five-year period beginning with Fiscal Year 2008.
3. For WSSC and M-NCPPC, it is the Council's policy intent to support WSSC's and M-NCPPC's plans to implement a five-year phase in of the difference between the OPEB pay-as-you-go contributions and the ARC beginning with Fiscal Year 2008, in coordination with the Prince George's County Council.

This is a correct copy of Council action.



Linda M. Lauer, Clerk of the Council

**Other Post Employment Benefits:** The Governmental Accounting Standards Board (GASB) has issued Statement 45, Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions, which addresses how state and local governments should account for and report their costs and obligations related to Other Post Employment Benefits (OPEB). County agencies are required to disclose their OPEB liabilities in their financial statements, starting with the fiscal year beginning July 1, 2007 (FY08).

In November 2006, the County obtained actuarial valuation information addressing the extent of the County's liability to its retirees for other post employment benefits as of July 1, 2006. Based on the assumptions and qualifications stated therein, the OPEB report concluded that, assuming full pre-funding, the FY08 annual required contribution (ARC) for the County and its tax supported agencies is \$240.0 million, and the related actuarial accrued liability (AAL) is \$2.6 billion. The County has determined that a five year phase in of the difference between the current pay-as-you-go amount to the ARC would be a responsible approach to pre-funding, and believes that such an approach is acceptable to the rating agencies, who will be evaluating the County's response to the GASB disclosure requirements, and its approach to its obligations to current and future retirees for health and other non-pension benefits.

The County is committed to the responsible fiscal management of the County's OPEB obligations and intends to establish a trust on or before July 1, 2007 for such purposes. It is the County's intent to ramp up to full funding of the ARC over a five-year period beginning with FY08. This approach allows the County to use a discount rate higher than its operating investment rate for accounting and budget-

ing purposes, which will result in lower costs and liabilities than if the County did not have a trust in place.

Proposed FY08 OPEB Trust Contributions	
	FY08
<b>Montgomery County Government (MCG)</b>	
<u>General Fund:</u>	
Other Post-Employment Benefits NDA	12,067,320
<u>Proprietary Funds:</u>	
Bethesda Parking District	28,540
Wheaton Parking District	4,280
Silver Spring Parking District	22,830
Solid Waste Collection	12,840
Solid Waste Disposal	102,750
Liquor Control	445,260
Permitting Services	305,400
Community Use of Public Facilities	38,530
Motor Pool	238,320
Risk Management	17,120
Central Duplicating	42,810
<u>Participating Agency Contributions:</u>	
Housing Opportunities Commission	524,000
Revenue Authority	68,000
Strathmore Hall	50,000
Montgomery County Television	35,000
Washington Suburban Transit Commission	5,000
State Agencies	12,000
<b>Total MCG Trust Contributions</b>	<b>14,020,000</b>
<b>Montgomery County Public Schools Trust Fund</b>	<b>16,060,000</b>
<b>Montgomery College Trust Fund</b>	<b>606,400</b>
<b>Park and Planning Commission Trust Fund</b>	<b>1,210,500</b>
<b>Total Contributions/Assets Held in Trust</b>	<b>\$31,896,900</b>

Resolution No:	16-555
Introduced:	May 14, 2008
Adopted:	May 14, 2008

**COUNTY COUNCIL  
FOR MONTGOMERY COUNTY, MARYLAND**

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By: County Council

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**SUBJECT:** Resolution to Amend Resolution No. 16-87 to Establish an Eight-Year Funding Schedule for County Agencies' Annual Required Contribution for Retiree Health Benefits (Other Post Employment Benefits – OPEB)

**Background**

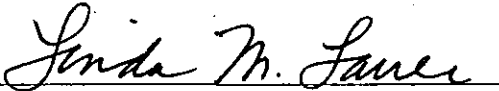
1. The Governmental Accounting Standards Board (GASB) has issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other than Pensions*, which addresses how state and local governments should account for and report their costs and obligations related to retiree health benefits, referred to as Other Post Employment Benefits (OPEB).
2. County agencies (the County Government, Montgomery County Public Schools, Montgomery College, the Washington Suburban Sanitary Commission, and the Maryland-National Capital Park and Planning Commission) are required to disclose their OPEB liabilities in their financial statements, starting with the fiscal year beginning July 1, 2007 (FY 2008).
3. Establishment of separate trusts and adoption of a written policy of the County's intent to phase in full funding of the difference between the pay-as-you-go contributions and the Annual Required Contribution allows the County agencies to use, in their actuarial valuations, a discount rate higher than their operating investment rate for accounting and budgeting purposes. Absent such a policy, County agencies would be required to record OPEB liabilities in their financial statements of almost twice as much as liabilities required with such a policy.
4. On April 10, 2007, in Resolution No. 16-87, the Council acknowledged that the County agencies intended to establish one or more trusts on or before July 1, 2007, and stated the Council's policy intent to fund the OPEB obligation over a five-year period beginning with FY 2008.
5. On April 1, 2008, the Council approved Expedited Bill 28-07, Personnel – Other Post Employment Benefits Trust – Establishment. This Bill established a Retiree Health Benefits Trust for the County Government and designated the Board of Investment Trustees to manage the investment of the trust funds. Trusts are now in place for all the tax-supported agencies except Montgomery College, which is in the final stages of establishing a Trust.
6. In the FY 2009 Recommended Operating Budget, the Executive proposed a phase-in period of eight years instead of the five-year phase-in that was planned in FY 2008, in response to the County's fiscal situation.

**Action**

The County Council for Montgomery County, Maryland approves the following resolution:

1. The Council is committed to the responsible fiscal management of the County agencies' obligations for Retiree Health Benefits (Other Post Employment Benefits - OPEB) and acknowledges that County agencies have already established or intend to establish one or more trusts for such purposes.
2. It is the Council's policy intent to fund the difference between the OPEB pay-as-you-go contributions and the Annual Required Contribution, for the tax supported agencies, over an eight-year period starting with FY 2008 and ending with FY 2015.
3. For WSSC and M-NCPPC, it is the Council's policy intent to support these agencies' plans to implement, over eight years or less, a phase-in of the difference between the OPEB pay-as-you-go contributions and the ARC starting with FY2008, in coordination with the Prince George's County Council.

This is a correct copy of Council action.



Linda M. Lauer, Clerk of the Council



OPEB  
Future Fiscal Impact of 8 Year Phase-in to the ARC (using pension discount rate)

Agency	2009	2010	2011	2012	2013	2014	2015	Total over Future 7 Years
County	\$ 19,700,000	\$ 32,000,000	\$ 44,000,000	\$ 56,000,000	\$ 68,000,000	\$ 80,000,000	\$ 93,000,000	\$ 392,700,000
MCPS	18,300,000	30,000,000	42,000,000	54,000,000	66,000,000	78,000,000	90,000,000	378,300,000
College	700,000	1,200,000	1,700,000	2,200,000	2,700,000	3,200,000	3,600,000	15,300,000
M-NCPPC (Montgomery County portion - 45%)	1,900,000	3,010,000	4,230,000	5,450,000	6,660,000	7,880,000	8,860,000	37,990,000
Subtotal - Tax Supported Agencies	40,600,000	66,210,000	91,930,000	117,650,000	143,360,000	169,080,000	195,460,000	824,290,000
WSSC								
Total	\$ 40,600,000	\$ 66,210,000	\$ 91,930,000	\$ 117,650,000	\$ 143,360,000	\$ 169,080,000	\$ 195,460,000	\$ 824,290,000

NOTES:

Other Assumptions

- Actuarial calculations based on 5% annual increases due to inflation and increases in employee or retiree population.
- There will be a policy decision at the agency level to dedicate Medicare Part D subsidies to fund OPEB costs.
- M-NCPPC valuation is for Montgomery/Prince George's Counties combined. This analysis assumes 45% relates to Montgomery County.

## MEMORANDUM

November 24, 2008

TO: Management and Fiscal Policy Committee

FROM: Multi-Agency OPEB Work Group

SUBJECT: Update for December 1, 2008 MFP Committee Meeting

The purpose of this memorandum is to provide an update on County agency activities related to implementation of Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions* (OPEB). As previously noted, tax-supported agencies impacted by GASB45 and represented on this work group include: the County, Montgomery County Public Schools (MCPS), Montgomery College (College), and the Montgomery County portion of the Maryland-National Capital Park and Planning Commission (M-NCPPC); the Washington Suburban Sanitary Commission (WSSC) is the only non tax-supported agency participating in the work group.

Information included in this status update addresses the following five areas, as requested by Council staff:

1. Status of Retiree Health Benefit (OPEB) trusts;
2. Status of communication plans;
3. Status of options for limiting liability;
4. Status of actuarial valuations; and
5. Lessons to date from the experience of other jurisdictions.

The current status and recent activities are presented below for each area.

### **Status Report**

#### **1. Status of Retiree Health Benefit (OPEB) Trusts**

All OPEB trusts have been established. Since the November 26, 2007 update, the County and the College completed implementation of their trusts.

The County's trust was established through Bill No. 28-07, effective April 10, 2008, which amended Chapter 33 of the Montgomery County Code to add Article XI, Other Post Employment Benefit Trust. Under this section, the Board of Investment Trustees is responsible for managing the assets of the OPEB trust.

On June 18, 2008, the College established an irrevocable trust agreement with U.S. Bank, National Association, (serving as Trustee/Custodian), with PFM Asset Management LLC, serving as Trust Administrator/Advisor. The Montgomery College Board of Trustees (listed below) is a co-trustee of the Trust and possesses oversight responsibility concerning certain policies and procedures related to the operation and administration of the Trust. In May, 2008, an Investment Policy Statement governing the OPEB Trust for the College was adopted by resolution and signed by President Dr. Brian Johnson.

MCPS's trust was established effective July 1, 2007 and was funded in September 2007 with the initial contribution. The members of the Board of Investment Trustees for the Montgomery County Employee Retirement Plans were appointed as the Board of Investment Trustees for the Other Post Employment Benefits (OPEB) Trust fund as well. This group meets quarterly to review the investment management of the assets. MCPS filed for a private letter ruling from the Internal Revenue Service in September 2008 and is awaiting response.

For the four agencies (all except the College) whose trust funds were established earlier in FY08, the prefunding contributions included in the FY08 appropriations/budgets were deposited into the trusts during FY08. For the College, initial contributions of approximately \$25 million were deposited with the trustee for FY08. This amount included both the budgeted FY08 prefunding amount, and the funds that had previously been accrued from the early 1990's under a Financial Accounting Standards Board (FASB) standard. These previously accrued funds, which were the subject of Council discussions and support several years ago, have the impact of reducing the College's current annual required contributions.

FY09 contributions have also been made to the trusts by MCPS, M-NCPPC, and WSSC. The County is depositing contributions to its trust on a quarterly basis; the first quarter's contribution has been made, and the second quarter is scheduled for mid-December. The College's FY09 contribution will also be made during the current fiscal year.

One issue noted in our last report was the inclusion of reversionary language in the trust documents. Reversionary language would address, in the event of plan termination, what would happen to any residual trust assets after all plan benefits and expenses were paid out. A situation under which this might occur is if national health care was established, eliminating the need for individual employer plans. All trust documents now contain reversionary language.

Since all trusts have now been established, the Work Group would anticipate that future reports would not include this topic.

## **2. Status of Communication Plans**

As of our last report, a County website, accessible from the Finance department home page, had been created which included frequently asked questions, actuarial valuations, financial impact information, multi-agency status reports to the MFP Committee, and County Council packets and resolutions. Since that time, to enhance transparency, the County's internet site has been expanded – the Board of Investment Trustees' website was updated to include information on the investment program for the Retiree Health Benefits Trust. The Finance webpage includes links to all information, including information maintained by the Board. Links to the Finance central home page have also been established from the Office of Human Resources HR Resource Library and from the Office of Management and Budget home page, to help ensure consistency and accessibility in the information provided.

MCPS has established a link to the County website on its Employee and Retiree Service Center, Retirement Planning webpage. The College has also established an Other Post Employment Benefit Page on its Human Resource website, with applicable links to the County's website. The M-NCPPC website is under development, and WSSC is in the evaluation stage.

For the status of specific agencies' website progress, and copies of the main OPEB web pages, see Attachment 1.

Other communications with retirees have also taken place. For example, the County has been meeting with retiree groups; MCPS has been including articles in Employee "For Your Benefit" and in Retirees Association newsletters. The College is sending a separate mailing with the annual notification of retiree rates informing them of the new retiree web site and the information that can be found on the web-site, including post-retirement benefit information. M-NCPPC plans to implement additional communications following the close of open enrollment which wraps up at the end of November. WSSC has met with the Retirees Association and briefed them on OPEB.

Agency representatives will be available at the December 1<sup>st</sup> MFP Committee meeting to address any questions on this topic.

### **3. Status of Options for Limiting Liability**

A variety of initiatives have been, and are being, pursued by county agencies – both joint and agency specific - to identify and address opportunities to limit OPEB liabilities. For the last several years, the benefit managers from each of the agencies have met to share information about the challenges and obstacles they face. In recent months, there have been changes to benefit management leadership at three of the County agencies.

Montgomery County Public Schools (MCPS) and the Washington Suburban Sanitary Commission (WSSC) each hired a benefit manager from outside their respective organizations. Richard Johnstone assumed the role of director of Benefits Strategy and Vendor Relations with MCPS in July, and Carole Silberhorn took over as Benefit Manager at WSSC this fall. They bring a fresh, outside perspective to county agency operations, and are valuable additions to the joint agency benefits team.

While limiting liabilities may sound innocuous, in many respects it boils down to either reducing benefits or requiring retirees to pay a larger portion of their benefit cost. Both are difficult to accomplish, even in the best of times. Each county agency has attempted over the years to meet the needs of its retirees while pursuing opportunities to reduce cost. The agencies have collaborated on multiple joint bid efforts and the results of those joint bid efforts have served to lower increases in the medical and prescription drug arena that otherwise would have been paid by the plans.

#### **Agency Specific Initiatives:**

- A few years ago, MCPS began requiring retirees to pay 36% of their health care costs, and amended their prescription drug plan by offering retirees the option to choose between two three tier co-pay prescription drug plans. One is a lower co-pay higher premium plan, while the other is a higher co-pay, lower premium plan. Both plans feature mandatory generic and mandatory mail order provisions, and require a retiree to pay double the retail co-pay to get a 90 day supply at the mail order pharmacy.
- A Joint Employee Benefits Committee (JEBC) at MCPS that includes membership from management, the four labor groups, and the retiree association meets every other month to review and discuss matters of benefit concern and to pursue cost savings opportunities. The JEBC is in the process of surveying all covered employees and retirees to determine their level of satisfaction with the plans, cost sharing, and service in general. The results of that survey will provide a springboard for further discussions. MCPS will be negotiating benefits with its three employee associations during FY 10 as current contracts expire on June 30, 2010.

- The County Government recently sought to amend its prescription drug cost share for active and retired employees by limiting the employer contribution to the high option prescription drug plan to the percentage it pays for the standard option prescription drug plan. During budget deliberations this past spring, the County Council expressed concern that the additional cost could present a hardship for retirees and recommended that the County phase in the higher premium for the high option prescription plan over a three year period. In 2009, retirees will pay 1/3 of the increased cost, while active employees pay the full difference between the standard and high option prescription plan cost.
- In union negotiations last winter, MCGEO, FOP, IAFF, and the County Government agreed to form a "Post-Employment Group Insurance Committee" for the purpose of studying insurance cost savings measures regarding post-employment group insurance, including eligibility, premium share and coverage. The Committee is currently engaged in data collection and analysis and is scheduled to convene in January. The Committee has a September 2009 target for completing its work.
- The College has a long established Benefits Review Committee (BRC) with representation from faculty, bargaining and non-bargaining staff, and administration. Each year the plans are reviewed and cost savings opportunities are discussed. There have been discussions surrounding the age and service requirements for retiree insurance eligibility and this will be further analyzed. The College, in conjunction with the BRC, will be conducting a full review of the entire benefits package over the next six months. Any recommendations for change would be considered for a January 1, 2010 implementation.

The benefit managers for the five county agencies will continue to meet and collaborate during 2009, and will pursue one or more joint bid opportunities.

#### **4. Status of Actuarial Valuations**

As of the date of this report, actuarial valuations as of July 1 (or June 30), 2008, which are used for the FY10 budget, are complete for M-NCPPC and the College. WSSC, as noted previously, will not be having an updated valuation prepared for the current year, as allowed for in the GASB standards. The valuation for MCPS has just recently been finalized, and is expected to be provided shortly for purposes of preparing the updated eight-year multi-agency phase-in analysis. The preliminary analysis for the County has been prepared, but the County is currently working with its actuary to resolve issues impacting the valuation, and anticipate that the valuation will be finalized during the first part of December.

Once all valuations have been finalized and the multi-agency phase-in analysis is prepared and reviewed, it can be provided to the Committee.

As the Committee may recall, the WSSC Commissioners, by resolution, elected in May 2007 to use a 5 year phase-in period for OPEB prefunding. So while the tax-supported agencies' budgets for FY09 were based on a revised 8 year phase-in, the FY09 WSSC approved budget includes OPEB funding based on the 5 year phase-in.

As part of a continuous improvement process and to incorporate lessons learned by us and by others, the Work Group has, during this past year, performed a due diligence reevaluation of the processes and assumptions used in the multi-year phase-in analysis. This was an ongoing process, and included the four actuarial firms that work with the County agencies and the Council.

Several key conclusions that resulted from that process are provided below:

- **Timing** – The Work Group addressed the timing of when updated actuarial valuation data would be available, and how that timeframe would relate to the Fiscal Plan and Recommended Budget processes.

For Fiscal Plan purposes in September, that fiscal year's phase-in number from the most recent OPEB 8 year display (multi-year phase-in analysis) would be used. The Work Group addressed a goal for the agencies to obtain draft actuarial valuations by mid to late October, in order to have that information available for recommended budget processes. These valuations would be shared in draft format with the Work Group to provide the opportunity to ensure any agreed-to changes across agencies have been implemented, and to identify any significant changes in key assumptions between agencies. Valuations would then be finalized and the multi-agency fiscal projections prepared, in early November, again providing members of the Work Group and their actuaries the opportunity for review before that is finalized. Updated numbers would then be available both for agencies' recommended budgets and for tax-supported projection purposes.

This timing discussed above is an aggressive goal, as the agencies and their actuaries are still working through complex implementation issues that directly impact the actuarial valuations. The Work Group and our agencies will continue to work in the future toward achieving this timeframe.

- **Assumptions and Methodologies** – The Work Group addressed several key assumptions and methodologies which impact both the current year phase-in numbers, and the calculations of future phase-in contributions.
  - Amortization Period – The Work Group specifically addressed whether the amortization period used in the actuarial valuations should be a 30 year “open” or “closed” period. A “closed” amortization period essentially means that as part of the annual required contribution (ARC) calculations, the unfunded actuarial liability is amortized, or spread out over a declining period of time. For example, in the first year, the amount would be spread over 30 years, next year the amount would be spread over 29 years, then 28 years, etc. This is very similar in concept to a mortgage, where a beginning liability is paid off over time.

An “open” amortization period essentially means that each year, the amortization period resets to 30 years, and the new balance is now amortized over another 30 years. Under this method, conceptually, liabilities may not be paid off since there is never an end to the amortization period. For this reason, the closed period is often used for actuarial valuation purposes, and therefore for accounting and financial reporting purposes, to ensure that liabilities are being paid off over time. This also means that the closed amortization period will result in a higher ARC.

The majority of Work Group members, both agency finance personnel and actuaries, felt that the use of the closed method during the phase-in years – as it would typically be used for valuation, accounting, and financial reporting purposes - would provide for a more sound fiscal approach to managing the OPEB liabilities. This is because while we are building up liabilities on our financial statements (the portion of the ARC each year that we are not contributing), we are at least paying towards the interest and perhaps some principal on those liabilities. However, given the current fiscal situation, and since we are still ramping up to the full ARC, the Work Group agreed that each tax-supported agency would use the open method in its actuarial valuation, thus resulting in a lower annual required contribution. WSSC’s valuation from last year also uses a 30 year open period. If the fiscal situation significantly improves later during the phase-in period, that decision would be revisited.



The amortization period was the only area discussed that had an impact (downward) on the current year phase-in contributions; it also has an impact on amounts projected for future phase-in contributions. The remaining two areas discussed only impact the future phase-in amounts.

- Use of Actuarial Projections Rather than 5% Estimates in Displays for Future Phase-in Years – The Work Group discussed and determined that it would be more appropriate and precise to use key actuarial assumptions in the calculation of *future year* projections. This had no effect on the annual actuarial valuations, and the annual calculations for budget purposes.

In the past, the future years' phase-in numbers have been based on a projection process that relies in large part on a general 5% increase assumption. That is, a 5% increase has been applied to many components of the calculation, similar to when a general 5% assumption may be built into future spending increases for planning purposes. This did not take into account, for example, that the valuation assumes closer to an 8% long-term rate of return on investments, and that medical cost trends may range from 10 decreasing down to 5% over the long-term.

The Work Group, in conjunction with the actuaries, determined that it would be most appropriate to utilize an actuarial projection that takes into account the assumptions in the actuarial valuations in the future years' projections. This will help make the future year projections of the phase-in contributions more accurate, based on current data. It will also have no impact on the amounts actually budgeted each year for the phase-in contributions, since each year's budget is based on an actual calculation for that year from the latest actuarial valuation, including normal increases in retiree health care pay-go costs.

- Use of Each Year's ARC Rather Than an "Even Ramp Up" to the FY15 ARC When Calculating the Pre-Funding Amount for Future Years – Similar to the item above, this item only affects the calculation of *future year* projections. In the past, the approach to calculating the additional contribution (which the phase-in amount is based upon), was to look at the additional contribution required in the year we begin fully funding the ARC (now 2015), and then to generally ramp up to that amount evenly over the intervening years. This is a different method than is used for the annual budget process, which calculates each year's prefunding (i.e., 3/8<sup>ths</sup>, 4/8<sup>ths</sup>, etc.) based on that year's actuarial calculation.

The Work Group agreed that it would provide a more accurate presentation to base each year's projected phase-in amount on that year's projected ARC, rather than to ramp up in equal increments to the ultimate ARC over time. Again, this change in display for future year's phase-in amounts will have no impact on the amounts actually budgeted each year.

The Work Group believes the efforts described, discussed and implemented in conjunction with the actuaries, will help provide the basis for more consistent reporting across agencies, and for reporting of projections based on methods better aligned with the actual budgetary calculations.

It should also be noted that the GASB accounting and reporting standards have now been implemented by all agencies. The standards were effective for, and implemented by, the County, MCPS, the College, and WSSC for FY08. M-NCPPC implemented the trust-related standards in FY07 (since it already had a formal trust established), and the employer-related standards in FY08..

#### **5. Lessons to Date from the Experience of Other Jurisdictions**

The agencies in the Work Group continue to utilize information and experiences of others in our Retiree Health Benefits implementation efforts. This information is gathered through publicly available information, such as websites and publications from industry, consulting, and actuarial firms. We also incorporate information gathered from relationships with other government professionals and other jurisdictions. Information may also be proactively shared with us during the year by our actuaries, auditors, and other consultants.

During the year, information identified from these processes was used in the determination to extend the phase-in period to 8 years, in our accounting and financial reporting efforts, and in discussions over options for limiting liabilities.

As a Work Group, our impression from information available through the resources described above is that the experiences of other jurisdictions, and lessons that can be learned from them, have not significantly changed during the last year. We will continue to take advantage of such resources in our evaluation and decision making processes.

The Work Group appreciates this opportunity to keep the MFP Committee apprised of agency progress towards OPEB implementation, and to provide information on related topics of interest to the Committee. Representatives from each agency and several of the actuarial firms will be present at the December 1, 2008, MFP Committee meeting to answer questions about the material provided.

Attachments

## AGENCY OPEB WEBSITE STATUS

Communications Website	MC Govt	MC College	M-NCPPC	MCPS	WSSC
	Available by accessing Finance, OHR and OMB sites	A retiree website is now live. Separate tab at the top titled "Other post employment benefits"	Under construction.	Linked to County from Employee & Retiree Service Center Retirement Planning section	Under evaluation
Website Address	<a href="http://www.montgomerycountymd.gov/mcgmpl.asp?url=/content/finance/opecb.asp">http://www.montgomerycountymd.gov/mcgmpl.asp?url=/content/finance/opecb.asp</a>	<a href="http://www.montgomerycollege.edu/oltr/retirees/">http://www.montgomerycollege.edu/oltr/retirees/</a>	Not available. Intend to modify slightly the materials presented by MC Government.	<a href="http://www.montgomeryschoolsmd.org/departments/ersc/retirement_planning.shtml">http://www.montgomeryschoolsmd.org/departments/ersc/retirement_planning.shtml</a>	
Links will be available to the County Council documents	Yes	Yes	Yes	Yes	



## Retiree Health Benefits / Other Post-Employment Benefits (OPEB)

Compliance with GASB 45 and OPEB Accounting Requirements – Retiree Health Benefits Funding and Reporting

**Commitment** Montgomery County is committed to providing a comprehensive benefits program for its employees – both during their active work years and in retirement. It is also committed to setting aside funds now to pay those benefits in the future.

**Accountability** A change in governmental accounting rules now requires the County to report how much it will cost each year to provide not just pension payments, but also health, life insurance, and other benefits in retirement for eligible employees. In addition to reporting the amount of the liability, the County is creating a Trust Fund to set aside and invest the money to pay those costs.

**Challenges** The County operates with significant competition for limited resources and must balance the budget needs of our growing community with our commitment to provide comprehensive benefits to both our active employees and retirees. While we cannot guarantee there will never be changes to our benefits offering, we can promise an honest and transparent dialogue and partnership with our employees and retirees to identify solutions to meet the budget challenges we are sure to face.

- [OPEB FAQs](#)
- [Status Reports to the County Council](#)
- [Financial Impact Information](#)
- [County Council Packets and Resolutions](#)
- [Actuarial Valuations](#)
- [Investment Program – Board of Investment Trustees](#)

## Overview

County employees are compensated in a variety of ways in exchange for their services. In addition to a salary, employees may become eligible for retirement benefits (pension) and other health benefits such as medical care, dental, vision, and life coverage. For more than 50 years, the County has set aside monies and invested them in a special retirement Trust (also known as the "Pension Trust Fund") to be available to pay pension payments to retirees. However, until just this past year, the monies for retiree health benefits (also known as other post employment benefits or OPEB) have not been set aside – they were paid out of each year's annual operating budget.

To ensure that funding is available in the future for these important benefits, and to comply with changes in governmental accounting requirements, the County has taken the first step towards retiree health benefits funding and reporting – the County has estimated its retiree health benefits costs, and has reported the outstanding liability in its financial report.

Beginning in this budget year (Fiscal Year 2008), the County is setting aside monies in a trust fund that will be administered by the County's Board of Investment Trustees, which also oversees the Pension Trust Fund. The Board of Investment Trustees will construct a prudent investment program to ensure that we move toward our goal of ensuring that there will be enough funds available to pay future post retirement health benefits. These are the same steps that were taken years ago to ensure future funding of retiree pension costs.

## **Contents**

The materials contained on these web pages are primarily the results of a Multi-Agency Retiree Health Benefits (OPEB) Work Group that has been meeting over the past four years on this topic, as well as the public record on this topic in the form of Council review packets on this and related subjects.

The Work Group has worked collaboratively to update actuarial valuations, which include amounts consistent with the phase-in approach, described below, in the respective agency budgets, and to establish Retiree Health Benefits (OPEB) Trusts.

## **Current Budget Plan**

Beginning in FY08, the County implemented a plan to set aside funds for retiree health benefits, similar to what we have been doing for retiree pension benefits for more than 50 years. The reasons for doing this are

simple: due to exponential growth in expected retiree health costs, the cost of funding these benefits, which are currently paid out as the bills come due, may soon become unaffordable. Setting aside money now and investing it in a Trust Fund, which will be invested in a similar manner as the Pension Trust Fund, not only is a prudent and responsible approach, but will result in significant savings over the long term.

During the Fiscal Year 2008 budget process, the County Executive recommended, and the County Council approved, a resolution calling for a five-year phase-in to the full annual pre-funding level required to fund our OPEB obligations. However, in developing the FY09 budget, and facing a \$401 million budget gap, the County Executive had to make some tough choices. While committed to addressing the unfunded Retiree Health Benefit liability, the Executive determined that we could not afford, in current fiscal circumstances, the previous five-year phase-in plan. The FY09 budget calls instead for an eight-year phase-in, or seven additional years after taking into account the funding already set aside in FY08.

#### **Establishment of Retiree Health Benefits (OPEB) Trust**

The County Council has recently adopted legislation that establishes a Retiree Health Benefits (OPEB) Trust. The FY08 budget amounts approved by the County Council have been set aside and will be deposited into the Trust, along with monies approved in FY09 and later years. The funds in the Trust will be invested in a similar manner as the County's pension plan, with the amount growing over time and available in the future to pay the cost of retiree health benefits. The out year or future costs are reflected in our fiscal planning documents. As the County faces the inevitable budget pressures in future years, our challenge will be to stick to our current funding plan.

An additional challenge comes with regards to any future promises made to retirees. Going forward, the future costs of current benefit levels are fully disclosed in our financial statements. Combined with an expectation that these benefits be funded, our challenges will be to carefully evaluate and plan for the cost impacts of any future benefit changes. The Retiree Health Benefits (OPEB) work contained herein has provided us with the tools that will allow us to fully analyze and consider any future cost implications.

**EMPLOYEE & RETIREE  
 SERVICE CENTER (ERSC)**

**MOST REQUESTED**

- > ePaystub
- > 457(b) and 403(b)  
 Information
- > Summer Pay Enrollment
- > Open Enrollment
- > Active Employee  
 Benefits and Forms
- > Change in Personal  
 Status
- > Employment and Salary  
 Verification
- > Retirement Planning

**CONTACT US  
 TOOLS & RESOURCES**

- > Pay Dates
- > Calendars
- > Salary Schedules
- > MCT Credit Union
- > Staff Development
- > Tuition  
 Reimbursement
- > Special Tax Info for  
 Educators

**INFORMATION**

- > Timekeepers
- > Payroll Reporting  
 Procedures for  
 Emergency Leave
- > Policies
- > Other Links
- > Forms
- > Work Schedules
- > MCPS Employees  
 Retirement and Pension  
 Trust

**HUMAN RESOURCES**

- > Classification
- > Teacher Certification
- > Teacher Recruitment  
 Calendar
- > Job Opportunities
- > How To Apply
- > Employee Assistance

**UNION CONTRACTS**

- > MCEA Teachers
- > SEIU Support
- > MCAASP Administrators
- > MCBOA Noncertificated  
 Supervisors

**EMPLOYEE AND RETIREE SERVICE CENTER > RETIREMENT PLANNING**

**Retirement Planning**

Montgomery County Public Schools (MCPS) is providing pension eligible employees with their MCPS personal statement of core (if applicable) and supplemental pension benefits. MCPS is the only school district in the state of Maryland to provide a supplemental pension benefit.

Retirement statements will be sent to pension eligible staff in September 2008. The personal retirement statement will be mailed to the employee's home address (currently on file with MCPS). The information contained in the personal retirement statement is through June 30, 2008.

Employees that receive their core pension from MCPS will receive a green statement. Employees that receive their core pension from the State of Maryland will receive a blue statement. Sample statements are included below.

**Sample Statements:**

- Core pension from MCPS
- Core pension from the State of Maryland

**Publications:**

**Understanding Your Retirement Statement-** A publication that provides detailed explanations about information contained in the retirement statement.

**Understanding Your Retirement-** A booklet created to guide you through the retirement process.

**Questions:**

Questions about the Retirement Statements

If you have additional questions about your MCPS core or supplemental pension statement please direct all questions in writing to the **Employee and Retiree Service Center, 7361 Calhoun Place, Ste. 190, Rockville, MD 20855**. Please include a copy of page 2 of the retirement statement with your inquiry. Receipt of your inquiry will be acknowledged with a confirmation notice and expected response date.

For additional questions about your state core pension, please contact the State Retirement and Pension System of Maryland. They can be reached at 1-800-492-5909 or via their Web site at <http://www.sra.state.md.us>.

The State Retirement and Pension System of Maryland publication The Mentor provides information on SRA-sponsored pre-retirement seminars and a retirement checklist for members within 12 months of retirement. Additionally, the SRA publishes a bi-annual publication Retiree News and Notes that provides helpful information for "soon-to-be" and current retirees.

**Retirement Workshops:**

If you are thinking about retiring in 2009, you should plan to attend one of the ERSC-sponsored workshops.

**Retirement Estimate:**

**MCPS Core and Supplemental Benefit Estimate**

- Request for Estimate of Retirement Benefits (90K)  
 State Core Benefit Estimate
- Request for Estimate of Retirement Benefits (88K)

**Designation of Beneficiary/Beneficiaries**

- Update Beneficiary/Beneficiaries

**Information regarding Other Post Employment Benefits (OPEB)**

- <http://www.montgomerycountymd.gov/mcqtmpl.asp?url=/content/finance/opeb.asp>

**Retirement Calculators--Sites to help you plan for retirement!**

- [www.ssa.gov/OACT/ANYPIA](http://www.ssa.gov/OACT/ANYPIA)  
 The official Web site of the Social Security Administration

OHR HOME	HOME	SOCIAL SECURITY	MEDICARE PART D INFORMATION	OTHER POST EMPLOYMENT BENEFITS	CONTACT US
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## Retiree Benefit Information

Retiree Health Benefits/Other Post-Employment Benefits (OPEB)	Links
<p><b>Compliance with GASB 45 and OPEB Accounting Requirements –Retiree Health Benefits Funding and Reporting</b></p> <p><b>Commitment</b> Montgomery College is committed to providing a comprehensive benefits program for its employees – both during their active work years and in retirement. It is also committed to setting aside funds now to pay those benefits in the future.</p> <p><b>Accountability</b> A change in governmental accounting rules now requires the College to report how much it will cost each year to provide not just pension payments, but also health, life insurance, and other benefits in retirement for eligible employees. In addition to reporting the amount of the liability, the College has created a trust to set aside and invest the money to pay those costs. The College previously had been voluntarily abiding by an accounting standard that required a recognition of the liability and chose to set aside funds for these benefits.</p> <p><b>Challenges</b> The College operates with significant competition for limited resources and must balance the budget needs of our growing community with our commitment to provide comprehensive benefits to both our active employees and retirees. While we cannot guarantee there will never be changes to our benefits offering, we can promise an honest and transparent dialogue and partnership with our employees and retirees to identify solutions to meet the budget challenges we are sure to face.</p>	<ul style="list-style-type: none"> <li>■ Overview of Retiree Health Benefits Funding and Reporting</li> <li>■ OPEB FAQs</li> <li>■ Status Reports to the County Council</li> <li>■ Financial Impact Information</li> <li>■ County Council Packets and Resolutions</li> <li>■ Actuarial Valuations</li> </ul> <p>Some of these links are provided by Montgomery County Government. The information is relevant and does apply to the College as well.</p>



## **MEMORANDUM**

**DATE:** November 26, 2008  
**TO:** Management and Fiscal Policy Committee  
**FROM:** Thomas Lowman, Bolton Partners, Inc. *TL*  
**SUBJECT:** Comments on the OPEB Plans

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This memo is an update to our prior memos dating back to 2006. We have focused on four of the following five key areas:

1. Status of Retiree Health Benefit (OPEB) trusts;
2. Status of communication plans;
3. Status of options for limiting liability;
4. Status of actuarial valuations; and
5. Lessons to date from the experience of other jurisdictions.

We have received a copy of the Multi-Agency OPEB Work Group's November 24, 2008 memo and attended their meetings over the last few months.

### ***1. Status of Retiree Health Benefit (OPEB) trusts***

The November Multi-Agency OPEB Work Group memo noted that all five agencies have set up Trusts. Because of this, the Work Group anticipates that future reports would not include this topic.

The Council probably now has no more immediate interest in these trusts than it would in the existing pension trusts. We assume the Council will have available to it the annual investment returns and information on how the trust funds are invested.

The only thing that we would add is that the IRS is taking a more vigorous role in reviewing governmental pension plans. While not directly addressing OPEB plans, you should anticipate that both pension and OPEB trusts may require some modification in response to evolving IRS reviews.

## ***2. Status of Communication plans***

I have no specific comment to add.

## ***3. Status of review of options for limiting liability***

Deciding how to limit liability is not easy and as is stated in the Work Group's November memo "it boils down to either reducing benefits or requiring retirees to pay a larger portion of their benefit cost". This usually means that the needs of unions (their membership) and retirees must be considered along with those of the taxpayers.

Since complying with GASB45, only limited benefit changes have been made by the County and its agencies. As noted in the Work Group's memo, the change in the prescription drug cost sharing was implemented in FY09 for active employees and phased in over three years for retirees. For the County, the establishment of the "Post-Employment Group Insurance Committee" is a good step. We understand that they will not report back until September 2009. The Council might want to provide suggestions or guidance to this Committee. In prior memos we suggested the Council might consider the following possibilities:

- Provide guidance on what the County can afford and ask the agencies to design plans around those fiscal constraints.
- Provide a common plan design and suggest that all agencies and unions work toward this design. This "common" design might be different for existing employees vs. new hires. If this approach is taken, the Council might wish to get fiscal impact information from the agencies' actuaries. For a variety of reasons this would be the more difficult of the two options.

We assume that fiscal constraints are even tighter now than they were in the past. With anticipated higher pension costs and revenue shortfalls, the reality for many counties will be that funding for pensions and OPEB will limit what can be spent for salaries unless a new balance in pay vs. benefits is decided upon. We encourage the Council to provide guidance.

## ***4. Status of Actuarial Valuations***

We have not seen the new actuarial reports so we have not commented on them in this memo.

A considerable amount of meeting time was spent on understanding (1) the eight year phase in plan, (2) the "open" vs. "closed" 30 year amortization period, and (3) the projections of cost for future years. We agree with the decisions discussed on pages 7 and 8 of the Work Group's memo. As was noted in the memo, the adoption of a 30 year "open" amortization period will reduce the expense. The difference between open and closed is greater in future years.

##### *5. Lessons to date from the experience of other jurisdictions*

In our prior memo we discussed changes in benefits in St. Mary's County and Baltimore County. We are also now aware of a change in Frederick County for employees hired since August 1, 2008. The County had provided for 50% of the retiree health care cost for those hired after July 1, 1992 who had at least 10 years of service (more is provided to pre-1992 hires). This was changed to the following cost sharing:

<u>Years of Service*</u>	<u>Monthly Premium</u>	
	<u>Retiree Pays</u>	<u>County Pays</u>
10 to 14.9	75%	25%
15 to 19.9	65%	35%
20 to 24.9	55%	45%
25+	45%	55%

State wide, the overall pace of change when measured over the last 12 months seems slow. Given the importance to retirees and the unions, this is understandable.

Some trends related to the recession will take time to evolve. Even if the facts are known now, the reaction has yet to occur. For example, there are two Maryland jurisdictions where we can project almost a 100% increase in their pension cost over then next few years. However, the hard budget decisions related to these facts have not had to be made at this time.

## **POST RETIREMENT GROUP INSURANCE**

### **Generic Scenarios to Reduce OPEB Liability**

#### **Premise**

Reducing the future costs of providing post retirement group insurance will reduce the overall liability to an organization and therefore reduce the amount of that liability to be funded. Many organizational factors will influence which options will be considered and which will not. The template below is only an attempt to identify various factors that influence group insurance costs.

#### **Affected Groups**

- Current Retirees
  - Medicare
  - Non-Medicare
- Current Actives
  - Retirement eligible
  - Not retirement eligible
- Future New hires

#### **Factors influencing post retirement group insurance costs and related action considerations for addressing costs**

- Eligibility for post retirement group insurance
  - Considerations –*
    - More rigorous age and service requirements for employees
    - Availability to dependents
      - Health coverage not available to dependents
      - Health coverage not available to dependents if eligible for coverage elsewhere
    - Not eligible for post retirement medical or prescription when Medicare becomes primary
- Employer contribution towards post retirement group insurance
  - Considerations –*
    - Reducing contribution amounts overall
    - Weighting rates based on years of service
    - Percent of contribution based on lowest cost plans with retiree paying the rate differential for more costly plans

- Contribution towards retiree group insurance only, with retiree paying rate differential for dependents
  - Contributions based on flat dollar amounts versus percent of premium (could be incorporated via a Health Savings Account in a Consumer Directed Health Plan)
  - Determining the effect of active-retiree subsidy practices on post retirement costs
- Funding
  - Considerations –*
    - Potential advantages of moving to fully insured Medicare supplement plans
    - Active employees pre-funding a portion of their post retirement benefit cost.
- Benefit delivery mechanisms
  - Considerations –*
    - Mandatory generic drugs where available
    - Mandatory use of mail order for certain maintenance drugs
    - Use of certain pharmacies for specialty drugs
- Plan design changes
  - Considerations –*
    - Deductible amounts
    - Co-pay amounts
    - Co-insurance levels
    - Mandatory prescription formularies
    - Annual out-of-pocket and lifetime maximums
    - Post retirement life insurance amounts
- Items covered
  - Considerations –*
    - Exclude certain items currently covered for medical, dental and prescription
- Plan elimination
  - Considerations –*
    - Not offering certain benefits post retirement, such as dental
    - Offering discount programs versus full coverage, e.g., for dental

## BENEFITS BEAT

### A Taxpayers' Benefits Bill of Rights

October 2008 By GIRARD MILLER

Evaluating retiree medical benefits from the citizens' perspective.

Questions, success stories or anecdotes about benefit issues in government? Girard Miller wants to hear from you.

E-mail him Earlier this year, the term "pension envy" began to take root. A California taxpayer group drew national attention for a proposed ballot initiative to curb perceived excesses in the state's various pension systems. Ultimately, that group failed to obtain sufficient signatures and lost its momentum.

That was then.

Now, as the recession deepens, many taxpayers are likely to see an even-greater gap between themselves — with private-sector pay cuts, layoffs and shrunk 401(k) plans — versus public employees, who are enjoying job protection, stable pensions and solid benefits. Although there will be furloughs and payless days in some government offices, the "benefits envy" issue could gain traction. And with the costs of retirement benefits doomed to rise — thanks to stock market losses in pension funds and new accounting rules — elected officials are now forced to choose between rising benefits costs, service reductions or tax increases.

Meanwhile, a controversial issue is smoldering in almost every city hall, school board office, state capital and county courthouse: the cost and level of retiree medical benefits. The new battleground for benefits-plan reforms will likely be retiree medical benefits, also called OPEB (for "other post-employment benefits").

The costs to taxpayers of mismanaged OPEB plans may be far greater than well publicized pension abuses. After decades of providing retirement medical benefits without funding them actuarially like a pension plan, public employers have run up a virtually unfunded \$1.5 trillion tab for benefits promised to state and local government employees.

Under new financial-reporting rules adopted by the Governmental Accounting Standards Board, these liabilities and the appropriate actuarial costs must now be recorded on the books of the public employers. Thus, a "hidden benefit" is now coming to light, and it is not a pretty picture.

The annual cost of funding these OPEB benefits properly is something I estimate to be in the range of \$125 billion, which represents an increase of almost \$75 billion in additional annual contributions. To put that increase in perspective, it equals roughly \$300 per capita annually on a national basis. State and local governments simply don't have the extra revenues to shell out another \$75 billion in 2009, and many will never have \$300 per capita per year to give employees and retirees forever. With a recession under way

and budgets already bleeding badly, the time has come to re-evaluate whether these retiree medical benefits are even affordable.

Elected officials, who are accountable to both voters and taxpayers, face a most undesirable choice with respect to these OPEB benefits. They can skip the actuarial payments, which guarantees that their liabilities will increase and that the hole will get deeper; they can raise taxes; they can cut services or freeze salaries to fill the gap; or they can redesign their benefits plan to relieve the burden on taxpayers and shift costs to employees and retirees. None of these is an attractive choice, but the option of plan redesign now appears to be the most sensible and probable.

To provide a context for evaluating OPEB plan design issues, public officials must consider three fundamental concepts of retirement plan finance: necessity, sustainability and sufficiency.

First, benefits awarded to public employees must be necessary, or else they are a waste of public funds. Citizens should not be expected to pay mandatory taxes to provide benefits to public employees (which many taxpayers do not receive in their own employment) unless labor market conditions necessitate such payments to be competitive in recruiting and retaining employees. Second, the cost of such benefits must be sustainable — the tax base of the employer must be sufficient and the taxpayers must be willing to support those costs in order to maintain services they receive. And third, the benefits plan of the public employer must be sufficient to achieve its necessary purpose and to satisfy the market hurdle of adequate compensation to attract and retain workers.

Historically, the current benefits provided to active public employees (incumbents) have met these tests. Even though health-care insurance premiums have increased over time, for example, most public employers have made adjustments in their health plans to provide a sustainable benefit that is sufficient to attract and retain workers. Nobody quibbles about giving Blue Cross or Kaiser Permanente HMO coverage to police officers, for example, and many local governments have learned how to work the managed-care systems just as efficiently as private companies. Some have increased employee cost shares, but no major public employer has discontinued medical benefits altogether. Similarly, nobody quibbles about employee-assistance programs or life insurance benefits for public employees. Although holiday schedules and sick leave systems may be subject to isolated abuses, they are not generally controversial. (The exceptions are the notorious pension spiking schemes that enable senior employees to inflate final compensation.)

The old adage was always that "public employees get lower salaries and we make up for it with good benefits." And because the visible benefits for active employees have been underwritten in the current budget year as they are working, there really has not been a major philosophical or financial issue over current benefits. It is the deferred benefits given to retirees that are more problematic.

In the pension arena, some would quibble that public-employee pensions are more generous than those provided in private employment, but overall the public pension

systems have operated on sound actuarial bases for nearly 50 years and are reasonably well funded (with some notorious, chronic exceptions). To their credit, most pension plans for public employees attempt to provide a reasonable retirement income to replace earnings during the working years, and the primary fault that taxpayers' groups have with their systems is the early retirement feature that sometimes gives public employees a huge benefit stream that dwarfs the service careers of the employees. Tales of police officers and firefighters retiring in their mid-40s after 20 years of service and collecting generous pension payments, while enjoying income from second careers, are growing in frequency — and will attract increasing attention as unreasonable.

Which brings us to retiree medical benefits — OPEB. Here we have a much different problem. The real costs of these benefits were swept under the rug for decades. Now the bills are coming due and the magnitude of their real costs has finally been calculated. Let's look at each of the basic tests for retirement plan reasonableness, and consider how traditional public-employee OPEB plan features measure up to a taxpayers' litmus test:

Necessity. The buzzwords often used in public-sector human resources management are that compensation and benefits plans must be adequate to "attract and retain" competent workers. For example, if a county pays its road crew minimum wages, the workers are likely to seek jobs elsewhere, and the road commissioners are left with the dregs of the workforce. To compensate for lousy pay, the old rule of thumb was that public agencies offered better benefits. And that clearly is part of the labor bargain that should be considered. But in the case of retiree medical benefits, there is very little if any evidence that any public employer awarded these benefits after conducting a survey to determine if total compensation costs and benefits were below the local labor market levels. Instead, administrators and elected officials discovered that they could give these benefits away (usually in collective bargaining with unions) without having to pay for them during their tenure. The costs would be borne by future taxpayers, and as long as the true expenses could be ignored, the necessity of these benefits was a non-issue.

In some cases, retiree medical benefits were given to public employees to complement a pension plan that originally was pretty meager. Twenty years ago, it was not uncommon to see monthly pensions below the poverty level for older public-sector retirees, so the medical benefit was a humane bone to throw them. And back then, the cost of insurance was a fraction of today's health care benefits. However, many if not most public pension plans have sweetened their benefits formulas in the past 20 years without making any reduction in the retiree medical promise, which has escalated dramatically in cost.

To satisfy taxpayers of the necessity of retiree medical benefits, a local labor market survey can be conducted. At a minimum, public employers should determine whether other employers in their jurisdictional boundaries and their relevant labor market actually provide OPEB benefits (not just other public agencies elsewhere in the state). If not, then it is essential to determine whether the local employers who compete for new recruits in public service offer total compensation plans (salaries, bonuses and benefits) that are so far above those in the governmental sector that the public agency simply cannot compete.



Here is what most will find: Many if not most local private employers have never provided retiree medical benefits. Smaller employers have seldom provided retiree medical benefits, and even the large national and multinational companies are running away from this benefit as fast as they can. So the only rationale for providing retiree medical, from a necessity standpoint, is that either (a) the salaries paid public employees are so low as to otherwise be uncompetitive in recruiting and retaining new employees; (b) the unions have cut a deal with previous politicians to put these benefits into the contracts regardless of the underlying labor markets; or (c) state laws on labor arbitration have set up sweetheart "comparables" in which the arbitrators make awards based on employers who do not genuinely compete for new recruits. Note that the latter two "necessities" are matters of labor law, and not real-world economics.

Labor unions and even some governmental human resources personnel like to compare compensation and benefits with other governmental units in the same state, but this is a logical fallacy. Most state and local government employees do not jump jobs from one jurisdiction to another. Exceptions are top-level managerial personnel, for whom compensation is already determined independently and for whom retiree medical benefits are a secondary consideration. Those who do relocate do so for reasons completely unrelated to retiree medical benefits. For mainstream workers, the relevant labor market for medical benefits determinations is the local market, not the statewide public sector. If "comparability and equity" (with non-local employers) are truly the drivers of fair compensation, then local taxpayers can rightfully ask why public employees should get better benefits than the people who pay the bills. Where is the "equity and comparability" there? And arbitration laws must be changed to incorporate this concept if the hearing officers ignore this concept. This is where the taxpayer groups should focus their energy, either legislatively or by voter initiative.

Drilling down deeper on this issue, the following corollary issues of necessity must be addressed when reviewing OPEB benefits plans:

- Would new employees accept a lower OPEB benefit level in general? (Most new employees could care less about retiree medical benefits; they want cash.)
- Is a costly defined-benefit arrangement necessary to attract new employees, or would a lower-cost defined-contribution plan or a cost-controlled DB plan be sufficient for new recruits?
- Why are taxpayers awarding lifetime benefits to employees who worked less than a full service career? Shouldn't their past or future employers pay part of the cost of their retirement medical expenses? Why is this entirely a taxpayer responsibility? Shouldn't OPEB benefits be calibrated for the years of service worked in relation to a full working career (e.g., 30 years)? If so, why should public employees earn more than 3.33 percent of a lifetime medical benefit for each year of service?
- Why should state and local taxpayers pay for retiree medical benefits before workers attain the Medicare retirement age? It's one thing to award a pension and allow early

retirement (usually with an actuarial reduction), but it's another to grant medical benefits before Medicare kicks in — and far more expensive.

- How many taxpayers are eligible to receive retiree medical benefits before attaining Medicare age? In the private sector, retirement benefits are generally taxable by the federal government if awarded prior to age 62, so there is a huge payer-payee disconnect here. Again, where is the "equity" and "comparability" for taxpayers?
- Why are taxpayers responsible for paying benefits to dependents of retirees? It's appropriate to provide for lifetime benefits of widows and orphans of heroic employees who are killed in service, but what is the rationale for lifetime benefits for dependents of early retirees? Why don't public employers require an actuarial reduction for "joint and survivors rights" to OPEB benefits, just like pensions and annuities?

Sustainability. The second test of a retirement benefit plan is whether the employer and its taxpayers can afford to provide the ongoing financial resources to sustain the plan indefinitely. This is where OPEB plans generally flunk. The mere fact that the vast majority of public agencies cannot afford today to fund their plans actuarially is *prima facie* evidence that they are not fiscally sustainable as presently designed. Unless the employer's financial team can present to its elected officials a long-term plan to properly fund the actuarially required contribution to an OPEB plan without raising taxes or cutting services, it is not sustainable from a taxpayer perspective.

This raises the following questions of sustainability:

- For OPEB plans now failing to meet their annual actuarially required contribution, will the elected officials agree in public to devote all future revenue increases to properly fund the plan, rather than expanding services and payrolls? If not, then the OPEB plan is not sustainable.
- Should the plan be modified so that future retirees receive lower benefits, for the services they provide hereafter? This is called a tiered-benefit plan, and is not difficult to establish as far as plan design is concerned.
- Should incumbent employees contribute to their OPEB plan, or contribute more than they do now, as their fair share of this cost?
- Should retiree benefits be capped in the future, to reduce the taxpayers' risk of runaway medical cost inflation? Either a hard-dollar cap or a "soft cap" such as the CPI index can help assure that an OPEB plan is actually sustainable.
- Should employees be required to contribute to a defined contribution (DC) plan in order to accumulate the savings necessary to pay their fair share of retiree medical costs? Shouldn't unused sick time be contributed to such a plan instead of allowing senior employees to "cash out" upon retirement in order to spike their pensions? Such a defined-

contribution plan feature solves two problems: it reduces pension abuse while providing a funding source for retiree medical costs.

- Should retiree co-pays, deductibles and the percentage of insurance premiums be increased in order to trim the employer's cost to sustainable levels?

Even if the local labor market surveys tell elected officials that retiree medical expenses are appropriate from a "fair compensation" standpoint, the hard facts of life are that if the tax or revenue base cannot support these benefits, then cost-mitigation measures are necessary.

A final consideration in this dimension is whether a continuation of the status quo will ultimately impair municipal borrowing capacity or bond ratings. So far, a government's failure to formally address its OPEB deficits has not resulted in penalties in the bond market. Following the recent credit market crisis, however, hard-headed analysts and investors will likely begin to take a second look at public employers' unfunded OPEB liabilities. Nationally, these total almost \$1.5 trillion in comparison to total outstanding state and local government bonded debt of \$2.7 trillion — over one-half. Put it this way: If you as a borrower were to accumulate home equity and credit card debt equal to half of the level of your mortgage, what would be your credit rating? Would your lenders allow you to borrow even more for a new boat or a second home? Ultimately, the OPEB time bomb will cause financial stress that impairs some public agencies' ability to provide necessary infrastructure, unless public officials confront the sustainability issue.

Sufficiency. Finally, in the spirit of fairness and balance, taxpayer groups need to turn the tables a bit and look at this issue from the employees' and retiree' perspective. At the end of the day, retirees need sufficient financial resources to cover their basic living costs including medical expenses. If state or local governments cannot afford to provide the resources and savings plans necessary to enable their retirees to live a secure, modest lifestyle in their old age after working a full career, then public-sector management has failed. Claiming empty pockets at the employer's level or hardship on taxpayers is a bit disingenuous if elderly career public servants must eat cat food to afford going to the doctor.

The issue of sufficiency does not require 100 percent employer subsidies, however. Nor does it require taxpayers to subsidize early retirees or mid-career workers who scurry to public employment for five or ten years to garner lifetime medical benefits. The question is whether the total resources accumulated during an employee's entire working life are reasonably sufficient to make the public plan viable for purposes of retaining and attracting employees — and to assure that retirees never become a future burden on taxpayers because of insufficient resources (aka the "welfare retiree" as portrayed by benefits lobbyists). Note, however, that this is a significantly different standard than the usual expectation in some public-sector benefits circles that the employer/taxpayer alone should provide cradle-to-grave benefits.

On the other hand, the ideological-libertarians and industry-lobbyists — who've never seen a defined contribution plan they didn't love — must also yield some ground in this area. Unfortunately, the contribution formulas used in many DC plans will never achieve the proper goals of a comprehensive compensation plan. For example, putting aside less than \$1,000 annually of combined employer and employee dollars into an OPEB-DC plan over 30 years will likely fail to cover a future retiree's Medicare Part B premiums and reasonable non-insured expenses. Even more sobering, combined contributions of \$3,000 annually are necessary to offset the average projected medical costs after age 65 in one of the most widely used national online retirement projection models. With the cost of governmental post-retirement medical benefits running almost \$5,000 annually, according to one national survey, we need to design plans that genuinely address those costs.

Therefore, it is important to ask the following questions about sufficiency:

- Is the total retirement package including pension sufficient to be labor-market competitive throughout the employee's career?
- Are the benefits available upon retirement sufficient for a full-career retiree to remain economically self-sufficient — and not become a taxpayer-burdening welfare case?
- Are the total of OPEB plan contributions, including employee contributions, sufficient to cover premiums and medical costs in excess of Medicare for those who have attained that age? (\$1,000 is a minimum threshold.)
- If a defined contribution plan is used for retiree medical costs, are the investment risks adequately backstopped by a reasonable (e.g., 2 or 2.5 percent times years of service) pension plan, appropriate investment guidance and diversification, and access to a plan feature that protects for catastrophic medical costs?

A reasonable standard of sufficiency may require employers to impose or negotiate significant mandatory payroll withholding requirements on employees in order to adequately fund the OPEB plan. These can be phased in over several years to reduce the impact on take-home pay. Even so, that may necessitate making concessions on the salary side in order for the employees' OPEB contributions to be affordable to them, so there is an element here of pushing air around in a circus balloon.

Finally, it is important that any defined-contribution plan used to assure sufficiency of OPEB benefits must have robust investment education and investment tools to enable employees to achieve their objectives, given the risks they will then face in the investment markets.

Summary: It's time to look hard at plan design from the taxpayers' viewpoint. Based on national experience with the problems of OPEB plans, very few public officials have looked at their plans through the prism of a taxpayer's perspective, and it will become increasingly important that they do so. Many OPEB plans will simply flunk the

sustainability text, and employers ultimately will have no choice but to trim their generous benefits to make ends meet. The sooner public managers begin to address this problem in advance of a crisis, however, the better served their constituents and ultimately their employees will be. OPEB liabilities grow every year that the actuarially required contribution goes unpaid. Experienced professional experts can help public officials solve the puzzle of achieving sustainability in plan design while ensuring sufficiency of benefits. Thus, the wisest public officials are those who establish OPEB strategy teams to develop and implement workable solutions. Those who fail to address necessity, assure sustainability and monitor sufficiency of OPEB plan designs will ultimately create deeper problems for future generations of taxpayers and employees as well.