Presentation Regarding Impact of OPEB Benefits on City of Rochester Hills

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Agenda

History

Other Postemployment Benefits (OPEB) added to GASB agenda in 1988

GASB 12 issued in 1990
- Interim statement on OPEB disclosures
- "Weak" disclosure standard

GASB 26 issued in 1994
- Interim standard for reporting OPEB administered through pension plans
- Separate reporting of pension and OPEB liabilities

GASB 34 issued in 1999
- Requires accrual based accounting

Proposed OPEB statement issued in February 2003 and revised in January 2004

GASB 43 and 45 issued in 2004
- Move from pay-as-you-go to accrual based accounting of OPEB benefits as required by GASB 34
- Similar to accounting for pensions

What is OPEB?

OPEB stands for <u>O</u>ther <u>P</u>ost<u>e</u>mployment <u>B</u>enefits

These include postretirement benefits other than pensions
- Retiree healthcare insurance, including medical, dental, vision, hearing
- Retiree life insurance
- Retiree long-term care insurance
- Implicit rate subsidies and retiree premiums based on blended active/retiree rates

Are considered a form of deferred compensation that should be recognized as benefits are earned while an employee is working

Benefits not included: (OPEB applies if used to pay retiree medical and implicit rate subsidies exist)
- Special termination benefits
- Early retirement incentive programs (Statement No. 47)
- Payment of accumulated sick leave (Statement No. 16)
- Retiree pays full cost of the program
- Defined contribution plans
- Cash payments or stipends (Statements No. 25 and 27)

Rochester Hills – OPEB: Supplemental Retiree Healthcare Program for closed group plus Implicit Rate Subsidy for all

What is an Implicit Rate Subsidy?

Medical premiums are more expensive as a person ages

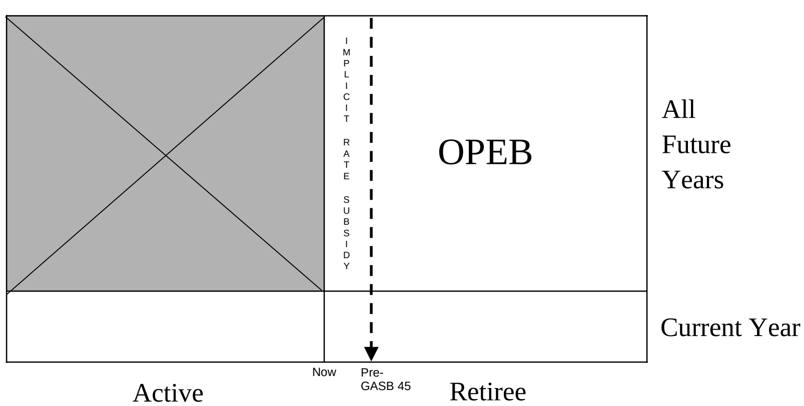
- Utilize more medical services
  Utilize more expensive medical services

Current single premium = $466 per month (regardless of age)

Approximate cost of insurance at various ages:

Age	Monthly Premium	
25	$ 259	
35	331	
45	424	
55	564	(subsidy is $98 per month)
64	794	(subsidy is $328 per month)

Impact of Implicit Rate Subsidy



Why are the Rules Changing?

Objectives of Proposed OPEB Statement

- Provide a true picture of cost of providing government services by properly recognizing the ultimate cost of OPEB benefits
- Systematically recognize OPEB cost over an employee's working lifetime as services are rendered
- Calculate the actuarial accrued liability for benefits earned to date
- Determine the "annual cost" of future benefits
- Estimate future cash flow requirements for benefits
- Monitor the funding progress of the plan

Key Accounting Requirements

Required Accounting Calculations

Annual Required Contribution (ARC) – the annual "actuarial" cost of the benefits earned

Normal Cost (value of benefits earned in current year)
+
Amortization of unfunded actuarial accrued liability (value of benefits previously earned)

Balance Sheet Liability (Net OPEB Obligation)

– Cumulative difference between ARC and contributions paid to an irrevocable trust

Timeline and Frequency

Effective Dates

2008 Fiscal Year

Earlier application of the standards is encouraged

Will require an actuarial valuation of the plan every 2 years

What does this mean to the City of Rochester Hills?

		SRHP	Implicit Rate	Total
New Minimum ARC (30 year)	=	$ 133,000	$156,000	$ 289,000
Less Current Pay-as-you go Cost	=	$ 60,000	n/a	$ 60,000
Less Implicit Rate Subsidy	=	n/a	$ 19,000	$ 19,000
Equals Increase in City Expenses	=	$ 73,000	$137,000	$ 210,000
Actuarial Accrued Liability	=	$ 1,969,000	$1,541,000	$3,510,000
ARC with 1 year amortization	=	$ 1,974,000	$1,596,000	$3,570,000

Notes: These figures assume that the city funds the full ARC each year.

What causes the increase in expenses?

Current (Pay-as-you-go)

- Includes only current retirees
- Considers only current year premiums
- No recognition of benefits earned to date
- All employees and retirees under age 65 charged the same rate

New (ARC)

- Includes projections for all employees and retirees
- Considers impact of anticipated future increases in medical costs
- Includes amortization of benefits earned to date, but not previously recognized
- Implicit subsidy of rates for retirees exists and must be valued

Financial Advantages of Funding the Liability

To Fund or Not to Fund?

"The discount rate should be the estimated long-term investment yield on the investments that are expected to be used to finance the payment of benefits"

Financial Advantages of Funding the Liability *(continued)*

Funded

- Contributions deposited into an Irrevocable Trust (usually higher than current cash flow)
- Benefits paid from the Trust
- Long-term investments
- Higher investment return (2-3% for fixed income investments)
- Decreases the Liability and ARC
- Full ARC funded – no net book liability
  Partial ARC funded – some book liability created
- No impact on credit rating
- Benefit security for retirees
- Liability = $3,510,000; Min ARC = $289,000 (at 5%)

Unfunded (pay-as-you-go)

- No change to current cash flow for payment of benefits
- Benefits paid by the general assets of the employer
- Short-term investments
- Lower investment return
- Increases the Liability and ARC
- Book liability – ARC minus pay-as-you-go
- Adverse impact on credit rating
- May not be able to afford even the pay-as-you-go in the future
- Liability = $4,549,000; Min ARC = $340,000 (at 3%)

Financial Advantages of Funding the Liability *(continued)*

Deciding whether or not to Fund – impact of the discount rate

	Unfunded Plan	Funded Plan
General Fund Assets	$ 3,570,000	$ 0
Trust Assets	0	3,570,000
ARC	(4,657,000)	(3,570,000)
Net Fund Balance Impact	$ (1,087,000)	$ 0

Note: ARC is the Normal Cost plus the Actuarial Accrued Liability amortized over one year.

Questions and Answers

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