Preparing for the New OPEB Accounting Standards GASB 74 & 75

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What is OPEB?

- OPEB is divided into two categories:
  - Postemployment health care benefits – always accounted for separately
  - Other forms of OPEB such as death benefits, life insurance and disability benefits – only accounted for separately when provided separately from a pension plan
- OPEB does not include termination benefits or termination payments for sick leave.
  - OPEB may include unused sick leave which is converted to enhanced OPEB benefits

The 1,000 ft. view of GASB 74/75

- The Good
  - Greater transparency; additional disclosures
  - Greater uniformity of measurement
- The Bad
  - Balance sheet recognition of the entire unfunded actuarial liability
  - Overemphasis on a point-in-time liability
  - Divorce from funding; no longer an ARC
- The Ugly
  - Additional complexity to an already complex subject
  - Most 10-year trend information will start from scratch
  - Volatile balance sheet liability and OPEB expense could make trending difficult

The 1,000 ft. view of GASB 74/75

- GASB 45 – Expense Drives the Balance Sheet
  - Accountability is focused on whether the employer is making the Actuarially Required Contribution
- GASB 75 – Balance Sheet Drives Expense
  - Accountability is focused on the Net OPEB Liability
- Goals of GASB 74/75
  - Make OPEB promises more understandable and transparent
  - Require detailed reconciliation of the Total OPEB Liability. Changes due to assumption changes, benefit changes and experience gains/losses are shown separately
  - Expanded disclosures regarding assumptions
  - Sensitivity analysis based on +/- 1% change to trend and +/- 1% change to discount rate

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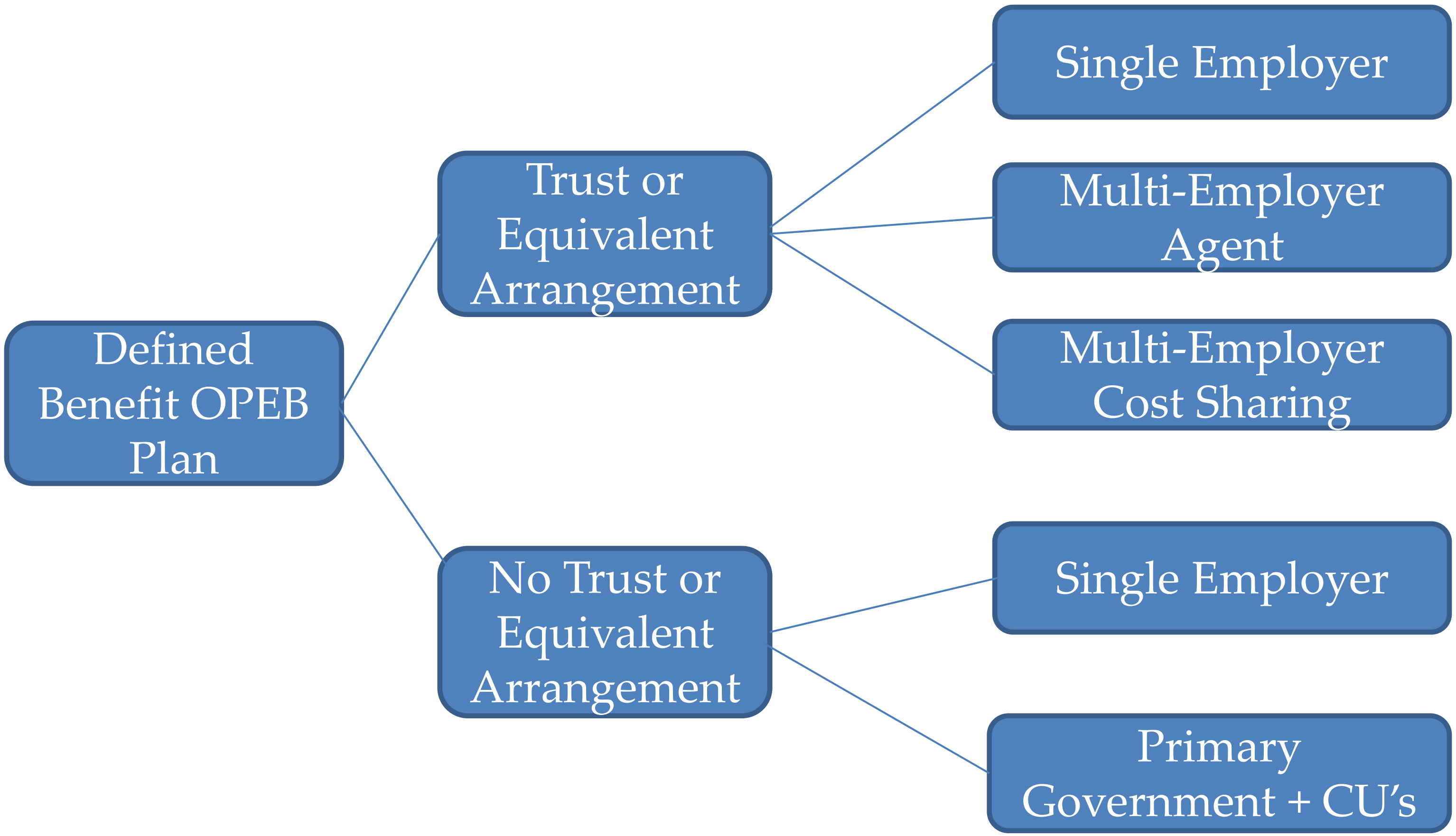
Effective Dates

- GASB 74 – Plan Reporting
  - Effective for fiscal years beginning after June 15, 2016 (i.e. effective for June 30, 2017 year ends)
  - GASB 74 would not apply to employers who do not have assets dedicated to OPEB.
- GASB 75 – Employer Reporting
  - Effective for fiscal years beginning after June 15, 2017 (i.e. effective for June 30, 2018 year ends)

Types of Plans



Terminology

GASB 43/45	GASB 74/75
Actuarial Accrued Liability	Total OPEB Liability
Actuarial Value of Assets	Fiduciary Net Position
Unfunded Actuarial Accrued Liability (UAAL)	Net OPEB Liability
Normal Cost	Service Cost
ARC & UAAL Amortization	Accounting expense is not tied to a funding contribution
Net OPEB Obligation – cumulative difference between expense and contributions	Net OPEB Liability & Deferred Inflows/Outflows of Resources

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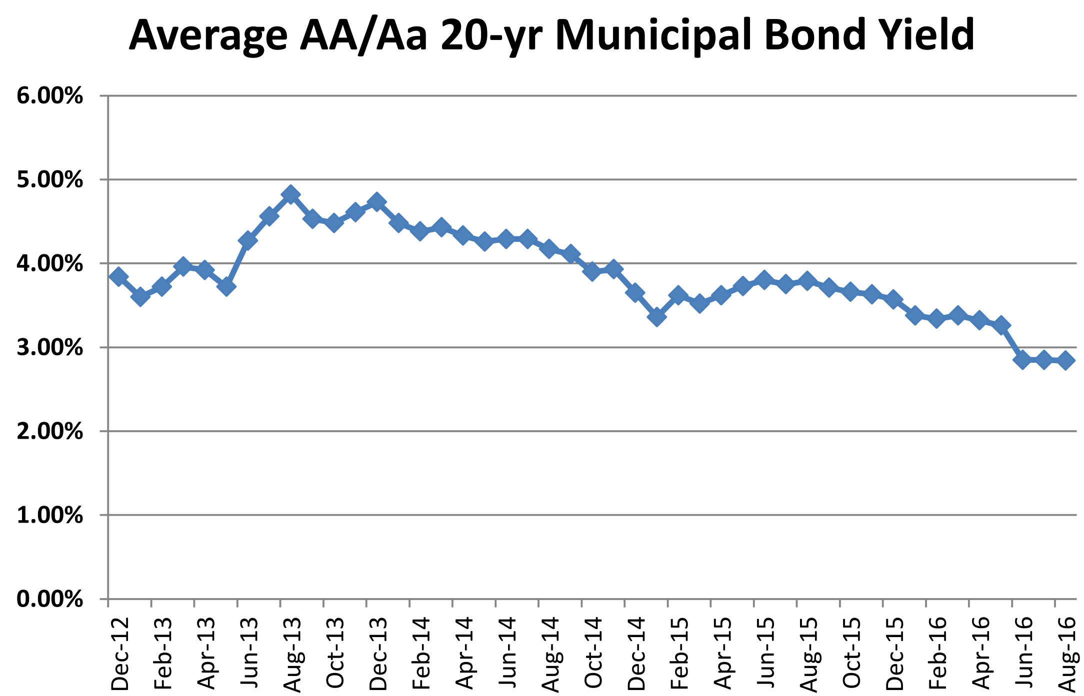
Preparing for the Impact to the Balance Sheet

- Differences between GASB 75's Total OPEB Liability and GASB 45's Unfunded Actuarial Accrued Liability:
  - New discount rate methodology
  - Required use of the Entry Age Normal Cost Method
  - Assets measured on market value of assets; no asset smoothing for accounting

New Discount Rate Methodology

- For pay-as-you-go plans, the discount rate will be based on the average yield for an index of 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher.
- Plans with assets will be required to perform a test to determine when assets will be depleted. The discount rate will be a blend of the long-term expected rate of return on plan assets and the municipal bond index rate.

Discount Rate



Accrued liability sensitivity is typically 10-15% per 1% in discount rate if there is no post-65 benefit and 15-20% if there is a post-65 benefit.

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Entry Age Normal Cost Method

- GASB 43/45 allowed several actuarial cost methods; many employers currently use the Projected Unit Credit method
- GASB 74/75 requires the Entry Age Normal method
- Entry Age method will generally produce a higher liability. Impact will vary based on plan structure and participant demographics.

Impact to the Balance Sheet - Example

- Unfunded plan using 4.50% discount rate and the Projected Unit Credit Method has an Actuarial Accrued Liability of $40 million and a Net OPEB Obligation (current balance sheet liability) of $15 million.
- For this plan, the impact of changing to the Entry Age Method is 15%
- For this example, let's assume the discount rate in FYE18 will be 3.50%
- Under GASB 75 methodology, the Total OPEB Liability is $55 million
- Balance sheet difference of $40 million
  - Note, accrued liabilities tend to grow over time

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Do I get a portion of the State's OPEB Liability?

- OPEB accounting will be similar as pension for state agencies, school districts and higher education institutions who participate in the State's cost-sharing retiree medical liability
  - These are the employers who pay the retiree medical payroll surcharge; 5.33% of payroll for FYE17
  - Proportion of liability, expense, deferred inflows/outflows based on employer's "contribution requirement" relative to total contributions
- Similar proportionate share approach for employers in the State's LTD plan
- Employers who have their own OPEB plan will not be assigned a portion of the State's OPEB liability. Current actuary will provide GASB 74/75 information

Do I get a portion of the State's OPEB Liability?

- For state agencies, school districts and higher education institutions who participate in the State's cost-sharing retiree medical liability (5.33% of payroll surcharge for FYE17)
  - Each employer's proportionate share of the Net OPEB Liability and OPEB Expense will be provided on the PEBA website similar to how the proportionate share of the Net Pension Liability and Pension Expense is currently provided for SCRS and PORS.
  - The initial GASB 75 exhibits are tentatively scheduled to be released in **November of 2017**.
- Employers who have their own OPEB plan will not be assigned a portion of the State's OPEB liability.
  - They will need to discuss GASB 74/75 timelines/fees with their actuary
  - They will not receive their OPEB accounting exhibits from PEBA

State's Cost-Sharing Retiree Medical Plan – June 30, 2015 Valuation

- The unfunded actuarial accrued liability (UAAL) as of June 30, 2015 was measured using a blended discount rate of 5.50%.
- AAL = $10.8 Billion; Assets = $1.0 Billion; 8.9% funded ratio
- The ratio of the UAAL to payroll was 125%
- The State's UAAL is measured using the Entry Age Normal method; no change required
- The ratio of the UAAL to payroll would have been 160% using a 4.00% discount rate

State's Cost-Sharing Retiree Medical Plan

- Estimating the Net OPEB Liability for employers in the State's cost-sharing retiree medical plan is difficult for two reasons:
  - Predicting the municipal bond rate
  - It's not clear yet how GASB 75's methodology for calculating the blended discount rate applies to the State's plan.

Implementation Guides

- GASB 74 Implementation Guide is scheduled to be released in February of 2017
- GASB 75 Implementation Guide is scheduled to be released in November of 2017
- Employers may be hesitant to implement before the implementation guides are released

Implementation Guides

- Hopefully, more guidance will be provided regarding the discount rate methodology for plans with unconventional funding policies
- Can plans with assets use the unfunded discount rate as a minimum?
- Using estimated benefits vs. actual benefits; need to capture implicit subsidy payments

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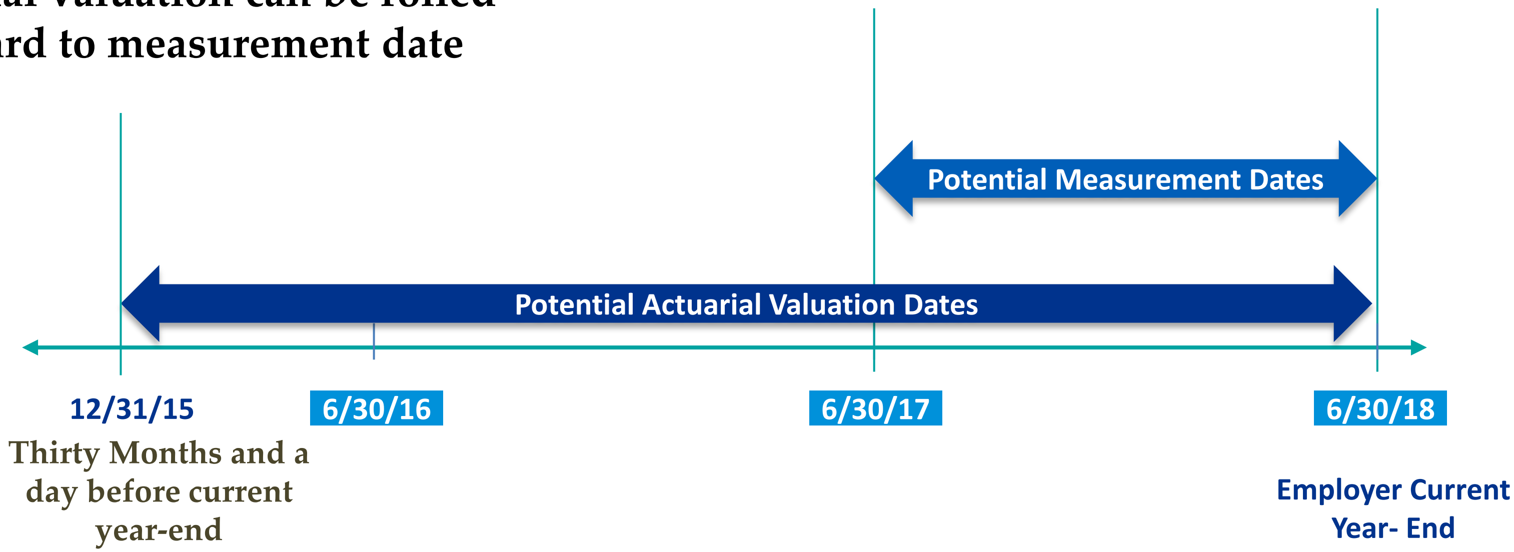
Measurement Date – GASB 75

Actuarial valuation can be rolled forward to measurement date



Measurement of the total OPEB Liability in employer's financial statements must be as of a date no earlier than the end of the employer's prior fiscal year.

Measurement must be based on an actuarial valuation performed within 30 months plus 1 day of the employer's year-end.

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Measurement Date – GASB 75

- Many employers will use a measurement date that is as of the beginning of their fiscal year. Similar to pension accounting.
- Deferred outflows of resources related to OPEB should be reported for employer contributions made after the measurement date and prior to the end of the fiscal year.
  - Employer contributions include pay-go benefits (net of retiree contributions) not reimbursed by the trust; trust contributions; administrative expenses for non-trusted plans. Refer to the appropriate section of GASB 75.

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Measurement Date – GASB 74

- For plan reporting, liabilities and assets are reported as of the end of the fiscal year
  - Measurement date = end of fiscal year
- Valuation date look back is 24 months instead of the 30 months allowed by GASB 75
- Plan's with assets will likely use the end of the plan year for the employer's reporting to avoid additional actuarial reports
- Employer's in a cost-sharing plan must use plan year end that falls inside the employer's fiscal year

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Employer note disclosures - Descriptions

Plan Description	A	B	C	D
Name of plan, administrator of plan, and type of plan	✓	✓	✓	✓
Benefit terms, including (1) classes of employees covered, (2) types of benefits, (3) key elements of OPEB formula, (4) terms or policies with respect to automatic benefit changes, including ad hoc colas, (5) legal authority	✓	✓	✓	✓
Number of employees covered	✓		✓	
Fact that no assets accumulated in a trust			✓	✓
Contribution requirements, including (1) authority under which contributions made, (2) legal or maximum contributions rates, (3) contribution rates, and (4) contributions made	✓	✓		
Authority under which to pay OPEB benefits as they come due and amount			✓	✓
Availability of audited plan financial statements	✓	✓		

A = Trusted: Single/Agent

B = Trusted: Cost-sharing

C = Non-trusted: Single

D = Non-trusted: PG + CU

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Employer note disclosures - Assumptions

Assumptions and Other Inputs	A	B	C	D
Significant assumptions, including inflation, healthcare cost trend rates, salary changes, postemployment benefit changes	✓	✓	✓	✓
Source of mortality assumptions	✓	✓	✓	✓
Dates of experience studies	✓	✓	✓	✓
Fact that projections of sharing of benefit costs based on established pattern of practice	✓	✓	✓	✓
Net OPEB liability sensitivity to healthcare trend rate (+/- 1%)	✓	✓		
Total OPEB liability sensitivity to healthcare trend rate (+/- 1%)			✓	✓

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Employer Note Disclosures - Discount Rates

Discount Rate	A	B	C	D
Discount rate used and change in discount rate	✓	✓	✓	✓
Assumptions about projected cash flows	✓	✓		
Long-term expected rate of return on plan investments and how determined	✓	✓		
Municipal bond rate used	✓	✓	✓	✓
Periods of projected benefit payments applied to long-term rate of return and municipal bond rate, if applicable	✓	✓		
Assumed asset allocation and long-term expected real rate of return for each major asset class	✓	✓		
Net OPEB liability sensitivity to discount rate (+/- 1%)	✓	✓		
Total OPEB liability sensitivity to municipal bond rate (+/- 1%)			✓	✓

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Employer Note Disclosures – Additional Disclosures

Additional Disclosures	A	B	C	D
Information about plan's fiduciary net position if report not publicly available	✓	✓		
Schedule of changes in ***net*** OPEB liability	✓			
Schedule of changes in ***total*** OPEB liability			✓	
Measurement date	✓	✓	✓	✓
Actuarial valuation date	✓	✓	✓	✓
Employers proportionate share of net (total) OPEB liability and basis for allocation		✓		✓
Changes in assumptions and benefit terms	✓	✓	✓	✓
Changes subsequent to measurement date	✓	✓	✓	✓
OPEB expense in current period	✓	✓	✓	✓
Balance of deferred outflows/inflows by source and aggregate impact on OPEB expense in each of next 5 years and thereafter	✓	✓	✓	✓

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Employer Required Supplementary Information - RSI

10-Year Schedules	A	B	C	D
Changes in net OPEB liability by source	✓			
Components of net OPEB liability and related ratios	✓			
Proportionate share of net OPEB liability		✓		
Employer contributions	✓	✓		
Changes in total OPEB liability by source			✓	
Total OPEB liability as a percentage of covered employee payroll			✓	
Proportionate share of total OPEB liability				✓

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Other Employer Required Supplementary Information - RSI

- 10-year schedule of contributions relative to actuarially determined contribution and contributions as a percentage of payroll. Only applicable for cases where an actuarially determined contribution is calculated or there is a statutory or contractually established rate

Period Ending June 30,	Actuarially Determined Contribution	Actual Contribution	Contribution Deficiency (Excess)	Covered Payroll	Actual Contribution as a % of Covered Payroll
2018	$ 213,424	$ 192,082	$ 21,342	$ 2,849,197	6.7%
2019	224,159	$ 201,743	22,416	2,590,679	7.8%
2020	244,159	$ 219,743	24,416	3,352,500	6.6%

- Comment on events that **significantly** affect trends in historical schedules
- RSI schedules prospective if information not initially available.

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Changes to Total OPEB Liability

	Total OPEB Liability
Balance 6/30/2017	$851,095
Changes for the year:	
Service Cost	16,712
Interest Cost	33,898
Changes in Benefit Terms	(90,550)
Difference between expected and actual experience	58,936
Changes in assumptions or other inputs	45,945
Benefit Payments	(23,983)
Net Changes	40,958
Balance 6/30/2018	$892,503

10-year schedule, showing previous discount rates

Similar 10-year schedule for changes in Plan Fiduciary Net Position

Doesn't apply to cost-sharing employers

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Sample OPEB Expense – GASB 75

Calculation of the OPEB Expense:

1. Service Cost	$16,712
2. Interest Cost (on Total OPEB Liability)	33,898
3. Benefit Changes (assuming reduction)	(90,550)
4. Member Contributions (non-retirees)	0
5. Projected Investment Earnings	0
6. Administrative Expenses	5,678
7. Other	0
8. Deferred Outflow/(Inflow) due to Liabilities	14,983
9. Deferred Outflow/(Inflow) due to Investments	0
10. Total Pension Expense/(Income)	**$(19,279)**

Contributions from the employer are not recognized in OPEB expense.

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OPEB Expense – Smoothing Gains/Losses

- Changes to the Total OPEB Liability (TOL) due to benefit changes are immediately recognized. Results in no deferred outflows or inflows of resources.
- Changes to the TOL due to assumption changes or differences between expected and actual experience are amortized over the average future working lifetime of the plan participants.
- The difference between actual and expected investment returns are amortized over a period of 5 years.

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Deferred Outflows and Inflows

- The amounts not recognized in OPEB expense are reported as deferred outflows or deferred inflows of resources related to OPEB.
- Deferred Outflow – quasi asset
- Deferred Inflow – quasi liability
- Notes will include schedule of future deferred outflows and inflows that will be recognized in the employer's expense

Deferred Outflows/Inflows of Resources Balances Related to OPEB

	Deferred Outflows of Resources (Losses)	Deferred Inflows of Resources (Gains)
Differences between expected and actual experience	$25,970	$14,134
Changes of assumptions	-	855
Net differences between projected and actual earnings on OPEB plan investments	17,782	-
Total	$43,752	$14,989

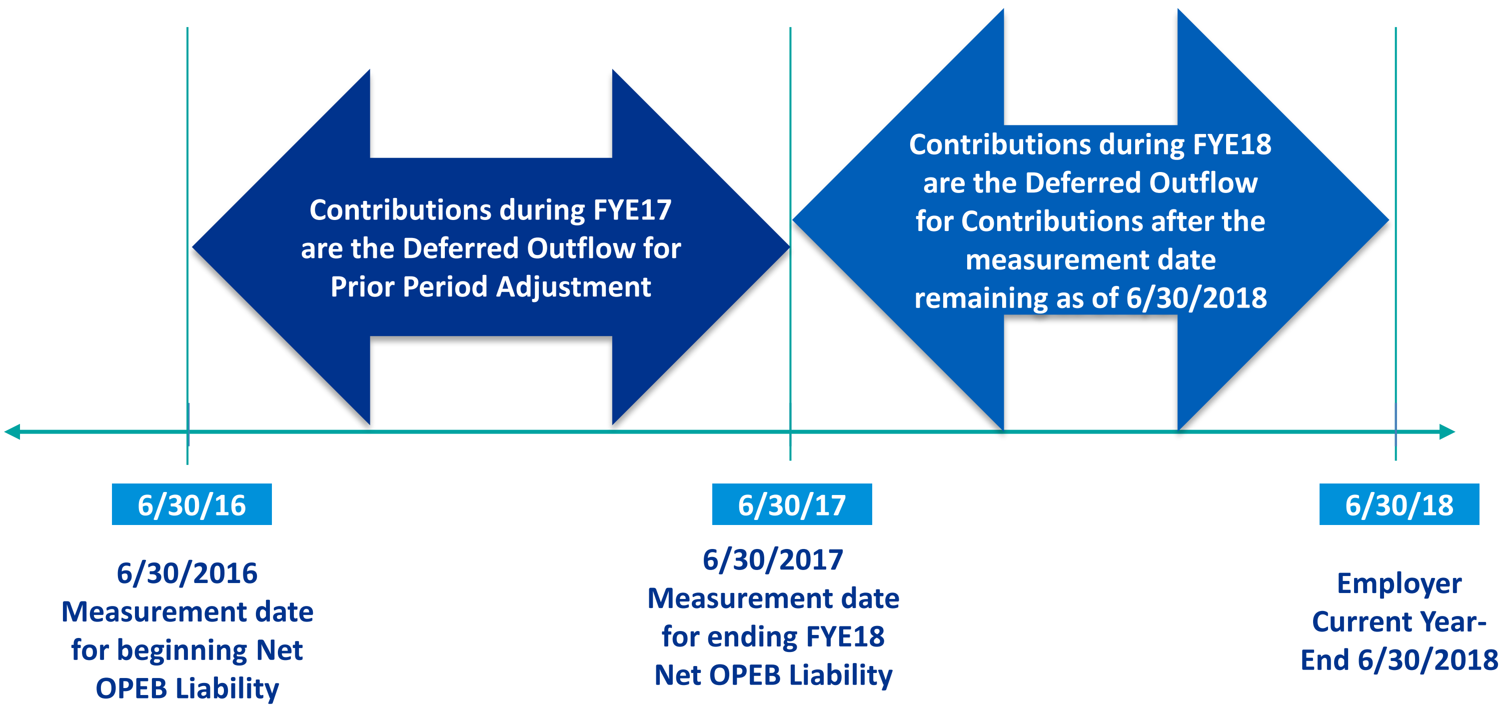
The Notes also need to include the Deferred Outflow of Resources related to contributions made after the measurement date; which may not be in the actuary's report.

Prior Period Adjustment

- Assuming guidance is similar to GASB 68:
  1. Remove the Net OPEB Obligation at the beginning of the fiscal year of implementation;
  2. Add Net OPEB Liability as of the beginning of the initial period of implementation
  3. Add a deferred outflow of resources balance for contributions made subsequent to the measurement date of the beginning Net OPEB Liability but before the start of the fiscal year
  4. Add balances associated with all other deferred outflows/inflows of resources determined as of the same date as the beginning net pension liability

Deferred Outflows for Contributions Made after the Measurement Date

- Example for employer whose measurement date is the beginning of the fiscal year



Target Asset Allocation and Assumed Real Returns

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return	Allocation-Weighted Long-Term Expected Real Rate of Return
Fixed Income	70%	1.80%	1.26%
Domestic Equity	0	5.80	0.00
International Equity	0	6.20	0.00
Private Equity	0	9.70	0.00
Real Estate	25	5.20	1.30
Commodities	0	2.10	0.00
Cash	5	0.50	0.03
Total	100%		2.59%
Expected Inflation			2.25%
Total Return			4.84%

Real rate is the rate above inflation. Can start preparing the table now.

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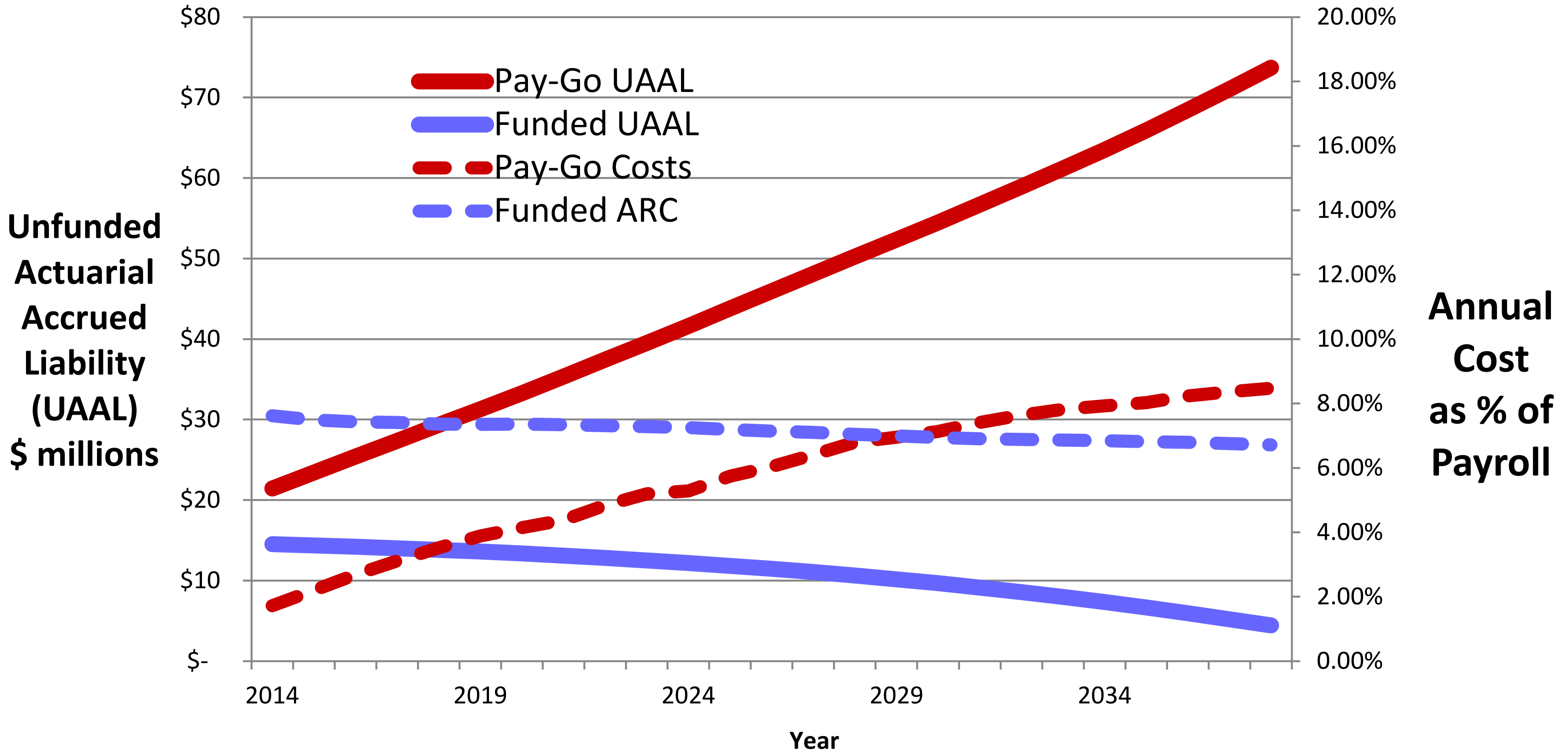
OPEB Funding

- GASB 75 does not require prefunding an irrevocable trust
- Is the current benefit sustainable? Will "funding" delay inevitable decisions?
- Resulting discount rate will depend on asset allocation and funding policy
- Develop a funding policy
- Amortization decisions
  - Level $ or Level % of pay amortization
  - Open of closed amortization period

Funding Policy

- Plans with strong funding policies will be able to use a discount rate equal to the trust's long-term assumed rate of return
- Plans with weak funding policies will likely be required to use a blended rate
  - Plans with long, open amortization periods
  - Plans that don't fund the ARC consistently
- For plans with assets, we suggest working with your actuary to develop a written funding policy

Pay-Go Versus Funding Example



30-year closed, level dollar amortization (7.50% vs. 4.50% discount rate)
Over the first 25 years, the cumulative pay-go costs equal $58 million and the cumulative ARC payments equal $67 million. The trust has $50 million in assets after 25 years.

Planning – Health Plan

- Identify and document controls over internal tracking of healthcare costs including splitting of costs between plans and between retirees and actives.
- Review key service providers or systems such as TPA, health insurer, healthcare software so that you will not be making key changes in the year of implementation.

Planning – Retiree Provisions

- Obtain documentation regarding key retiree health provisions and ensure that documentation reflects actual practice for:
  - Retiree eligibility including premiums paid and ability to leave and return to the plan
  - Dependent eligibility including premiums paid and ability to leave and return to the plan and ability to stay on plan after retiree has turned 65 and dependent has not
  - Specific plans retirees are eligible to participate in.
  - Ancillary benefits such as health care clinic
  - Post 65 provisions including:
    - Ability to stay on the plan
    - Plan becoming secondary to Medicare
    - Premium adjustments

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Planning – Actuarial Considerations

- If biennial valuations are used, will the year of implementation be an off year or new valuation. If off year, will actuary be willing to rerun the valuation for GASB 75 and update to the measurement year?
- What measurement date will work best for reporting purposes?
- Are overlapping assumptions consistent between the OPEB and the pension plans for the same employee groups?
- What are the key assumptions that drive the valuation?
- Will timing of the valuation work within the constraints of the financial reporting deadlines?

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Other items

- Annual measurement dates will be required
- Triennial valuations no longer allowed
- Expense volatility due to claims volatility, discount rate volatility, and plan changes
- GASB 74 also addresses assets accumulated for OPEB through defined benefit OPEB plans that are not administered through trusts that meet the criteria

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Other items

- GASB 75 is divided into several sections:
  - OPEB provided through plans administered as trusts or equivalent arrangements (meeting paragraph 4 requirements)
  - OPEB provided through plans that are **NOT** administered as trusts or equivalent arrangements (does not meet paragraph 4)
  - Special Funding Situation with a Non-Employer Contributing Entity

Make sure you are in the right section!

Take-aways

- Balance sheet will soon reflect the entire unfunded liability
- Discount rate volatility
- Expense will be driven by changes to the balance sheet liability
- Many more disclosures
- OPEB liability will likely get more attention
- GASB 74/75 Frequently Asked Questions can be found on the PEBA website

http://peba.sc.gov/gasb-faq.html

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Acknowledgement

Thank you to Danny White FSA, EA, MAAA who checked and peer reviewed this presentation