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Self-Funded Public Entities Impacted by GASB -- New (Largest) Liability On Financial Statements

MyHealthGuide Source: Michael Frank, Aquarius Capital, 5/31/07, www.AquariusCapital.com and *Actuary of the Future* May 2007 Article

Public entities such as school districts, municipalities and local governments are preparing to face the impact of reporting OPEB (Other Post Employment Benefits) liabilities. OPEB deals with the promise of providing coverage for post employment non-pension benefits such as healthcare and life insurance, and this obligation is anticipated to be more than hundreds of billions maybe a trillion dollars.

Government Accounting Standards Board (GASB) No. 43 and 45 require public entities to value and report this obligation. This will impact public entities that are both self-funded as well as fully-insured and will be the largest liability on their financial statements.

Self-Funded Entities and Others Be Required to Implement OPEB In Three Years

Over the next three years, public entities will be valuing and recording these liabilities. They will be hiring actuarial consulting firms to do these calculations. Entities with revenue of more than $100 million will be recognizing first, while entities with revenue under $10 million will be required to recognize these obligations by the third and final year of required implementation.

$5 Million a Year in Retiree Benefits May Have Booked Liability from $50 Million to $100 Million

For the traditional public entity, these costs have been valued on a pay-as-you-go basis recognizing and budgeting costs as dollars are being spent. This approach unfortunately does not value the impact of vesting benefits for current active employees that are earning these retirement benefits nor is it reflecting the impact of inflation on this benefit. A public entity that spends $5 million a year in retiree benefits may have a liability more like $50 million to $100 million.

Employers in the private sector have had to value these benefits beginning in the early to mid 1990s under Financial Accounting Standards Board Statement No. 106 (FAS 106). However, the obligations of those organizations in most cases did not have the same magnitude as anticipated for public entities under GASB 43 & 45. (Most companies that reflected FAS 106 recognized this liability as one of the largest obligations on their company, so it's still an issue for the private sector.)

Why Public Entities May Have Larger Liability Amounts Than Private Sector

The reason the FAS 106 liabilities, which are very large, were not as large as anticipated under the GASB 43/45 liabilities is because:

- *Retirement benefits offered in the private sector were less generous and in most cases dealt with benefits for individuals receiving benefits after age 65 whereby these benefits were secondary coverage behind Medicare.*

The public sector benefit eligibility may be much earlier since individuals will be eligible in their 50s, or in some cases 40s meaning that they could be receiving benefits 10 to 20 years prior to Medicare kicking in. Individuals in the public sector traded greater pay for richer retirement benefits. As a result, the magnitude of these OPEB liabilities, which would be valued as the present value of future benefits less the present value of future contributions (contributions made by the retirees), will be much greater.

GASB 43/45 Key Terms

- *Annual Required Contribution (ARC)*
    - The ARC is the employer's periodic contribution to the defined benefit OPEB plan, which reflects the service (normal) cost for benefits earned during the year plus the amortization of the prior liability earned prior to the initial implementation of GASB 43/45.

- *Unfunded Accrued Liability (UAL)*
    - The UAL is the excess of the accrued liability of benefits, which would be the present value of future benefits less future contributions accrued and earned to date, above the assets funded for the plan. In many cases, these asset amounts are zero except in cases whereby entities were required to fund benefit due to collective bargaining purposes.

The ARC and UAL are valued by actuaries. However, the most important take away for a reader is that these numbers are material and greater than the costs reported today, which is on a pay-as-you-go basis.

An important thing to know about GASB 43/45 is that it establishes standards for accounting and financial reporting. The decision and level of funding is determined by the public entity itself.

Other Issues Associated With OPEB

- ***Political.*** Public officials are bracing themselves for the reaction of the community when communicating OPEB numbers plus the annual communication of its fiscal budget (some budgets requiring voting of the community).

- ***Financial Ratings.*** Bond rating agencies are also going to require this so they can understand the debt obligation of the public entity for entities applying for financing.

OPEB Checklist to Get Started

- Inform public, employees, and if applicable, unions.
- Organize documents to clarify benefit levels for actives and retirees.
- Identify areas with large cost structures.
- Your actuary will need:
    - Electronic census (active, retirees and dependents).
    - Plan design.
    - Plan costs.
    - Employee and retiree contribution levels.
    - Plan assets.

Solutions to Manage OPEB

- Improved efficiency in managing benefits, including implementing cost containment measures.
- Competitively shopping for benefits, carriers or brokers.
- Potential negotiation of benefit reductions for current and/or future retirees.
- Improving integration of benefits with Medicare so Medicare benefits are exhausted prior to payment on the public entity's plan.
- Increasing retiree contributions for current and/or future retirees.
- Changing eligibility requirements.
- Establishing a special purpose trust like a VEBA may provide flexibility in establishing higher discount rates resulting in lower obligations (1% point increase in discount rate could lower liabilities 10% to 15% — a big number when dealing with $100 million-plus liabilities).
- Creative financing of benefits.
- Retiree buyouts, including selling off the obligations.
- Securitizing of benefits.
- Other solutions unique to a specific employer (larger insurance companies are spending significant energy to develop a solution for these public entities since the magnitude of dollars and opportunity is significant).

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About Aquarius Capital

Aquarius Capital, an organization that provides customized solutions in finance, insurance, and risk management in the life, accident and health insurance fields. Services include actuarial consulting, retail brokering, reinsurance risk management and managing general underwriting services. The management team of Aquarius have completed more than 300 OPEB valuations.

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