Managing the Challenge of OPEB

By Roger Pickens

The solution Gwinnett County, Georgia, developed for implementing GASB Statement No. 45 permits it to continue providing affordable benefits for the foreseeable future.

Gwinnett County, Georgia, won a 2008 Government Finance Officers Association (GFOA) Award for Excellence in Government Finance for its OPEB funding plan.

Gwinnett County, Georgia, wanted to ensure a smooth implementation of Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. To that end, a five-person team of managers from the Department of Financial Services sat down to develop a sustainable plan for funding retiree health care. What they came up with was a comprehensive approach to managing other postemployment benefit (OPEB) liability that, according to judges of the GFOA's Awards for Excellence in Government Finance, "will likely become the 'classic' strategy that many jurisdictions will use to resolve their OPEB challenges."

Gwinnett County's plan meets new accounting requirements, minimizes cost increases for retirees, and does not degrade the county's outstanding AAA credit ratings. The managers' persistence also led to new state legislation that makes it possible for Georgia counties to establish trust funds to meet this need.

THE CHALLENGE OF OPEB

In 1984, the Financial Accounting Standards Board required private businesses to disclose their accrued unfunded OPEB liabilities in their financial statements. These are generally post-retirement health and life insurance benefits. As a result, more than half of all companies that had been providing retiree health benefits have subsequently dropped their programs.

When a similar rule (GASB Statement No. 45) became applicable to governmental entities in 2007, Gwinnett County wanted to avoid a similar result. There were several problems, however. First, when actuaries calculated the county's annual required contribution (ARC) under the new standards, funding retiree health care would have cost more than $34 million a year — nearly 10 percent of the county's annual general fund budget — an unaffordable and unsustainable amount. Second, county management wanted to protect the county's outstanding AAA credit ratings. The challenge was to make policy and benefit-plan design changes that would:

- make ARC payments affordable,
- allow the county to continue providing health benefits for its retirees, and
- keep both the monthly county and retiree contributions affordable.

DEVELOPING THE OPEB FUNDING POLICY

The director of financial services wanted to find a fair and reasonable way to meet the seemingly incompati-

Exhibit 1: Gwinnett County OPEB Project Team

Team Members	Concentration
Finance Director	Budget/Bond Rating
Deputy Finance Director	Legislation and OPEB Accounting
Director of Risk Management	Actuarial Research and Policy Development
Employee Benefits Manager	Plan Design and Cost Containment
Pension Manager	Investment Strategies and Custodial Banking

ble goals of providing high quality health care for retirees while also funding the new required annual contribution. To tackle the problem, she appointed a five-person team, consisting of middle- and executive-level managers with expertise in areas relating to OPEB (see Exhibit 1). They studied numerous plan designs, sought funding sources, and eventually championed new state legislation that authorized cities and counties to establish OPEB trust funds.

The risk management division, which administered county health and retirement benefits, worked closely with an outside actuary to develop the necessary numbers for various plan designs. The same actuary also did a valuation of the county's defined benefit pension plan and was able to use much of that data in calculating the value of the proposed OPEB trust. Setting the actuarial assumptions was a cooperative process that was very helpful in ultimately deciding on a funding strategy.

In addition to educating and fully informing the County Board of Commissioners about GASB Statement No. 45, the director of financial services also wanted to make sure the county's other department directors understand the basics of the statement. In addition to being personally concerned about the future of their own retiree health benefits, department directors provide a communication channel to employees. Their understanding of the developing OPEB policies would be a key to ultimately achieving employee acceptance of funding changes. The Department of Financial Services also kept the human resources department informed of the county's progress in implementing GASB Statement No. 45 and welcomed its input.

The project team looked at several options, including one that would have increased eligibility requirements and another that would have based county contributions on years of service instead of contributing a set amount for each retiree. None of these options alone produced estimated results of the magnitude needed to solve the problem. Exhibit 2 summarizes the first three of six scenarios that were considered. Scenarios 4 and 5 were refinements of the first three, requiring more service for higher levels of county contributions, but they did not produce the dramatic results that were desired, either. The sixth scenario was dramatically different from the previous five, however, and it is the one that led the county administrator, the director of financial services, and other project staff to a successful solution.

Exhibit 2: The First 3 OPEB Scenarios Considered

	Beginning Status	Scenario 1	Scenario 2	Scenario 3
Characteristics:				
Minimum Eligibility	Direct Retirement	10 Years of Service	10 Years of Service	10 Years of Service
County Contribution	80%	10% for every 5 years of service	55% at 10 years 75% with 15+ years of service	75% of current lowest-cost HMO
Actuarial Results:				
Unfunded Actuarial Accrued Liability	$328 million	$299 million	$332 million	$287 million
Annual Required Contribution	$34 million	$29.4 million	$36.5 million	$28.8 million
Percentage of Annual Pay to Fund	16.05%	14.28%	17.63%	13.98%

Exhibit 3: County Maximum Funding Contributions

Retiree Group	County Contribution
Single, Over Age 65	$400
Single, Under Age 65	$600
Retiree +1, Both Over Age 65	$900
Retiree +1, Both Under Age 65	$1,200
Retiree +1, 1 Under Age 65	$1,100
Family, 1 Over Age 65	$1.200
Family, 2 Over Age 65	$1,100
Family, All Under Age 65	$1,500

The county changed its retiree health insurance benefit from paying a percentage of the health-care premium to paying a defined, fixed monthly contribution. For 2008, the county paid between $400 and $1,500 per month, per retiree, based on factors such as dependent coverage and Medicare eligibility. The contribution almost covers the entire premium for the least expensive health-care option, so retirees who choose that option will have minimal increases in their health-care costs for the next few years.

Effective January 1, 2008, the county's monthly contribution for its portion of the total health benefit premiums did not exceed the amounts shown in Exhibit 3. Any balance from the total monthly premium costs will be included in the retiree rates each year. Retirees will be charged at least the monthly premiums they paid in 2007, unless they change to a lower-cost health plan or a lower level of dependent coverage.

In addition, the county still offers retirees access to the same full array of health-care plans it offers active employees, but the retiree pays the difference between the county contribution and the premium for these more expensive plans. The new policy does not promise contribution increases such as cost-of-living adjustments, but the county might consider them in the future. These steps cut the ARC by more than half, saving hundreds of millions of dollars over time (see Exhibit 4).

DEVELOPING THE OPEB TRUST

To pay down the unfunded OPEB liability requires funding the ARC through an irrevocable trust. All contributions above the minimum pay-as-you-go annual contribution help moderate the future unfunded liability, and the trust can invest these funds to help defray future costs.

Gwinnett County faced a complication, however: Georgia law permitted only the state to establish an OPEB trust, not cities and counties. The project staff and the county's law department crafted proposed state legislation and sought support from county and municipal associations to get this law changed. The state legislature passed the bill at the end of its last day in session for the year, and it was signed into law by the governor in May 2007. By the end of June 2007, the county had created the trust and deposited the first contribution.

The county planned the OPEB trust to work together with its defined benefit pension trust. The Retirement Plans Management Committee manages both trusts, creating economies of scale. With the same trustees, investment managers, investment consultants, and custodial bank, the county can combine OPEB investment assets with the much larger retirement fund portfolio, getting the OPEB trust a more favorable investment fee structure and better investment diversification than it would have on its own.

The county fully funded its ARC in 2007 and again in 2008. Doing so provided better investment returns than originally planned and considerably reduced future ARC requirements.

COST EFFECTIVENESS

Gwinnett County paid $18,640 in

Exhibit 4: OPEB Project Results

- Defined contribution health benefit with 10-year vesting requirement for new employees hired on or after July 1, 2007
- Savings
- $192 million reduction in unfunded actuarial accrued liability (-58%)
- $22.3 million reduction in ARC
- Immediate reduction in ARC from 17.6% to 6.6% of payroll
- Reduction in 2016 ARC from 22.4% to 5.3% of payroll
- Impact for the county
- Greater immediate savings than a vesting scenario could provide
- Flexibility
- Affordability
- Relatively equal impact on active employees, new hires, and current and future retirees

2007 for the actuarial calculations used in creating various scenarios for new eligibility and funding policies. These were the only hard-dollar, variable costs of the project. All other work on the project was performed by salaried county staff.

When the project was implemented in 2007 and 2008, it reduced the county's unfunded actuarial accrued liability by more than 50 percent, from about $328.2 million at the beginning of 2006 to about $163.2 million a year later. The program also reduced the ARC from $34.1 million to $15.3 over the same timeframe. Fully funding the ARC in both 2007 and 2008 further reduced the ARC by another $1 million for each of the two years. Finally, the trust helped the county maintain its AAA ratings from the three main bond rating agencies.

CONCLUSIONS

The county's OPEB funding plan enabled it to achieve considerable savings without significantly increasing retiree contributions. The monthly contribution charged to retirees for the most popular health benefit option increased by only $5 for single coverage and $10 for family coverage in 2008, and there were no increases in 2009. While other governmental entities that provide retiree health benefits struggle over the requirements of GASB Statement No. 45, Gwinnett County's solution permits it to continue providing affordable benefits for the foreseeable future.

ROGER PICKENS was director of risk management Gwinnett County, Georgia, during the OPEB project. He managed the county's risk management division and served as ex-officio clerk of the county's retirement system board of trustees. Pickens recently made a transition from the finance department to the human resources department in his new role of benefits manager. His areas of responsibility include employee and retiree benefits, workers' compensation, and safety. Pickens came to Gwinnett County three years ago after having served for 23 years in a similar capacity as deputy director of finance for DeKalb County, Georgia.

Summary of the Gwinnett County Retiree Health Plan

- County contributions were changed from those of a typical benefit plan, where the county paid a percentage (approximately 80 percent) of the retiree health insurance premium, to a set monthly contribution
- Health plan includes prescriptions
- Retiree pays full premium for dental and vision but can access the county's group plan (implicit liability only)
- Vesting of health benefits after 10 years of service; employees must retire directly from the county
- No age limit to begin receiving retiree health benefits
- Benefit contributions decrease once employee and/or dependent is enrolled in Medicare
- County offers self-funded high-deductible health and HMO self-insured plans and one insured HMO
- No labor union contracts to deal with