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Other Postemployment Benefits:

Dealing With The Elephant In The Room

Municipalities, school districts, state and local governments, as well as other public entities, are facing an increasingly difficult issue: other non-pension, postemployment benefits (OPEBs) such as healthcare, ancillary products and life insurance. OPEBs represent more than hundreds of billions—maybe a trillion—dollars and have been relatively ignored.

With the recent requirements of the Government Accounting Standards Board Statements 43 and 45, public entities are now required to value and recognize that this obligation exists on an annual basis, even though these benefits are not received until after employment has ended.

Imagine the impact in a community already burdened with rising taxes and educational facility bonds, to have to account for an obligation that can range from tens to hundreds of millions of dollars.

The challenge for these entities is that OPEB obligations have always been there or at least have been there for a long time as a result of employee benefit packages developed through collective bargaining.

When Will This Happen? Over the next three years, public entities will be valuing and recording these liabilities. Those with revenue of more than $100 million will be the first required to recognize these obligations, while entities with revenue under $10 million will be required by the third and final year to carry out the required implementation. Many of these organizations have already started the process of valuation for both accounting and management purposes in order to know what amount of financing is required when applying for loans and bonds.

The first step to solving a problem is recognizing it. Americans are aware of the healthcare issues today with individual coverage potentially more than $4,000 per year and family coverage even greater. Inflation growing in double digits complicates things further, since future costs will be significantly greater.

How Have OPEBs Been Valued Prior to GASB 43 and 45? For the traditional public entity, OPEB costs have been valued on a pay-as-you-go basis, recognizing and budgeting costs as dollars are being spent. Unfortunately, this approach does not value the impact of vesting benefits for current active employees who are earning these retirement benefits, nor does it reflect the impact of inflation on this benefit. A public entity that spends $5 million a year in retiree benefits may have a liability of $50 million to $100 million.

This issue is not completely new; employers in the private sector had to value these benefits since the early to mid-1990s under Financing Accounting Standards Board Statement 106 (FAS 106). However, in most cases the obligations of those organizations did not have the same magnitude as anticipated for public entities under GASB 43 and 45. Yet most private companies recognize this liability as a very large financial obligation.

The FAS 106 liabilities were not as large as those anticipated under GASB 43 and 45 because retirement benefits offered in the private sector are, in most cases, less generous and deal with benefits received by individuals after age 65, making these benefits secondary coverage behind Medicare.

However, in the public sector, benefit eligibility may be much earlier because retirement eligibility may kick in after 20 to 25 years of service—meaning that individuals in their forties or fifties could be receiving benefits 10 to 20 years prior to receiving Medicare. Individuals in the public sector trade 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. Thus, an employer may have an actuarial liability of 10 to 20 times the current pay-as-you-go number.

What Are the Key Buzzwords in GASB 43/45? Two key terms are annual required contribution (ARC) and unfunded accrued liability (UAL).

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

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 where entities are required to fund benefits due to collective bargaining.

The ARC and UAL are valued by actuaries. However, the most important takeaway for a reader is that these numbers are material and greater than the costs reported today.

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.

What Other Issues Exist in Valuing OPEBs? Clearly, there will be political issues. As mentioned earlier, if a community is experiencing increases in taxes plus raising money for a school construction bond, reporting millions of OPEB liability will be tough. Most people do not understand that this obligation has always existed—GASB 43/45 is solely the process of recognizing and valuing it. The unfortunate perception is that government officials are spending dollars they do not have.

Now That We Have Identified the Problem, What Do We Do? Start talking about it with the appropriate parties and develop a strategy. Some organizations have started discussions with employees in particular during the collective bargaining process. The first reaction from unions during collective bargaining is that their retiree benefits will be cut. However, the issue is much more important than that; it could result in an insolvency of a public entity which means the promised benefits might not be there.

Some initial steps to help public entities would include getting their file documentation in order. This would include locating and clarifying benefit levels including obligations to retirees. Special attention should be paid to areas with a large cost structure. Some of the information needed to value this benefit includes electronic census information (active and retired employees and dependents), plan design, plan costs (e.g., premium rates, other costs if self-funded), retiree contributions and assets.

What Are Some of the Solutions?

- Managing benefits more efficiently, including cost containment measures.
- Shopping for competitively priced benefits (this might mean looking at new insurance carriers).
- Negotiating benefit reductions for current and/or future retirees (in the public sector elimination of these benefits may not be realistic).
- Improving integration of benefits with Medicare so Medicare benefits are exhausted prior to payment by 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 in order to provide flexibility for higher discount rates and, thus, lower obligations (a 1 percent point increase in discount rate could lower liabilities 10 to 15 percent—a big number when dealing with more than $100 million in liabilities).
- Financing benefits creatively.
- Buying out retirees, including selling the obligations.
- Securitizing benefits.

One final note is that larger insurance companies are spending significant energy to develop solutions for these public entities since the magnitude of dollars and opportunity is significant.

These solutions could be applied to legacy benefits or to current or future benefits, and each organization requires a unique solution.

What not to do: *Ignore this issue.* It is a real problem, and there is a great opportunity to assist public entities in developing a game plan. Benefit consultants and financial advisors can provide guidance and further clarification on solutions. Brokers and benefit consultants who have spent numerous hours to land a public entity as a client should be prepared to attack this issue. If they don't, the competition will have a game plan for their clients.