The Other Shoe Falls:
Implementing the GASB’s New Guidance on OPEB

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The Other Shoe Falls:

Implementing the GASB’s New Guidance on OPEB

Allison E Bradsher
Chief Financial Officer
City of Raleigh
Objectives of the New GASB Standards

- Improves Accounting and Financial Reporting
- Improves Financial Information Provided
- Creates Consistency in Reporting
- Not centered around funding / Full Liability
GASB 74

- Financial Reporting for Postemployment Benefit Plans Other than Pension Plans
- Issued June 2015
- Effective: Fiscal years beginning after June 15, 2016
- June 30 Year End -> Effective June 30, 2017
- Replaces GASB 43
- Assets in a defined Trust
- “Plan Accounting”

GASB 75

- Accounting and Financial Reporting for Postemployment Benefits Other than Pensions
- Issued June 2015
- Effective: Fiscal years beginning after June 15, 2017
- June 30 Year End -> Effective June 30, 2018
- Replaces GASB 45
- If no current assets or Assets not in a Trust
- “Employer Accounting”
## Key Changes for GASB 75

<table>
<thead>
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<th>Notes</th>
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</thead>
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<td>Balance Sheet</td>
<td></td>
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<tr>
<td>Terminology</td>
<td></td>
</tr>
<tr>
<td>Total OPEB Liability</td>
<td>Actuarial Accrued Liability (AAL)</td>
</tr>
<tr>
<td>Fiduciary Net Position</td>
<td>Plan Assets</td>
</tr>
<tr>
<td>Net OPEB Liability</td>
<td>Unfunded Actuarial Accrued Liability (UAAL)</td>
</tr>
<tr>
<td>Deferred Inflows &amp; Outflows</td>
<td>Amortization Schedules</td>
</tr>
<tr>
<td>Actuarially Determined Contributions</td>
<td>Annual Required Contribution (ARC)</td>
</tr>
<tr>
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<td></td>
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<tr>
<td>New Requirements</td>
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</tr>
</tbody>
</table>
## Financial Statement Impacts

<table>
<thead>
<tr>
<th>No Trust</th>
<th>Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recognize the full liability</td>
<td>Recognize net of plans net position</td>
</tr>
<tr>
<td>Prescribed Method</td>
<td>Expected rate of return</td>
</tr>
<tr>
<td>Amortization depends on type of cost element</td>
<td></td>
</tr>
<tr>
<td>Single Methodology - Entry Age</td>
<td></td>
</tr>
<tr>
<td>Change in current year assumptions are</td>
<td></td>
</tr>
<tr>
<td>immediately expensed</td>
<td></td>
</tr>
<tr>
<td>More Volatility in the OPEB expense</td>
<td></td>
</tr>
<tr>
<td>Significantly more disclosure requirements</td>
<td></td>
</tr>
</tbody>
</table>
Session Objectives

• Provide a 30,000 foot view of the standard including similarities and differences from shoe # 1-pension reporting

• Discuss strategies for ensuring a smooth implementation and audit of the GASB 74 and 75 numbers

• Describe the special considerations related to OPEB trust

• Examine the role of OPEB reporting in debt issuance and ongoing continuing disclosure
THE 30,000 FOOT VIEW
OPEB Overview

- GASB 74 (Plans) & 75 (Employers) are almost identical to their pension siblings GASB 67 (Plans) and 68 (Employers) except for:
  - Pension lessons learned have been built into the base standards (for example-GASB 71-transition guidance for contributions after the measurement date and GASB 73-non trusted plans have been incorporated into the base standards, subsections of the standard have also been labeled at the corner of each page to promote easy navigation)
  - Minor tweaking to better fit retiree healthcare have been made (for example, recognizing implicit rate subsidies or requiring sensitivity analysis for healthcare trend rate)
  - Alternative method for very small plans (100 or fewer total participants) is still included in the new guidance.
- GASB 74 is effective for fiscal years ending June 30, 2017
- GASB 75 is effective for fiscal years ending June 30, 2018

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OPEB Overview

- 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

- GASB defines a pension plan as all assets are available to pay all liabilities. Using Texas Municipal Retirement System as an example:
  - Disability is blended in with pensions as all disability assets and liabilities are accounted for in the pension trust fund
  - Supplemental Death is accounted for separately as related assets and liabilities have their own trust fund and cannot be used for any other purpose
OPEB Overview

- Major impacts of GASB 75 vs. GASB 45
  - Net or total OPEB liability is now recorded in SNP
  - Inflexible actuarial methodology and discounting guidance will produce a different (often higher) OPEB liability than GASB 45
  - Annual measurement dates are now required using either annual or biennial valuations
  - Triennial valuations no longer allowed
  - Expense volatility likely due to claims volatility, discount rate volatility and more frequent plan changes
  - Much more robust note and RSI is required
How Implementing OPEB Will Be Different

• While the accounting is similar, OPEB is different in several very significant ways:
  – Pensions are a salary and time based benefit whereas OPEB is a claims based benefit
    • OPEB is more difficult to project and future payment stream will be more volatile
    • The significance of assumptions will vary between pensions and OPEB with OPEB having many assumptions that do not exist in the pension world
  – Pensions are the base benefit and are well documented through a single set of documents but OPEB is most often an overlay benefit with the base benefit being active healthcare overlaid by a policy or practice allowing retirees to stay on the plan, with possibly a third set of documents related to the trust
  – Pension plans are most often independently governed administered and was primarily responsible for implementation, Implementation of OPEB will require a greater employer role
How Implementing OPEB Will Be Different

- Pensions are relatively stable with benefits not changing often, OPEB relationship to active healthcare means that the benefit changes every time healthcare plan is amended.
- In pensions, everything flows through the trusted plan, In OPEB, even when a trust exists, it is most often a reimbursement trust only—all expenses still flow through the employer.
- In pensions a significant amount of the audit focus was on the trusted plan, In OPEB much of the audit focus will be on the employer.
## Contrasting Pensions vs. OPEB

<table>
<thead>
<tr>
<th>Subject</th>
<th>Pensions</th>
<th>OPEB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefit</td>
<td>Time and salary based</td>
<td>Claims based, with no greater benefit over time</td>
</tr>
<tr>
<td>Documentation</td>
<td>Well defined in one cohesive set of documents</td>
<td>Benefit often evolved and is represented by multiple documents written at different times that may not be complete.</td>
</tr>
<tr>
<td>Governance</td>
<td>Independent, stand alone entities</td>
<td>Much greater employer involvement</td>
</tr>
<tr>
<td>Benefit Changes</td>
<td>Infrequent</td>
<td>Often as employers struggle to control healthcare costs</td>
</tr>
<tr>
<td>Accounting</td>
<td>Everything flows through the trust</td>
<td>Often non-trusted but even when trusted expenses are most often directly paid for by the employer</td>
</tr>
<tr>
<td>Audit</td>
<td>Significant focus on the plan</td>
<td>Greater focus on the employer</td>
</tr>
</tbody>
</table>
### Implementation-Assumptions

**Significant differences include** critical actuarial assumptions are either different or different in impact:

<table>
<thead>
<tr>
<th></th>
<th>Pensions</th>
<th>OPEB</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-Term Rate of Return</td>
<td>Long-Term Rate of Return</td>
<td>Long-Term Rate of Return</td>
<td>Usually the main driver for Pension; often immaterial for OPEB due to limited funding or non-trusted plans</td>
</tr>
<tr>
<td>Mortality Rate</td>
<td>Mortality Rate</td>
<td>Mortality Rate</td>
<td>Crucial for Pension because it determines the payment period; less so for OPEB since much of the liability is pre-65</td>
</tr>
<tr>
<td>Inflation/Salary Progression</td>
<td>Inflation/Salary Progression</td>
<td>Inflation/Salary Progression</td>
<td>For Pension this is usually the basis for the benefit; for OPEB it is usually important only for amortization purposes only</td>
</tr>
<tr>
<td>Retirement Age/Rates</td>
<td>Retirement Age/Rates</td>
<td>Retirement Age/Rates</td>
<td>For Pension this can be an age point if payment forms are actuarially equivalent; for OPEB retirement rates are crucial to determine cash-flows and liabilities</td>
</tr>
<tr>
<td>Inflation-COLAs</td>
<td>Health Care Trend Rate</td>
<td>Health Care Trend Rate</td>
<td>For Pension this only matters if the Plan has a post-retirement COLA; for OPEB this is the main driver for liabilities</td>
</tr>
<tr>
<td>Retirement Options- Retiree only, beneficiary receives 100%, 75%, 50% of annuity after death of retiree</td>
<td>Retiree Options-Plan Choice; Number of dependents /beneficiaries;</td>
<td>For Pension the options offered are often actuarially equivalent and do not impact plan liability; For OPEB there are multiple choices all of which significantly impact plan liabilities</td>
<td></td>
</tr>
</tbody>
</table>
### Implementation-Assumptions

<table>
<thead>
<tr>
<th>Pensions</th>
<th>OPEB</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>Utilization by Age</td>
<td>Individuals require more health care as they age. Actuarial tables exist showing the expected healthcare utilization of plan participants are various ages</td>
</tr>
<tr>
<td>None</td>
<td>Participation Rate</td>
<td>Unlike pension in which the payments flow only one way (to the retiree), retirees are most commonly expected to pay sometimes significant monthly premiums to continue receiving benefits. As expected, higher premiums typically result in lower participation as retirees may find less expensive options. Post 65 provisions also greatly impact participation rate.</td>
</tr>
<tr>
<td>None</td>
<td>Cadillac Tax</td>
<td>This tax for “luxury” level of benefits is likely to affect many plans and will significantly add to the costs.</td>
</tr>
</tbody>
</table>
PLANNING FOR A SMOOTH IMPLEMENTATION
Planning the Implementation

- Ensure documentation is accurate
- Internal Controls over healthcare plans and census data
- Actuarial Considerations including measurement date
- Audit Considerations
- Communicating Results
Planning the Implementation

• Documentation
  – Current, unambiguous and complete
  – Plan is being administered as documented
  – Actuary has been provided all necessary and up to date documents

• Internal Controls
  – Census data is accurate and complete
  – All participants and all claims are properly classified between active and retiree
  – Cutoffs around the measurement date are strong and ensure accurate deferred outflow
Planning the Implementation

• Actuarial Considerations
  – Actuary meets all qualification standards with experience in both healthcare and pension valuations
  – Assumptions and methodology are reasonable
  – Proper consideration given to selection of the measurement date
  – Updating/roll forward procedures are appropriate

• Audit Considerations
  – Plan documents are in order
  – Internal controls and procedures well documented
  – Actuary is prepared to address questions

• Communicating results
  – No surprises

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Measurement Date Considerations

• A good measurement date should:
  – Facilitate timely financial reporting
  – Minimize the need for roll-forwards from the valuation date
  – Facilitate a quality actuarial valuation by:
    • Allowing ample time for the gathering of related census and claims data
    • Coincide adequately with the Health plan year to be able to incorporate the most recent changes in plan provisions.
  – Avoid different measurement dates for plan and employer when plan financial statements are included in the employer’s financial statements.

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Sample measurement date scenario

- A government set up a reimbursement trust when implementing GASB 45 using the same FYE as the government-September 30th.
- The plan financial statements are included as a fiduciary fund in the government’s financial statements.
- The government has had GASB 43/45 valuations on a biennial basis as of December 31st-the health plan year.
- The government is now considering deciding whether to change the plan fye to December 31st knowing that gasb 74 requires the plan to measure its pension amounts on its fye.
Based on the following analysis, the government decided to switch to December Plan year

<table>
<thead>
<tr>
<th>Retaining the Plan’s September 30th year end</th>
<th>Switch Plan to December 31st year end</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. GASB 74 effective for FY 2017 for plan. If 12/31 valuation date retained, amount will updated to 9/30/17</td>
<td>1. GASB 74 first effective in FY 2018-same as the government</td>
</tr>
<tr>
<td>2. Employer data still reported in 2017 using GASB 45</td>
<td>2. 2016 plan statements will be included in 2017</td>
</tr>
<tr>
<td>3. In 2018, the valuation would be rolled forward to 9/30/18 and the employer would use either 9/30/17 or 9/30/18 pension amounts to report its numbers</td>
<td>3. For 2018, the employer would implement using the same measurement date as the plan 12/31/17.</td>
</tr>
<tr>
<td>4. In future years the government would continue to deal with measuring plan liabilities at plan YE and would likely be rolling forward the valuations each year.</td>
<td>4. For future years, the government would only need to update the valuation every other year.</td>
</tr>
</tbody>
</table>
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TOPICS

Qualifying Trusts
Discount Rate Selection
Cash Flows
Investment Related Disclosures
QUALIFYING TRUST*

Requirements¹

• Contributions are irrevocable

• OPEB plan assets for exclusive benefit of plan members
  • Includes OPEB administrative expenses and refunds of employee contribution in accordance with benefit terms

• OPEB plan assets legally protected from creditors of the employer, nonemployer contributing entities, plan administrators and plan members

* Or equivalent arrangement

¹ GASB 75, paragraph 4
QUALIFYING TRUST*

Common Qualifying Trusts

• Integral Part Trust
  • Section 115 trust

• Voluntary Employees Beneficiary Association (VEBA)
  • Section 501(c)(9) trust

• Section 401(h) trust
  • Established within a qualified pension fund

* Or equivalent arrangement
QUALIFYING TRUST*

• Does not qualify
  • Pay as you go (PayGo)
  • Informal set asides within general fund
  • Secondary/stabilization trust
    • Second trust ultimately designed to fund qualifying OPEB trust

• Potentially qualifying
  • Multifunction trust (e.g., active employee/OPEB)
    • *May* qualify if OPEB/non-OPEB assets partitioned
    • Partitioned OPEB assets must meet qualifying trust requirements

* Or equivalent arrangement
DISCOUNT RATE SELECTION

Single Rate Used to Determine Total OPEB Obligation

• Expected rate of return on OPEB plan investments, to the extent that:
  • Fiduciary net position projected to be sufficient to make projected benefit payments, and
    • Based on cash flow projections
    • Investment strategy in place to achieve that return

• To extent conditions above not met:
  • Yield/index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher
    • This is the PayGo discount rate

1 GASB 75, Paragraph 36
DISCOUNT RATE SELECTION¹

Expected Rate of Return

• Current range
  • 6.00% to 7.50%
  • Downward trend since 2009
  • Nominal rate includes inflation

• Consistent with Actuarial Standards of Practice (ASOPs)

• Forward looking
  • Historical rates of return not determinative
  • Various methods available consistent with ASOPs

¹ GASB 75, Paragraph 36
DISCOUNT RATE SELECTION
Bond Buyer GO 20-Bond Municipal Bond Index

Value as of 5/11/2017 is 3.81%
Source: St. Louis Federal Reserve and Bond Buyer
DISCOUNT RATE SELECTION¹
Impact of Discount Rate

• Rule of thumb
  • 100 basis point increase in the discount rate
  • 10% to 15% decrease in Total OPEB Obligation

• Example:
  • 3.50% PayGo discount rate: $100 million Total OPEB Obligation
  • 6.50% qualifying trust discount rate: $70 million Total OPEB Obligation

¹ GASB 75, Paragraph 36
CASH FLOW PROJECTIONS

Employer Contributions

- Cash flow projections determine the single, blended discount rate based on
  - Expected return on plan assets, and
  - 20-year municipal bond rate

- Future cash flows of employer contributions
  - Professional judgement if a formal written policy, statute or contract exists regarding contributions
  - Otherwise, projected contributions are limited to the average contributions of the prior five (5) years

\(^1\) GASB 75, Paragraphs 37 to 39
INVESTMENT-RELATED DISCLOSURES

• Disclosure requirements identical for pension and qualifying OPEB trusts

• OPEB trusts typically own shares of mutual funds, collective investment trusts or external investment pools, **not** the underlying assets

• Example: GASB 72, *Fair Value Measure and Application*
  • Funds typically found to be Level 1 inputs based on following criteria
    • Unit/share prices quoted on a daily basis
    • Fund is actively traded
    • Funds transact at 100 percent of the unit/share value
CLOSING THOUGHTS

• There is still time!

• Qualifying trusts
  • Review in advance with auditor
  • Involve legal counsel as appropriate
  • Confirm qualifying trust in conformance with plan documentation, administrative practices

• Full vs. Partial vs. PayGo Funding
  • Balance sheet impact
  • Budget planning/impact
  • Intergenerational equity
  • Securing the benefit

• Discount rate and cash flow projections
  • Will be impacted by any changes in funding policy
Contacts

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New GASB Pension Accounting Rules

Statements 74 & 75
New GASB Pension Accounting Rules, Statements 74 and 75

- No direct effect on funding or contributions
- Accounting entries on CAFRs will be different than actuarial funding calculations, called the “divorce” of accounting from funding
- You can’t fund the GASB 74/75 OPEB Expense number, even if you try
- Unfunded liabilities will be on the balance sheet: renamed “Net OPEB liability,” and calculated somewhat differently
## Comparison of Old and New GASB OPEB Rules

<table>
<thead>
<tr>
<th></th>
<th>Old GASB, 43 &amp; 45</th>
<th>New GASB, 74 &amp; 75</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Volatile Discount Rate - Varies with High Grade Municipal Tax Exempt Bond Index?</strong></td>
<td>No</td>
<td>No, for well-funded plans (e.g., prefunding ARC, 6.0-8.0% actuarial discount rate) Yes, volatile for others, including PAYGO</td>
</tr>
<tr>
<td><strong>Discount Rate for Prefunded Plans Forecast to Run Out of Money if new hires are not included in forecast</strong></td>
<td>Typically ~6.0%-8.0%</td>
<td>&quot;Blended rate&quot; of actuarial and high grade muni (e.g., <em>Bond Buyer GO 20 rates.</em>)</td>
</tr>
<tr>
<td><strong>Discount Rate for Pay As You Go Plans</strong></td>
<td>Typically ~3.0%-4.5%</td>
<td>Will change from year to year, (e.g., Bond Buyer GO 20 rates). Range of ~2.8% - 6.0% in recent years.</td>
</tr>
<tr>
<td><strong>Market Value/Smoothed Value For Reporting</strong></td>
<td>If there are assets in a trust, market value is allowed, but smoothed actuarial values are more common</td>
<td>Market Value</td>
</tr>
<tr>
<td><strong>Can Accounting Method Be Used For Contributions?</strong></td>
<td>Yes</td>
<td>No (actuarial becomes different from accounting)</td>
</tr>
</tbody>
</table>

*Bond Buyer GO 20-Bond Municipal Bond Index*
<table>
<thead>
<tr>
<th>Pension vs OPEB, Sample Differences Which Can Affect Funding &amp; Portfolios</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pension</strong></td>
</tr>
<tr>
<td>Duration of Liabilities</td>
</tr>
<tr>
<td>Funded ratio</td>
</tr>
<tr>
<td>Growth in assets</td>
</tr>
<tr>
<td>Contributions vs Withdrawals</td>
</tr>
<tr>
<td>Liquidity needs/cash outflow volatility</td>
</tr>
<tr>
<td>Changes in benefits</td>
</tr>
<tr>
<td>Common discount rates</td>
</tr>
<tr>
<td>Investment restrictions</td>
</tr>
<tr>
<td>Mandates to fund ARC</td>
</tr>
<tr>
<td>Big multiemployer plans</td>
</tr>
</tbody>
</table>
Implications for OPEB Prefunding – 1. Contributions & Asset Allocations

- If prefunding, don’t simply copy the asset allocation of your pension plan.
- If given a menu of potential allocations, don’t just select the most popular; OPEB plans vary quite a bit from employer to employer.
- If only placing prefunding money in the trust (i.e., PAYGO paid directly by employer), little or no need for cash allocation at the trust.
- If major OPEB plan changes are contemplated, think carefully before funding amounts now that would be near 100% of liabilities after changes.
- Be careful about any state or local restrictions on investment portfolios (e.g., no tobacco, max % of equity in portfolio, or even no equity allowed).
Implications for OPEB Prefunding – 2. Trust Administration, RFPs

- Many more employers will have to make investment decisions for OPEB than for pensions.
- Will you have an OPEB committee? Who will be on it? Will they need additional education (e.g., investments, accounting, state law)?
- There is considerable variation in how OPEB trusts operate and how fees are charged:
  - OPEB trust RFPs require considerable care.
  - Duties performed by employer may vary considerably.
  - Bundle of services from providers could be quite different.
  - Fees structure and fee transparency can vary considerably between providers.
  - Potential provider conflicts of interest.

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Implications for OPEB Prefunding – 3. OPEB & Pension Correlations

- Rating agencies expected to pay more attention to pension funding than OPEB funding
- Consider whether to try to target total pension + OPEB contributions, rather than treating them completely separately
  - Changes in Pension and OPEB liabilities, or pension and OPEB ARCs often don’t have a high correlation
  - If you currently have little or no funding for OPEB, OPEB investment returns have little effect on unfunded liabilities/NPL
  - May want to consider simulations to develop strategies & policies
Discount Rates

- GASB 74/75 specify use of “index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher” for any OPEB plan projected to run out of money if all actuarial assumptions are met, contributions are as expected, and new hires are not included in the calculations. (source: GASB 75, paragraph 79)

- The Bond Buyer GO 20 Index is often used for blended rate calculations. Another choice is the S&P Muni Bond 20-Year Index. (rate sources: BondBuyer, S&P)

- For pensions, Moody’s recalculates liabilities using the Citi Pension Discount Curve, and might do so for OPEB. (rate source for Citi Curve: Society of Actuaries)
Historical Data

Bond Buyer GO20 Index
S&P Muni Bond 20 Year
Citi Pension Curve - Taxable Corp
Potential Challenges and Issues
Actuaries & Auditors: Knowledge, Timing, Workload, Cost

- Considerable additional work for actuaries, especially the first time
- Many more employers need OPEB actuarial for GASB 74/75 than pension actuarial for GASB 67/68 (pensions are more likely to be in big, multi-employer plans)
- Smaller entities used to get OPEB actuarial studies at a minimum of every three years; now, at a minimum of every two years
- The most common year ends are 6/30, 9/30, and 12/31
  - High peak demand for calculations and services
  - Good idea to get work done early, avoid the rush
- May be delays completing work due to understanding and/or implementing new rules
Official Statement Disclosures

- If you receive GASB 74/75 data which is more recent than what is included in your last CAFR/audit, consult bond/disclosure counsel
  - Likely result is to disclose the most recent actuarial data in your POS/official statement
  - May be discussion regarding studies still in “draft” stage
- Material changes to benefits, funding, or employee contributions could also have occurred since the most recent CAFR
  - Bond/disclosure counsel may recommend describing those changes as well, even if there is no new actuarial study incorporating changes
- Similarly, disclose most recent data to rating agencies
Other Rating Issues

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If you are issuing bonds after receiving your first GASB 74/75 numbers, rating agencies may not yet have fully converted to using the new GASB standards:

- Different fiscal years of different issuers
- Desire to have a broad group for comparison
- Most issuers will not have a history “as if” new rules had been implemented earlier
- Any future changes to rating agency criteria or methodology

Rating agencies typically:

- Appreciate the more extensive disclosure of the new rules
- Like having a single actuarial method
- Like the sensitivity calculations for discount rate and medical trend
- Have been studying the new rules for some time
- Have not yet decided on any changes to methodology
Some employers will show negative net assets

Unlike transition to GASB 67/68, under GASB 74/75 some employers may use higher discount rate for financial statements than actuarial calculations

– For example, an employer might use a PAYGO actuarial discount rate of 3.5% and Bond Buyer GO 20 rate might be over 3.5% at financial statement date

– In a future year, the effects could reverse, with actuarial discount rate less than Bond Buyer GO 20 rate

Especially early on, consider having someone who is very well versed in GASB 74/75 assist with rating presentation:

– Perhaps the actuary, but check with them in advance

– Municipal advisor that has an OPEB specialist

– Internal staff expert, even if person is not usually on rating calls
Disclosure

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