MEMORANDUM

March 5, 2007

TO: Management and Fiscal Policy Committee

FROM: Multi-Agency OPEB Work Group

SUBJECT: Update for March 19, 2007 MFP Committee Meeting

The purpose of this memorandum is to provide an update on County agencies' 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). Tax-supported agencies impacted by GASB45 and represented on this work group include: the County government, 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.

At the June 26, 2006 Management and Fiscal Policy (MFP) Committee meeting on this subject, the Committee identified areas it would like to be updated on periodically. At the November 27, 2006 MFP Committee meeting, the agencies provided an update on progress in those areas. The current status, including progress since the November 27th meeting, is presented below for each area.

Status Report

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

  At the November 27th meeting, all agencies except WSSC had completed the process of obtaining an updated valuation. WSSC's 2006 valuation was being prepared; their information presented was as of June 2005. WSSC's updated 2006 valuation is currently still in the process of being prepared; it has taken longer than originally anticipated to update census data for the valuation. It is anticipated that the WSSC results will be available by late March.

  Attachment C, which has not changed since the November 27th meeting and which is being provided again for the benefit of any new committee members, presents a summary of the latest actuarial valuation results for the tax-supported agencies. Those 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.

  As presented in the November 27th meeting, the County intends to implement a five-year phase-in approach. At the November meeting, we noted that the rating agencies had indicated that a phase-in approach is acceptable, and that rating agency statements at that time focused on a five year period. Attachment C displays the estimated FY08 budgetary impact of the five-year phase-in approach which is $38.9 million for the tax-supported agencies.

  County executive and legislative branch officials have met with all rating agencies as part of the regular fiscal update process, where the agencies expressed particular interest in the County's plans for managing and funding the OPEB liability. Consistent with those presentations, and pursuant to other detailed discussions, the rating agencies' expectations are that the County will be implementing a five-year phase-in approach.

  The three tax supported agencies submitting their recommended budgets to the County Executive, included in their FY08 submissions the phase-in amount presented to the MFP Committee at the November 27th meeting. The County Executive's FY08 Recommended Budget, which will be issued after the date of this report but before the March 19th MFP Committee meeting, will include the FY08 phase-in amounts for all tax-supported agencies that were presented at the November 27th meeting.

  It was noted at the June 26, 2006 MFP Committee meeting and in Attachment A of the November 27th report, that in order for the County agencies to take advantage of the long-term discount rate assumptions used in the valuation processes, the County Council would need to have an adopted written policy of its intent to phase-in to full pre-funding over five years. Absent such a written policy, the County agencies would be required to use short-term discount rate assumptions which have generally resulted in a doubling of the Annual Required Contribution and the Actuarial Accrued Liability.

  The work group is in the process of providing the Council Staff Director with proposed language for such a resolution.

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

  Attachment A provides an update for each agency on the work related to establishing OPEB trusts. As noted at the November 27th meeting, 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 A provides an update for each agency on the work related to exploring options for limiting liability, which for most agencies has not significantly changed since the November meeting.

- 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. Of the five County agencies represented on the work group, each agency has used one of two firms, Aon Consulting or Mercer Human Resource Consulting, for its FY06 updated valuation. All firms used Mercer Human Resource Consulting for the 2003 valuation process. Each of the agencies is also using one of the firms for its normal health benefits consulting, and for additional OPEB-relating consulting services. These two firms have been represented whenever possible at the work group meetings. In addition, whenever areas of potential inconsistency in valuation methodology have been identified, the two firms have worked together at the agencies' request to try and ensure as much consistency as possible in methodologies. The Council's consultant, Mr. Tom Lowman, attended the last two meetings of the multi-agency OPEB work group and has continued to share, throughout this process, his experiences with other jurisdictions. County agencies and their actuarial firms have also consulted with GASB staff, as necessary, on matters requiring technical clarification.

  The County agencies have also worked with in-house legal counsel, where applicable. Several agencies have also consulted with outside counsel as part of the creation of a trust. Legal counsels for the tax-supported agencies have also been in communication with each other, to share information learned and to discuss options.

As it relates to trust and investment activities, agencies have also coordinated with their investment consultants and managers on matters such as trust options and investment implications, economies of scale and impact on fees, and opportunities for cross-agency contracts.

Relating to communications, and as noted below, the County agencies are attempting to incorporate the input of communications consultants on staff with one of our actuarial firms.

Throughout the process, representatives of the County agencies have continued to share information and learned experiences with representatives of other Maryland counties implementing GASB45 for FY08.

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

The goal of the County agencies is to keep agencies, employees, retirees, and the public informed of developments on this topic, and to try where possible to have a consistent message. Attachment B presents the communication plan recently developed by the agencies.

As noted in the November MFP Committee meeting, the agencies' primary focus until that time had been to obtain updated actuarial valuations, begin the process of creation of legal trusts including analysis of options, and identify and consider plan design changes. Currently, the tax-supported agencies are in various stages of drafting and/or issuing communications on this topic. Communications to date have included articles in employee and/or retiree newsletters, and discussions with/presentations to various interested parties.

The work group has recently created a communications subgroup, which includes members of the Interagency Benefits Workgroup. The communications subgroup will be working together to begin implementation of the communication plan. The County agencies are also exploring working with communications consulting resources on staff with one of the actuarial firms.

Representatives from each agency will be present at the March 19, 2007 MFP Committee meeting to answer questions about the material provided.

Attachments

Status of OPEB Trust Establishment, Plan Design Change Considerations, and Communications

Agency	Trust Establishment	Plan Design Change Considerations
County	The County has created draft legislation to establish an Internal Revenue Code (IRC) Section 115 Trust for OPEB benefits. The Office of the County Attorney drafted the legislation, which was reviewed by outside legal counsel and affected County departments. The legislation is anticipated to be transmitted to the Council in the near future. Currently, IRS guidance is not clear regarding the tax impact of accepting employee contributions into a Section 115 trust. Therefore, the County's intent is to only permit employer contributions, not employee contributions, to be made to the trust, and the legislation reflects this intent. If further clarification is provided by the IRS, an amendment to the trust could be made at that time. The County is currently in the process of developing a Plan Document, and updating/clarifying the adoption agreement(s) to be signed by outside organizations participating in the County's plan. The College has also recently expressed an interest in possibly participating in the County's trust. The County is currently in the process of working with the College to explore that option.	The County worked 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. Regarding the OPT/SLT MCGEO bargaining units and the Police FOP bargaining unit, the parties tentatively agreed to a reopener (pending Council approval) scheduled to begin in September 2007. No agreed to or arbitrated changes could take effect prior to July 1, 2008. For the Fire IAFF bargaining unit, negotiations for a successor collective bargaining agreement are scheduled to begin in November 2007. No agreed to or arbitrated changes could take effect prior to July 1, 2008.

Status of OPEB Trust Establishment, Plan Design Change Considerations, and Communications

MCPS	MCPS presented a draft amendment to the current pension trust document to the Board of Education Audit Committee on February 20, 2007. The amendment creates a "Master Trust" that contains two component trusts for pension and OPEB benefits. Each component trust would satisfy the exclusive benefit rules whereby assets under each can only be used for participants therein. By using this approach, MCPS will take advantage of the favorable investment contracts it has already negotiated for the pension plan, provide common investments, use the same investment committee, and simplify administration. The Board of Education will consider a resolution to approve the Trust Amendment (effective July 1, 2007) at its March 13, 2007 meeting.	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. MCPS is working with the unions and retiree association to review plan design in the context of the GASB funding challenge.
College	The College is working toward the establishment of a trust for FY08. More recent discussions have resulted in additional consideration to further investigate the possibility of whether the County Government's trust document can be written to include language that may allow the College to ride their trust agreement.	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. The College reviews all of the group insurance plans annually and makes changes to specific plan provisions to meet budget guidelines. Additionally, we will be participating in a bid process with the other County agencies this year and an overall review of the plans will be part of this process.

Status of OPEB Trust Establishment, Plan Design Change Considerations, and Communications

M-NCPPC	M-NCPPC has a trust in place with a balance of approximately $130,000. We are discussing with an outside law firm a review of this trust to assure that it still meets all requirements. We are also examining changing governance from the current small board to the same trustees that make up the Pension (Employees' Retirement System) Board.	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, and consistent with the November report, 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 is currently drafting a Section 115 trust document for Commission review and approval.	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.

Attachment B

OPEB COMMUNICATIONS PLAN

Stated Goal is to "Keep agencies, employees, and the public informed of developments on this issue," and to have a consistent message.

Interagency Communications Plan:

- Agencies should identify appropriate communication mechanisms (web sites, newsletters, etc.)
- Communication mechanisms should have a consistent message
- Each agency posts OPEB/GASB45 information on its web site for easy access by employees and the public
  - Preferably come to agreement as to how/where it appears
  - Part of financial, human resources, or main page highlight ("what's new"?)
- Web sites should have common elements
  - FAQs (with as many common definitions and explanations as possible)
  - Actuarial valuations should be posted
  - Status reports on activities
  - Financial impact information
  - Incorporate Council perspective/resolutions/etc.
- Explain the WHYs
  - Why OPEB disclosure is important
  - Why we have to not only comply with disclosure, but also fund the obligation
  - Why we are setting up trusts
  - Why considering benefit plan changes is appropriate
  - Why it is important to employees
  - Why it is important to citizens/taxpayers
  - Cause and effect relationships – additional benefits flow into the actuarial calculations and require more funding. Scarcer resources for salaries. It's all related.

Suggested Actions:

1. Identification of single point of contact within each agency
2. Identification of appropriate communication mechanisms
3. Subgroup drafts common descriptions and FAQs
4. Contacts obtain input from others in respective agency
5. Obtain input from legal counsel and public information, as appropriate
6. Notify labor unions, as appropriate
7. Finalize common materials for all to use
8. Individual agencies post to web sites and incorporate to other communication mechanisms

OPEB
Actuarial Valuation Results and Key Assumptions
MFP Committee Meeting - March 19, 2007

	County	MCPS	College	M-NCPPC [7]	Subtotal Tax-Supported Agencies	WSSC [3]
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	$ 71,580,790	$ 85,297,418	$ 3,212,000	$ 6,373,050	$ 166,463,258	$ 9,712,000
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	$ 15,500,790	$ 21,057,418	$ 786,400	$ 1,531,050	$ 38,875,658	$ 1,942,400
ARC as % of PayGo [5]	3.18	2.87	2.21	3.16		2.03
Actuarial Accrued Liability (AAL) [6]	$1,100,530,000	$ 1,299,000,000	$ 57,800,000	$ 94,695,750	$ 2,552,025,750	$ 200,000,000
Assumptions						
Discount Rate, assuming Full Prefunding [1]	8%	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
Amortization Method	Level % of Pay	Level % of Pay	Level % of Pay	Level % of Pay		Level $ [4]
Medical Cost Trend Rate (post 65)	10% -> 5%	10% -> 5.25% [8]	10% -> 5%	10% -> 5%		13% -> 5.5%

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

5-Year Phase-In Calculation	Ref	County	MCPS	College	M-NCPPC - (PG & MC)	Mont Cty Portion of M-NCPPC [1]	Subtotal Tax-Supported Agencies	WSSC [5]	
Full Prefunding (ARC)		$ 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	B+C+D	26,720,000	43,000,000	2,500,000	4,919,000	2,213,550	74,433,550	9,400,000	(3)
Less: Implicit Rate subsidy	E	5,500,000	-	-	1,300,000	585,000	6,085,000	-	(4)
Equals: Additional FY08 funding required for ARC		$ 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	Ref	County	MCPS	College	M-NCPPC - (PG & MC)	Mont Cty Portion of M-NCPPC [1]	Subtotal Tax-Supported Agencies	WSSC [5]	
Medicare Part D subsidy [2]	D	$ 730,000	$ 2,900,000	$ 150,000		$ 135,000	$ 3,915,000	$ -	(4)
Implicit Rate Subsidy	E	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 Al 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.

DRAFT

Resolution No: ______
Introduced: March XX, 2007
Adopted: March XX, 2007

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

By: County Council

Subject: Resolution XX-XXXX Regarding Council's Intent To Phase-in Full Funding Of The County Agencies' OPEB Annual Required Contribution Over A Five Year Period Beginning In FY2008

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, Montgomery County Public Schools, Montgomery College, the Washington Suburban Sanitary Commission [WSSC], 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 (FY08).

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 2008 annual required contribution (ARC) for the County, its tax supported agencies, and the Montgomery County portion of the Maryland-National Capital Park and Planning Commission, 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, who 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 ARC, for the tax supported agencies, on an amortized even basis over a five-year period beginning with Fiscal Year 2008.

3. For WSSC, it is the Council's policy intent to support WSSC's plan 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.

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Linda M. Lauer
Clerk of the Council