Finance Committee Presentation Outline

☐ Results of the analysis by Buck Consultants, LLC
  ■ Overview of GASB 45 and its requirements
  ■ Methodology used to calculate GASB 45 costs
  ■ Initial assessment of the County’s GASB 45 costs

☐ Management Considerations
  ■ Options available to the County to manage the cost
  ■ Additional unresolved issues requiring further investigation
  ■ Recommended direction to County staff

May 4, 2006
Overview of GASB 45

☐ Accounting and financial reporting for Postemployment Benefits other than Pensions (OPEB)
  ■ GASB 45 applies to governmental employers
  ■ Mandates uniform accrual-based accounting
  ■ For the County it is effective for the fiscal year beginning July 1, 2007

☐ Objectives of GASB 45
  ■ Report OPEB the same way pensions are currently reported
  ■ Recognize cost of OPEB systematically over employees’ years of service
Overview of GASB 45

☐ OPEB stands for Other Postemployment Benefits
☐ OPEBs are all benefits other than pension benefits and include medical, prescription drugs, dental, vision, hearing and Medicare Part B or Part D premiums
☐ OPEBs can also include other postemployment benefits when provided separately from a pension plan
  ☐ Life insurance
  ☐ Long-term care
  ☐ Long-term disability
☐ For Contra Costa County OPEBs include medical, prescription drug, dental and self-funded long term disability
Overview of GASB 45

- Currently, most governmental employers use a Pay-As-You-Go (PAYGO) method to report OPEB costs.

- Financial statements only report the OPEB benefits being paid in the current year as the expense.

- Since OPEB is reported in this manner, there has been little or no pre-funding of OPEB benefits.
Overview of GASB 45

Why is GASB Requiring this Reporting?

☐ OPEB benefits are part of the compensation for services rendered by employees

☐ Benefits are “earned,” and obligations accrue or accumulate, during employment

☐ Entities are not properly accounting for the future benefits that are promised and/or expected by employees

☐ Analysts will be able to evaluate OPEB obligations in the same way they currently evaluate pension obligations
Overview of GASB 45

- The new standard requires the measurement of two items:
  - The value of premium payments made on behalf of the retiree and his or her covered dependents
  - The value of the "subsidy" that occurs if the retiree rates are lower than the actual cost of the benefits

- The "subsidy" results if an employer:
  - uses the same rates for active and retired employees
  - does not set the retiree rates to be equal to the actual cost of providing coverage
Overview of GASB 45

- The new standard requires the disclosure of two key items:
  - The Unfunded Accrued Actuarial Liability (UAAL).
  - The Annual Required Contribution (ARC)
    - This is made up of the normal cost – the amount that the active employees earn for their service in the year
    - And a not greater that 30 year amortization of the UAAL
- The standard does not require that the ARC be funded
- However, the credit rating agencies will look at how an entity is handling the liability – including whether the liability is being funded – in determining ratings

May 4, 2006
Overview of GASB 45

- The likely credit implications of GASB 45 include:
  - Lack of funding along with recent rapid health-care cost increases will result in significant OPEB obligations (primarily health care)
  - These obligations may adversely impact credit rating
  - Reporting OPEB could reveal:
    - Funding could strain operation
    - Employers may be unable to fulfill obligation
    - Unfunded liabilities will be considered in rating process

May 4, 2006
Methodology Used to Calculate GASB 45 Costs

- The measurement of the liability can broadly be determined by:
  - Projecting employer cash outflows for benefits
  - Discounting projected benefits to the current date (or the Present Value (PV))
  - Allocating the PV of projected benefits to periods using an acceptable actuarial cost method

- This measurement includes the use of demographic and economic assumptions (including the healthcare cost trend rate)
Methodology Used to Calculate GASB 45 Costs

- Substantive Plan – The plan as understood by the employer and plan members
- Need to consider:
  - Eligibility, underlying benefits and cost sharing arrangements
  - Historical patterns of changes
  - Written documents and communications to participants
- Other plan features
  - Caps on Employer’s share of benefits
  - Potential implicit rate subsidies
  - Medicare Part B or Part D premium reimbursement
Methodology Used to Calculate GASB 45 Costs

- Retired and Active Employee Census Data
- Substantive Plan
- Assumptions and Methods

- Actuarial Cost Method
- Actuarial Present Value (PV) of Total Projected Benefits
- Assets

Annual Rebuilt Contribution (ARC)

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Methodology Used to Calculate GASB 45 Costs

INPUT

- Census Data
- Demographic Assumptions
- Participation & Dependent Coverage Assumptions

OUTPUT

Base year per capita costs + Trend and Aging Assumptions = Substantive plan

Projected Covered Population \times Projected Per Capita Costs = Total Projected Benefits - Projected Retiree Contributions = Projected Employer Provided Benefits

May 4, 2006
Methodology Used to Calculate GASB 45 Costs

Total PV of Benefits is discounted value of projected benefit payments

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<th>Year</th>
<th>Projected Employer Provided Benefits</th>
<th>Total Present Value of Benefits</th>
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Discount Rate

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Methodology Used to Calculate GASB 45 Costs

- Discount rate – Expected long-term investment yield on investments expected to be used to finance payment of benefits. Investments could include:
  - Plan assets — for a funded plan (where assets are accumulated in a trust)
  - Employer assets — for an unfunded plan
  - A combination of plan and employer assets — for a partially funded plan
Initial Assessment of the County’s GASB 45 Costs

☐ As of January 1, 2006, Buck estimates than the Actuarial Liability for the current benefit plan is:

■ $2.57 billion under the assumption that the County continues to fund the OPEB benefits on a PAYGO basis

■ $1.43 billion under the assumption that the County elects to fully fund the Annual Required Cost (ARC) each year
Initial Assessment of the County’s GASB 45 Costs

- As of January 1, 2006, Buck estimates than the Annual Required Cost (ARC) for the first year is:
  - $216.33 million under the assumption that the County continues to fund the OPEB benefits on a PAYGO basis
  - $102.70 million under the assumption that the County elects to fully fund the Annual Required Cost (ARC) each year
  - This compares to the expected PAYGO cost of $33.15 million for the first year
Initial Assessment of the County’s GASB 45 Costs

- If the County elects to fully fund the ARC, then the net OPEB obligation – or the liability that is shown on the balance sheet – is $0
- If the County elects to continue to only fund the PAYGO costs, then the difference between the ARC and the PAYGO cost is reflected as the net OPEB obligation
- This would be $216.33 million less the $33.15 million PAYGO cost or $183.18 million
- This OPEB obligation would continue to increase over time until it is equal to the actuarial liability
Initial Assessment of the County’s GASB 45 Costs

- The chart on the next page provides a 30-year projection of:
  - The ARC under the assumption that the ARC is fully funded each year
  - The ARC under the assumption that the PAYGO cost is funded each year
  - The expected PAYGO costs for each year
Initial Assessment of the County’s GASB 45 Costs

$ in Millions

- ARC at 4.5% - PAYGO Funding
- ARC at 7.9% - Full Funding
- Annual Cashflow or PAYGO Cost

May 4, 2006
Management Considerations
Options Available to the County

☐ Option 1 - Continue to fund the PAYGO costs

☐ Option 2 - Modify the existing OPEB plan

☐ Option 3 - Pre-fund all or portion of liability

☐ Option 4 - A combination of the above options
Option 1: Continue PAYGO Funding

☐ Under this option the County would leave the current OPEB plan unchanged

☐ It would not fund the ARC above the required PAYGO funding

☐ Essentially, this Option is keeping the status quo
Option 1: Continue PAYGO Funding

☐ Pros:
- Minimizes short-term budget impact
- No change from current process
Option 1: Continue PAYGO Funding

Cons:

- Large long-term budget impact as the costs continue to grow
- Net OPEB obligation continues to grow on balance sheet and will reach a level consistent with the $2.57 billion actuarial liability
- Estimate that in 5 to 6 years, the County’s total liabilities will exceed total assets
- Risk of credit rating downgrade
Option 2: Modify the Existing OPEB Program

- Under this option, the County would look at changes in the existing OPEB programs. Although the County has not initiated any analysis on any options, the changes could include:
  - Changing the eligibility requirements for the benefit
  - Changing the coverage amounts (deductibles, copays, coinsurance, etc.)
  - Changing the amount the County contributes towards coverage
  - Unblending the active and retiree rates
Option 2: Modify the Existing OPEB Program

Pros:
- Reduced liability and PAYGO costs
- Produce an ARC that may be within the County's ability to fund
Option 2: Modify the Existing OPEB Program

- Cons:
  - May affect competitiveness with other employers
  - A portion of the employees are covered under CalPERS, where the County has little or no control on program design
Option 3: Pre-funding in an Irrevocable Trust

- Under this option the County would pre-fund some portion of the ARC up to the full amount through a Trust.
- By pre-funding the obligation through an irrevocable trust or equivalent arrangement, the County can use a higher discount rate – which by itself lowers the liability and ARC.
- The investment earnings will help reduce the long term cost commitment from the County general fund for the OPEB benefits.
Option 3: Pre-funding in an Irrevocable Trust

Pros:
- Reduces liability by allowing higher discount rate assumption (higher assumption only applies to the portion pre-funded)
- Reduces risk of credit rating downgrade
- Reduces budget volatility by establishing funding plan not tied to annual premium cost increases
Option 3: Pre-funding in an Irrevocable Trust

Cons:
- Full pre-funding is likely not affordable
- Uncertainty as to whether the State/Federal Government will reimburse pre-funded amounts
- Risk that pre-funding will be unnecessary if liability is reduced by unforeseen events such as major assumption changes or nationalized health care
- Risk of investment losses in the trust fund
Option 4 – A Combination of Options

- The county may wish to consider a combination of approaches to manage its OPEB liability, which may include:
  - Modifications to the current OPEB plan
  - Partial pre-funding through an irrevocable trust or equivalent arrangement
Additional Unresolved Issues Requiring Further Investigation

☐ Research competitive level of current OPEB benefits
☐ Research State and Federal positions on reimbursement of OPEB expenses
☐ Identify steps to establish a trust for accumulating pre-funding assets
☐ Identify options for managing investment of trust assets
Recommended Direction to County Staff

☐ Prepare an analysis of liability reductions that could be produced through changes to healthcare benefits and present in closed session

☐ Prepare an analysis of the cost associated with funding varying levels of the liability and make recommendations concerning the portion of the liability that should be pre-funded and present at a future meeting of the Finance Committee
Recommended Direction to County Staff

- Investigate unresolved questions concerning State/Fed cost reimbursement, establishment of an irrevocable trust for pre-funding assets, and investment options for pre-funding assets and report back at a future meeting of the Finance Committee.
- Work with California State Association of Counties (CSAC) and other public sector partners to gather data and develop statewide strategies for managing this issue.