



City of Cambridge

FINANCE DEPARTMENT

LOUIS DePASQUALE

Assistant City Manager/Finance

MEMORANDUM

TO: Robert W. Healy
City Manager

FROM: Louis DePasquale, James Monagle, David Kale, Michele Kincaid, Sheila Keady-Rawson, David Holland, Michael P. Gardner

DATE: November 24, 2009

RE: GASB 45 OPEB Actuarial Study

We have received a report dated November 4, 2009 from Chris Grabrian of Gallagher Benefit Services and their subsidiary, Healthcare Analytics, on the actuarial valuation of City of Cambridge post employment welfare benefits as of January 1, 2009. We have met several times to review the study and prepare recommendations for going forward, to account for our OPEB obligations as required in future financial reports.

Study Methodology

The report is based upon information supplied by the City, including demographic data about our employees, retirees and their dependents, and the plan designs for our benefit plans available to retirees. The report is structured using some of the same methodologies as our original, baseline report conducted by the Segal Company in 2007¹. For example, the study continues to use the "Projected Unit Credit" actuarial method (which is the method required under FASB 106 for private sector OPEB accounting) for determining liabilities. The study includes exhibits that show different outcomes based upon changes in other assumptions, such as interest rates and the rate of health care cost growth. Because of the long time frame involved, small changes in these assumptions can have a major impact on estimated actual costs. The study uses healthcare cost increase assumptions over time as recommended by the actuary, based on medical trend rates observed in the marketplace, and the City's experience compared to the marketplace.

The investment return variable (discount rate) recommended by the actuary is 4.5%, assuming we will continue on a pay-as-you-go method. This rate is 50 basis points lower than the discount rate used in the previous study, based upon the recommendation of the actuary. The new study also recommends that an 8.00% interest rate be applied when the City begins to contribute funds to an irrevocable trust to pay for this expense.

¹ Gallagher Benefits was selected to complete this actuarial study as of Dec. 31, 2008 based upon a competitive bidding process. They were the low bidder, hence the change in actuarial companies to complete the study.



Using these assumptions, the actuary determined that the **Unfunded Actuarial Accrued Liability (UAAL)** as of January 1, 2009 was \$586,433,000. As of July 1, 2009, the UAAL was \$598,995,000.

This is somewhat lower than the UAAL reported in the prior study. At our request Gallagher Benefit Services identified a number of factors that contributed to both increasing and decreasing the estimated liability compared to the previous study. The actuary has provided a summary of the factors contributing to increasing and decreasing ultimate costs.

Annual Required Contributions of the Employer (ARC)

The Governmental Accounting Standards Board (GASB) requires the determination of an employer's annual OPEB cost equal to the annual required contribution of the employer (ARC). The components of the ARC include the Normal Cost, i.e. the amount of money required each year to meet just the cost of benefits earned by active employees in the following year; and the Amortization Payment needed to pay off the unfunded liability.

The **Normal Cost** of this obligation (that is, the portion of the present value of future benefits that is allocated to the calendar year 2009 for active plan members) is \$18, 957,000, as of January 1, 2009. This amount, as of July 1, 2009 is \$19,379,000 for the next fiscal year. The Annual Required Contribution of the employer, combining the Normal Cost and the amortization of the unfunded liability (see below), adjusted for interest obligations and a discount for present value of the net OPEB Obligation, is \$44,893,000 for the period July 1, 2009 through June 30, 2010.

Amortization Schedules

To determine the amortization payment on the unfunded actuarial accrued liability, one must pick an amortization period and amortization method. Our earlier study selected a 30 year amortization period (the longest permitted under GASB). We are now two years into this period. GASB allows two methods of setting annual payments, either level dollar or level percentage of payroll. We did not consider the option of level dollar funding, based upon the difficulty of meeting the initial cost. The amortization method option was done as a level percentage of payroll, assuming payroll increases of 3.5% per year.

Information on Costs and Reporting on a Pay-As-You-Go Basis

The report describes what the Annual Required Contribution is using a 4.5% discount rate assumption (pay-as-you-go), while also applying the Projected Unit Credit actuarial cost method and a 30-year 4.5% increasing amortization payment. Page 2-3 of the report shows the structure of one of the items that is to be reported in future years, the Net OPEB Obligation, or NOO, which is the difference between the ARC referred to above and the actual payments made in any given year. As stated in some of the explanatory materials published by the GASB about GASB 45:

The Net OPEB Obligation (not the same as the UAAL) will increase rapidly over time if, for example, a government's OPEB financing policy is pay-as-you-go, and the amounts paid for current premiums are much less than the annual OPEB cost.

The NOO beginning July 1, 2009 is estimated at \$41,747,000. The chart on p.2-3 shows that the NOO at the end of fiscal 2010 is estimated to increase to \$65,720,000. The NOO will continue to grow, to the extent our annual contributions are less than the annual OPEB cost.

Future Funding Recommendations

In January 2009 the state legislature enacted permissive legislation to allow cities and towns to create trust funds to permanently set aside monies to help fund OPEB unfunded liabilities². The City has not yet accepted this legislation, but should do so now.

It is recommended that the City Council be requested to accept this statute, Chapter 479 of the Acts of 2008, a copy of which is attached. This would enable the City to establish a permanent irrevocable trust fund to set aside monies to begin to cover this liability.

There are several possible funding sources for such a trust, which have been discussed in the past. We recommend that the City begin by using one source that is immediately available: the Health Claims Trust account. This account, which was set up nearly twenty-five years ago, is designed to be a source of revenue in any year where health claims greatly exceed expectations (and appropriation). Since inception, the fund has not had to be tapped for this purpose. It currently has approximately \$17.7 million available.³ We believe it would be fiscally prudent to transfer \$2 million initially from this account, and place it in the new OPEB Trust fund. Once transferred into this irrevocable trust it could not be used for any other purpose.⁴ Once an initial transfer was made, the City would be able to evaluate the status of the Health Claims Trust fund annually, and, assuming the fund maintained a healthy balance sufficient to cover possible excess claims, consider whether it remained prudent to transfer a similar amount on an on-going, annual basis for meeting future OPEB claims.

A second source might be an annual appropriation to such a fund. Given the extreme fiscal pressures the City faces in these turbulent economic times, with the loss of substantial state aid, such an appropriation is not likely in the immediate future.

A third potential source of such funding might be applying funds that would otherwise be appropriated to the Retirement Board, once the City meets its unfunded liability for pensions, and becomes fully funded. The Retirement Board will be conducting its biennial actuarial study of pension funding effective January 1, 2010. After completion of that study we will learn when, under the current funding schedule, the unfunded liability will be met. When the unfunded pension liability is met, funds should be available to

² Chapter 479 of the Acts of 2008

³ The fund also serves as the revolving account for the receipt of employee and retiree health insurance contributions. These funds are used to help finance annual health claims costs.

⁴ The current Health Claims Trust account has no such legal restriction.

apply to the OPEB liability. This is not likely to occur in the near term; thus it is recommended to begin with transfers from the Health Claims Trust account.

Conclusion

Overall, the report reflects positive results as a result of the proactive actions taken by the City, such as increasing the contribution rate for retiree health insurance from 10% to 15% effective October 1, 2009. The report has applied more conservative assumptions in the latest study, such as lowering long-term rate of return on assets from 5% to 4.5%, and increasing healthcare cost trends. The report also includes adjustments to certain trends to more accurately reflect current demographics. Overall, the City has positioned itself to address the OPEB liability in an orderly and planned manner in the future, which has been recognized by the rating agencies as part of its positive credit rating.

The first step in the process we are recommending would be to request that the Cambridge City Council accept Chapter 479 of the Acts of 2008, providing for the establishment of an OPEB liability trust fund. This trust fund is an irrevocable trust and assets can only be used to fund the OPEB liability

As noted earlier, the City has been evaluating strategies to fund the OPEB liability prior to receiving its initial evaluation in 2007, as well as waiting for legislation to be enacted to allow cities and towns to establish an OPEB Trust Fund.

Now that the second OPEB study has been completed and legislation has been enacted in 2009 to allow the City to establish an OPEB Trust Fund, it would be prudent for the City to establish an OPEB Trust Fund in concert with an initial appropriation, while awaiting the completion of the Pension Actuarial Study in 2010. As you are aware, the current actuarial study has the City fully funding its pension liability in 2013, which would allow approximately \$13 million annually to be reallocated to OPEB liability funding. While we believe that this date may change based on the decline in the stock market since the last study, the City should still be able to meet its obligation well before the 2030 deadline. It should also be noted that there are proposals to extend the deadline to 2040.

Therefore, we are recommending the best source of initial funding to the OPEB Trust Fund is a transfer from the Health Claims Trust account. It is recommended that an initial transfer of \$2 million from the Health Claims Trust Fund be authorized as soon as the legislation is accepted and the trust established according to its terms. In addition, this Committee will continue to review possible funding sources to allow for an annual contribution based on financial conditions of the City.

The General Laws of Massachusetts

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CHAPTER 32B. CONTRIBUTORY GROUP GENERAL OR BLANKET INSURANCE FOR PERSONS IN THE SERVICE OF COUNTIES, CITIES, TOWNS AND DISTRICTS, AND THEIR DEPENDENTS**Chapter 32B: Section 20. Other Post Employment Benefits Liability Trust Fund; local option; funding schedule**

[Text of section added by 2008, 479 effective January 10, 2009.]

Section 20. A city, town, district, county or municipal lighting plant that accepts this section, may establish a separate fund, to be known as an Other Post Employment Benefits Liability Trust Fund, and a funding schedule for the fund. The schedule and any future updates shall be designed, consistent with standards issued by the Governmental Accounting Standards Board, to reduce the unfunded actuarial liability of health care and other post-employment benefits to zero as of an actuarially acceptable period of years and to meet the normal cost of all such future benefits for which the governmental unit is obligated. The schedule and any future updates shall be: (i) developed by an actuary retained by a municipal lighting plant or any other governmental unit and triennially reviewed by the board for a municipal lighting plant or by the chief executive officer of a governmental unit; and (ii) reviewed and approved by the actuary in the public employee retirement administration commission.

The board of a municipal lighting plant or the legislative body of any other governmental unit may appropriate amounts recommended by the schedule to be credited to the fund. Any interest or other income generated by the fund shall be added to and become part of the fund. Amounts that a governmental unit receives as a sponsor of a qualified retiree prescription drug plan under 42 U.S.C. 1395w-132 may be added to and become part of the fund.

The custodian of the fund shall be: (i) a designee appointed by the board of a municipal lighting plant; or (ii) the treasurer of any other governmental unit. Funds shall be invested and reinvested by the custodian consistent with the prudent investor rule set forth in chapter 203C.

This section may be accepted in a city having a Plan D or Plan E charter by vote of the city council; in any other city by vote of the city council and approval of the mayor; in a town by vote of the town at a town meeting; in a district by vote of the governing board; in a municipal lighting plant by vote of the board; and in a county by vote of the county commissioners.

CITY OF CAMBRIDGE

**ACTUARIAL VALUATION OF
POSTEMPLOYMENT BENEFIT PLAN AS OF
JANUARY 1, 2009**

November 4, 2009



Healthcare Analytics

a Division of Gallagher Benefit Services, Inc.

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Scope

This report presents the results of the actuarial valuation of the City of Cambridge (“City”) postemployment benefit plan (other than pensions) as of the valuation date of January 1, 2009 under the Governmental Accounting Standards Board Statement No. 45 (GASB 45).

The purpose of the report is to:

- Determine the plan’s liabilities as of January 1, 2009,
- Determine the Annual Required Contribution (ARC) and annual OPEB expense for the period July 1, 2009 to June 30, 2009 under GASB Statement No. 45 (GASB 45),
- Provide an estimate of the June 30, 2009 net OPEB obligation and,
- Document actuarial assumptions and plan provisions used in the January 1, 2009 actuarial valuation.

Postemployment Benefits

The City provides postemployment benefits for eligible participants enrolled in the City sponsored plans. The benefits are provided in the form of:

- An implicit rate subsidy where pre 65 retirees receive health insurance coverage by paying a combined retiree/active rate.
- An explicit subsidy where pre 65 and post 65 retirees receive contributions from the City for their health plans.

Section 7 describes the postemployment benefits and plan provisions.

Methods and Assumptions

GASB 45 allows the use of one of several actuarial cost methods. These cost methods allocate the OPEB costs differently. The method used in this valuation is the **Unit Credit**. This method is the only method allowed under the Financial Accounting Standards Board’s corresponding statement, *Statement of Financial Accounting Standards No. 106*.

The valuation results are developed assuming a **discount rate** of 4.50%. Under GASB 45, the discount rate to be used for the valuation is determined based on the long term investment yield on the investments used to finance the payment of benefits. For this valuation it is assumed that postemployment benefits are paid from general assets which generally consist of short-term investments. If the City is considering prefunding or transferring assets to a trust, or equivalent arrangement, in which plan assets are established and dedicated to providing benefits to retirees and beneficiaries in accordance with the terms of the plan, the determination of the discount rate would be based on the nature and mix of current and expected investments. The City should consult with its auditors in selecting an appropriate discount rate. Alternative valuation results are provided in Section 5 assuming discount rates of 5.00% and 8.00% in the event the City wishes to determine the impact of a change in the discount rate on its annual OPEB expense.

Other critical assumptions used in the actuarial valuation are the health care cost trend rate and participation assumptions. The health care cost trend assumption is used to project the cost of health care to future years. The valuation uses a **health care cost trend rate assumption** of 11.00% initially grading down by 0.50% each year to an ultimate trend rate of 5.00% in 2021 for the healthcare plans. The Medicare Part B premium assumes a trend rate of 6.00% initially grading down by 0.25% each year to an ultimate trend rate of 5.00%.

The **participation assumption** is the assumed percentage of future retirees that participate and enroll in the healthcare plan. In absence of any recent postemployment plan participant enrollment data, the participation assumption used in this valuation is 100% and is based on the participant's share of the cost of postemployment health plan. The City should monitor the healthcare plan participant enrollment in future years in case this assumption needs to be revised.

Liabilities

The **actuarial accrued liability** is the present value of future benefits which is attributable to past service. The actuarial accrued liability of the City's postemployment benefit plan as of January 1, 2009 is \$586,433,000. The **unfunded actuarial accrued liability** is the difference between the actuarial accrued liability and the actuarial value of plan assets. **Plan assets** are financial assets that are segregated and restricted in a trust (or equivalent arrangement). Assets in this trust are dedicated to providing benefits to plan participants and are legally protected from creditors of employers. Since there are no plan assets, the unfunded actuarial accrued liability for the City's postemployment benefit plan is the same as the actuarial accrued liability, \$586,433,000.

The **normal cost** is the portion of the present value of future benefits that is allocated to the current year for active plan members. The normal cost for the active members of the City's postemployment benefit plan for the period January 1, 2009 to December 31, 2009 is \$18,957,000.

The table below summarizes the City's postemployment benefit plan liabilities.

	January 1, 2009	July 1, 2009
Accrued Actuarial Liability	\$586,433,000	\$598,995,000
Normal Cost	\$18,957,000	\$19,379,000

Annual OPEB Cost and Annual Required Contribution

The major component of the **annual OPEB cost** is the **annual required contribution** (ARC). The ARC is the sum of the normal cost and the amortization of the unfunded actuarial accrued liability. The unfunded actuarial accrued liability is amortized over the maximum allowable period of 30 years on a closed basis. The ARC for the City's postemployment benefit plan for the period July 1, 2009 to June 30, 2010 is \$44,704,000 which is comprised of the normal cost (plus interest) of \$19,810,000 and amortization of unfunded actuarial accrued liability (plus interest) of \$24,894,000.

The other components of the annual OPEB cost are one year's interest on the **net OPEB obligation** (defined below) at the beginning of the year and **adjustment to the ARC**. The adjustment to the ARC is the discounted present value of the net OPEB obligation at the beginning of the year. Since the City adopted GASB 45 in fiscal year 2008, the net OPEB obligation at June 30, 2009 is equal to the underfunding of the ARC during fiscal years 2008 and 2009. The net OPEB obligation is estimated to be \$41,747,000 as of June 30, 2009.

The table below summarizes the annual OPEB cost for the City's postemployment benefit plan for the period July 1, 2009 to June 30, 2010.

	Annual OPEB Cost
ARC	\$44,704,000
Interest on Net OPEB Obligation	\$1,879,000
Adjustment to ARC	(\$1,690,000)
Total	\$44,893,000

It is important to note that GASB 45 does not require the City to prefund an amount equal to the ARC. The ARC represents an accounting expense. The City should report the OPEB expense for the year equal to the annual OPEB cost.

Net OPEB Obligation and Recognition in Financial Statements

The **net OPEB obligation** (NOO) is the cumulative difference between the annual OPEB cost and the employer's contributions to the plan since the City's adoption date of GASB 45. A positive (negative) year-end balance in the net OPEB obligation should be recognized as a year-end liability (asset) in the City's financial statements.

Estimates of the net OPEB obligation for fiscal year ends June 30, 2008 through June 30, 2010 are shown below. The employer contribution is estimated to be the pay-as-you-go (i.e. expected postemployment benefit payments less participant contributions) for each period.

	FY 08	FY 09	FY 10
Net OPEB Obligation – Beginning of Year	\$0	\$20,363,504	\$41,747,000
Annual OPEB Cost	\$37,485,904	\$39,526,820	\$44,893,000
Employer Contributions*	\$17,122,400	\$18,143,112	\$20,920,000
Increase in Net OPEB Obligation	\$20,363,504	\$21,383,708	\$23,973,000
Net OPEB Obligation – End of Year	\$20,363,504	\$41,747,213	\$65,720,000

* Estimated using pay as you go

Under GASB 45, an employer has made contributions if the employer has done one or more of the following:

- 1) Made payments of benefits directly to or on behalf of a retiree or beneficiary
- 2) Made premium payments to an insurer
- 3) Irrevocably transferred assets to a trust, or equivalent arrangement, in which plan assets are dedicated to providing benefits to retirees and beneficiaries in accordance with the terms of the plan and are legally protected from creditors of the employer or plan administrator.

Earmarking of employer assets or other means of financing that do not meet the conditions above do not constitute employer contributions.

The actual year-end net OPEB obligation can be determined once the contribution information is available later in the year. If the City needs assistance in determining the year-end net OPEB obligation, they would be advised to contact Healthcare Analytics.

Actuarial Certification

At the request of City of Cambridge, Healthcare Analytics, a division of Gallagher Benefit Services, Inc., has completed an actuarial valuation as of January 1, 2009 under Statement No. 45 of the Governmental Accounting Standards Board (GASB 45). The calculations derived for this report have been made on a basis consistent with our understanding of GASB 45. The valuation has been conducted in accordance with generally accepted actuarial principles and practices. The results of this report are to be used solely for the purpose of meeting employer financial accounting requirements.

In preparing the results of this report, we have relied on employee data, plan information and claims data provided by City of Cambridge. While the scope of the engagement did not call for us to perform an audit or independent verification of this information, we reviewed it for reasonableness. The accuracy of the results presented in the report is dependent upon the accuracy and completeness of the underlying information.

The undersigned is a member of the American Academy of Actuaries and meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

Respectfully submitted,
Healthcare Analytics



Chris Grabrian, EA, ASA, MAAA
Consulting Actuary
November 4, 2009
(952) 356-0706

The following tables provide a summary of participant counts, actuarial accrued liability by source and type, and unfunded actuarial accrued liability as of January 1, 2009.

NUMBER OF PARTICIPANTS	
Actives (Fully Eligible)	830
Actives (Not Fully Eligible)	1,956
Retirees	2,168
TOTAL	4,954

ACTUARIAL ACCRUED LIABILITY (AAL)	
BY EMPLOYEE TYPE	
Actives (Fully Eligible)	\$156,421,000
Actives (Not Fully Eligible)	\$91,988,000
TOTAL ACTIVES	\$248,409,000
Retirees	\$338,024,000
TOTAL	\$586,433,000
BY BENEFIT	
Medical Claims	\$265,460,000
Administration	\$11,548,000
Medical Contributions	(\$164,744,000)
Medical Subsidy	\$401,616,000
Medicare Part B Subsidy	\$67,975,000
Life Subsidy	\$4,578,000
TOTAL	\$586,433,000
BY SUBSIDY TYPE	
Explicit Subsidy	\$474,169,000
Implicit Subsidy	\$112,264,000
TOTAL	\$586,433,000
BY AGE	
Actives (<65)	\$80,893,000
Actives (65+)	\$167,516,000
TOTAL ACTIVES	\$248,409,000
Retirees (<65)	\$72,322,000
Retirees (65+)	\$265,702,000
TOTAL RETIREES	\$338,024,000
TOTAL	\$586,433,000

UNFUNDED ACTUARIAL ACCRUED LIABILITY (UAAL)	
Actuarial Accrued Liability	\$586,433,000
Plan Assets	\$0
Unfunded Actuarial Accrued Liability	\$586,433,000

The Actuarial Accrued Liability as of July 1, 2009 is \$598,995,000.

The following tables provide the annual required contribution (“ARC”) for the period July 1, 2009 to June 30, 2010 and an estimate of the net OPEB obligation as of June 30, 2010.

ANNUAL REQUIRED CONTRIBUTION (ARC)	
Normal Cost	\$19,379,000
Interest on Normal Cost	\$431,000
Amortization Payment	\$24,352,000
Interest on Amortization Payment	\$542,000
TOTAL	\$44,704,000

NET OPEB OBLIGATION *	
Net OPEB Obligation - Beginning of Year	\$41,747,000
ARC	\$44,704,000
Interest on prior year NOO	\$1,879,000
Adjustment to ARC	(\$1,690,000)
Annual OPEB Cost	\$44,893,000
Employer Contributions *	\$20,920,000
Increase in Net OPEB Obligation	\$23,973,000
Net OPEB Obligation – End of Year	\$65,720,000
Percentage of OPEB Cost Contributed	46.60%

* Estimated using expected pay-as-you-go cost.

The following exhibit illustrates the impact of a 1% change in the health care trend rates:

		POSTEMPLOYMENT BENEFIT PLAN	
		Plus 1%	Minus 1%
VALUATION RESULTS			
ACTUARIAL ACCRUED LIABILITY (AAL)			
TOTAL		\$691,904,000	\$514,343,000
UNFUNDED ACTUARIAL ACCRUED LIABILITY (UAAL)			
TOTAL		\$691,904,000	\$514,343,000
ANNUAL REQUIRED CONTRIBUTION (ARC)			
Normal Cost		\$23,488,000	\$14,888,000
Interest on Normal Cost		\$1,057,000	\$670,000
Amortization Payment		\$26,422,000	\$19,642,000
Interest on Amortization Payment		\$1,189,000	\$884,000
TOTAL		\$52,156,000	\$36,084,000
IMPACT OF TREND CHANGE			
ACTUARIAL ACCRUED LIABILITY (AAL)			
TOTAL		\$105,471,000	(\$72,090,000)
% CHANGE		17.99%	-12.29%
TOTAL		\$105,471,000	(\$72,090,000)
% CHANGE		17.99%	-12.29%
Normal Cost		\$4,531,000	(\$4,069,000)
Interest on Normal Cost		\$204,000	(\$183,000)
Amortization Payment		\$4,027,000	(\$2,753,000)
Interest on Amortization Payment		\$181,000	(\$124,000)
TOTAL		\$8,943,000	(\$7,129,000)
% CHANGE		20.70%	-16.50%

The following exhibit provides valuation results at 5.0% and 8.0% discount rates:

POSTEMPLOYMENT BENEFIT PLAN		
	Discount Rate 5.00%	Discount Rate 8.00%
VALUATION RESULTS		
ACTUARIAL ACCRUED LIABILITY (AAL)		
TOTAL	\$550,634,000	\$372,187,000
UNFUNDED ACTUARIAL ACCRUED LIABILITY (UAAL)		
TOTAL	\$550,634,000	\$372,187,000
ANNUAL REQUIRED CONTRIBUTION (ARC)		
Normal Cost	\$16,596,000	\$8,905,000
Interest on Normal Cost	\$830,000	\$712,000
Amortization of Unfunded Accrued Liability	\$22,438,000	\$21,507,000
Interest on Amortization	\$1,122,000	\$1,721,000
TOTAL	\$40,986,000	\$32,845,000
IMPACT OF DISCOUNT RATE CHANGE		
ACTUARIAL ACCRUED LIABILITY (AAL)		
TOTAL	(\$35,799,000)	(\$214,246,000)
% CHANGE	-6.10%	-36.53%
TOTAL	(\$35,799,000)	(\$214,246,000)
% CHANGE	-6.10%	-36.53%
Normal Cost	(\$2,361,000)	(\$10,052,000)
Interest on Normal Cost	(\$23,000)	(\$141,000)
Amortization Payment	\$43,000	(\$888,000)
Interest on Amortization Payment	\$114,000	\$713,000
TOTAL	(\$2,227,000)	(\$10,368,000)
% CHANGE	-5.15%	-23.99%

30-YEAR SUMMARY OF PROJECTIONS

The following exhibit provides the expected cash flows for the postemployment benefit plan based on the current population, plan provisions and actuarial assumptions:

Year	Benefit Payments	Retiree Contributions	Explicit Subsidies	Net Benefit Payments
1 st Year	\$13,802,000	(\$8,693,000)	\$15,022,000	\$20,131,000
2 nd Year	\$14,828,000	(\$9,328,000)	\$16,209,000	\$21,709,000
3 rd Year	\$16,250,000	(\$10,162,000)	\$17,699,000	\$23,787,000
4th Year	\$17,333,000	(\$10,831,000)	\$19,197,000	\$25,699,000
5th Year	\$17,809,000	(\$11,111,000)	\$20,590,000	\$27,288,000
6th Year	\$18,670,000	(\$11,695,000)	\$22,248,000	\$29,223,000
7th Year	\$19,567,000	(\$12,225,000)	\$23,914,000	\$31,256,000
8th Year	\$20,513,000	(\$12,888,000)	\$25,765,000	\$33,390,000
9th Year	\$21,259,000	(\$13,366,000)	\$27,542,000	\$35,435,000
10th Year	\$22,151,000	(\$14,002,000)	\$29,480,000	\$37,629,000
11th Year	\$23,244,000	(\$14,692,000)	\$31,529,000	\$40,081,000
12th Year	\$23,803,000	(\$15,030,000)	\$33,347,000	\$42,120,000
13th Year	\$24,155,000	(\$15,292,000)	\$35,008,000	\$43,871,000
14th Year	\$24,585,000	(\$15,467,000)	\$36,429,000	\$45,547,000
15th Year	\$24,850,000	(\$15,625,000)	\$37,871,000	\$47,096,000
16th Year	\$25,427,000	(\$15,995,000)	\$39,428,000	\$48,860,000
17th Year	\$25,458,000	(\$16,082,000)	\$40,795,000	\$50,171,000
18th Year	\$26,184,000	(\$16,554,000)	\$42,307,000	\$51,937,000
19th Year	\$25,659,000	(\$16,229,000)	\$43,400,000	\$52,830,000
20th Year	\$26,502,000	(\$16,776,000)	\$44,908,000	\$54,634,000
21st Year	\$26,330,000	(\$16,784,000)	\$46,175,000	\$55,721,000
22nd Year	\$27,314,000	(\$17,470,000)	\$47,737,000	\$57,581,000
23rd Year	\$27,627,000	(\$17,668,000)	\$48,921,000	\$58,880,000
24th Year	\$27,751,000	(\$17,690,000)	\$49,906,000	\$59,967,000
25th Year	\$26,258,000	(\$16,784,000)	\$50,435,000	\$59,909,000
26th Year	\$25,532,000	(\$16,239,000)	\$51,005,000	\$60,298,000
27th Year	\$23,859,000	(\$15,165,000)	\$51,201,000	\$59,895,000
28th Year	\$22,357,000	(\$14,176,000)	\$51,335,000	\$59,516,000
29th Year	\$21,476,000	(\$13,633,000)	\$51,478,000	\$59,321,000
30th Year	\$20,572,000	(\$12,966,000)	\$51,328,000	\$58,934,000

30-YEAR SUMMARY OF PROJECTIONS

The following exhibit provides funding projections based on plan provisions and actuarial assumptions presented in sections 7 and 8.

Fiscal Year Ended June 30	Projected Benefit Payments	Normal Cost With Interest	Amortization of UAAL With Interest	Total Funding Requirement	Additional Funding	Assets at End of Year	AAL at End of Year	UAAL at End of Year
2010	\$20,920,000	\$19,810,206	\$24,894,243	\$44,704,450	\$0	\$0	\$624,815,456	\$624,815,456
2011	\$22,748,000	\$19,810,206	\$26,714,695	\$46,524,901	\$0	\$0	\$649,928,984	\$649,928,984
2012	\$24,743,000	\$21,633,240	\$28,598,560	\$50,231,800	\$0	\$0	\$675,996,829	\$675,996,829
2013	\$26,493,000	\$21,633,240	\$30,616,680	\$52,249,920	\$0	\$0	\$701,448,785	\$701,448,785
2014	\$28,255,000	\$23,624,039	\$32,716,131	\$56,340,170	\$0	\$0	\$728,279,970	\$728,279,970
2015	\$30,240,000	\$23,624,039	\$34,981,973	\$58,606,013	\$0	\$0	\$754,289,387	\$754,289,387
2016	\$32,323,000	\$25,798,041	\$37,338,331	\$63,136,372	\$0	\$0	\$781,562,254	\$781,562,254
2017	\$34,413,000	\$25,798,041	\$39,874,824	\$65,672,866	\$0	\$0	\$807,925,893	\$807,925,893
2018	\$36,532,000	\$28,172,106	\$42,517,914	\$70,690,020	\$0	\$0	\$835,736,637	\$835,736,637
2019	\$38,855,000	\$28,172,106	\$45,369,165	\$73,541,271	\$0	\$0	\$862,424,172	\$862,424,172
2020	\$41,100,000	\$30,764,644	\$48,341,291	\$79,105,936	\$0	\$0	\$890,667,917	\$890,667,917
2021	\$42,995,000	\$30,764,644	\$51,549,919	\$82,314,563	\$0	\$0	\$918,245,462	\$918,245,462
2022	\$44,709,000	\$33,595,761	\$54,923,273	\$88,519,034	\$0	\$0	\$948,205,972	\$948,205,972
2023	\$46,321,000	\$33,595,761	\$58,593,887	\$92,189,648	\$0	\$0	\$977,866,834	\$977,866,834
2024	\$47,978,000	\$36,687,410	\$62,475,132	\$99,162,543	\$0	\$0	\$1,010,329,010	\$1,010,329,010
2025	\$49,515,000	\$36,687,410	\$66,704,352	\$103,391,762	\$0	\$0	\$1,042,680,781	\$1,042,680,781
2026	\$51,054,000	\$40,063,569	\$71,189,036	\$111,252,605	\$0	\$0	\$1,078,366,422	\$1,078,366,422
2027	\$52,384,000	\$40,063,569	\$76,082,966	\$116,146,535	\$0	\$0	\$1,114,298,321	\$1,114,298,321
2028	\$53,732,000	\$43,750,419	\$81,290,405	\$125,040,825	\$0	\$0	\$1,154,238,050	\$1,154,238,050
2029	\$55,178,000	\$43,750,419	\$86,981,252	\$130,731,671	\$0	\$0	\$1,194,496,891	\$1,194,496,891
2030	\$56,651,000	\$47,776,552	\$93,040,675	\$140,817,226	\$0	\$0	\$1,239,177,324	\$1,239,177,324
2031	\$58,231,000	\$47,776,552	\$99,655,873	\$147,432,425	\$0	\$0	\$1,284,253,219	\$1,284,253,219
2032	\$59,424,000	\$52,173,189	\$106,703,542	\$158,876,731	\$0	\$0	\$1,334,632,455	\$1,334,632,455
2033	\$59,938,000	\$52,173,189	\$114,406,970	\$166,580,159	\$0	\$0	\$1,386,753,318	\$1,386,753,318
2034	\$60,104,000	\$56,974,427	\$122,666,926	\$179,641,352	\$0	\$0	\$1,445,958,004	\$1,445,958,004
2035	\$60,096,000	\$56,974,427	\$126,960,268	\$183,934,695	\$0	\$0	\$1,507,835,078	\$1,507,835,078
2036	\$59,705,000	\$62,217,498	\$136,345,839	\$198,563,338	\$0	\$0	\$1,578,256,064	\$1,578,256,064
2037	\$59,418,000	\$62,217,498	\$146,659,288	\$208,876,786	\$0	\$0	\$1,652,139,381	\$1,652,139,381
2038	\$59,127,000	\$67,943,064	\$90,739,024	\$158,682,088	\$0	\$0	\$1,735,497,895	\$1,735,497,895
2039	\$58,418,000	\$67,943,064	\$95,491,487	\$163,434,550	\$0	\$0	\$1,823,332,319	\$1,823,332,319

Eligibility

Members of Group 1, 2 and 4 may retire upon the attainment of age 55 with 10 years of creditable service or a total of 20 years of creditable service regardless of age.

Benefit Design

Non-Medicare Eligible Retirees

Non-Medicare eligible retirees receive health care coverage through one of five self insured medical plans offered. A summary of the key plan design features for each plan is provided in the tables below.

Blue Choice

	In-Network	Out-of-Network
Deductible (2X Family)	None	\$500
Coinsurance	100%	80%
Coinsurance Maximum (Single/Family)	None	\$1,500/\$2000
Office Visit Benefit	\$15 copayment	80% after ded.
Emergency Room Benefit	\$75 copayment, waived if admitted	
Rx Drug Copayments		
Generic	Retail - \$10, Mail Order - \$10	
Preferred	Retail - \$30, Mail Order - \$30	
Non-Preferred	Retail - \$50, Mail Order - \$50	

HMO Blue

Deductible	None
Coinsurance	100%
Annual Out of Pocket Maximum	None
Office Visit Benefit	\$15 copayment
Emergency Room Benefit	\$75 copayment, waived if admitted
Rx Drug Copayments	
Generic	Retail - \$10, Mail Order - \$10
Preferred	Retail - \$30, Mail Order - \$30
Non-Preferred	Retail - \$50, Mail Order - \$50

Advantage Blue

Coinsurance	100%
Annual Out of Pocket Maximum	None
Office Visit Benefit	\$20 copayment
Emergency Room Benefit	\$75 copayment, waived if admitted
Rx Drug Copayments	
Generic	Retail - \$10, Mail Order - \$10
Preferred	Retail - \$30, Mail Order - \$30
Non-Preferred	Retail - \$50, Mail Order - \$50

Harvard Pilgrim

Coinsurance	100%
Annual Out of Pocket Maximum (2X Family)	None
Office Visit Benefit	\$15 copayment
Emergency Room Benefit	\$75 copayment, waived if admitted
Rx Drug Copayments	
Generic	Retail - \$10, Mail Order - \$20
Preferred	Retail - \$30, Mail Order - \$60
Non-Preferred	Retail - \$50, Mail Order - \$150

Tufts

Coinsurance	100%
Annual Out of Pocket Maximum (2X Family)	None
Office Visit Benefit	\$15 copayment
Emergency Room Benefit	\$75 copayment, waived if admitted
Rx Drug Copayments	
Generic	Retail - \$10, Mail Order - \$20
Preferred	Retail - \$30, Mail Order - \$60
Non-Preferred	Retail - \$50, Mail Order - \$100

Medicare Eligible Retirees

Medicare eligible retirees receive health care coverage through one of five fully insured medical plans and a self/fully insured Medex II plan (self insured medical and fully insured Rx) offered only to grandfathered retirees. A summary of the key plan design features for each plan is provided in the tables below.

Medex II

Medical	
Hospital Inpatient	100%
Office Visit Benefit	N/A
Rx Drug Copayments	
Generic	Retail - \$10, Mail Order - \$20
Preferred	Retail - \$25, Mail Order - \$50
Non-Preferred	Retail - \$45, Mail Order - \$90

Managed Blue for Seniors

Medical	
Hospital Inpatient	100%
Office Visit Benefit	\$10
Rx Drug Copayments	
Generic	Retail - \$10, Mail Order - \$20
Preferred	Retail - \$25, Mail Order - \$50
Non-Preferred	Retail - \$45, Mail Order - \$90

Blue Medicare PFFS

Medical	
Hospital Inpatient	\$100 Ded/100% Coinsurance
Office Visit Benefit	\$15
Rx Drug Copayments	
Generic	Retail - \$10, Mail Order - \$20
Preferred	Retail - \$25, Mail Order - \$50
Non-Preferred	Retail - \$45, Mail Order - \$90

First Seniority Freedom (Harvard Pilgrim)

Medical	
Hospital Inpatient	100%
Office Visit Benefit	\$15
Rx Drug Copayments	
Generic	Retail - \$10, Mail Order - \$20
Preferred	Retail - \$20, Mail Order - \$40
Non-Preferred	Retail - \$35, Mail Order - \$105

Tufts Medicare HMO

Medical	
Hospital Inpatient	\$200 Ded./ 100% Coinsurance
Office Visit Benefit/Specialist Visit	\$10/\$15
Rx Drug Copayments	
Generic	Retail - \$10, Mail Order - \$20
Preferred	Retail - \$25, Mail Order - \$50
Non-Preferred	Retail - \$50, Mail Order - \$100

Tufts PFFS

Medical	
Hospital Inpatient	\$200 Ded/100% Coinsurance
Office Visit Benefit	\$15
Rx Drug Copayments	
Generic	Retail - \$10, Mail Order - \$20
Preferred	Retail - \$25, Mail Order - \$50
Non-Preferred	Retail - \$50, Mail Order - \$100

Participant Contributions

Eligible retirees must contribute a percentage of the following monthly plan premiums to continue coverage after retirement. The percentage contributed by the retiree is dependent on their date of retirement as follows: Eligible retirees who retired before October 1, 2009 contribute 10% of the plan premium and eligible retirees who retire after October 1, 2009 contribute 15% of the plan premium.

The Medex plan is closed to new retirees. Retirees in the Medex plan contribute 1% of the Medex monthly plan premium.

Non-Medicare Eligible Monthly Plan Premiums (effective 4/1/2009)

Rate Tier	Blue Choice	HMO Blue	Harvard Pilgrim Healthcare HMO	Tufts	Advantage Blue
Individual	\$722.76	\$507.33	\$444.93	\$548.33	\$917.03
Family	\$1,843.07	\$1,298.97	\$1,205.75	\$1,489.00	\$2,294.47

Medicare Eligible Monthly Plan Premiums (effective 1/1/2009)

Rate Tier	Medex II	Managed Blue for Seniors	Blue Medicare PFFS	First Seniority Freedom	Tufts Medicare HMO	Tufts PFFS
Individual	\$341.57	\$320.73	\$174.30	\$235.00	\$164.00	\$182.00

Non-Claim Expenses

Non-claim expenses (administrative fees) are based on current amounts charged per retiree as of 4/1/2009 and shown in the table below. These administrative fees are included in the Non-Medicare Eligible Monthly Plan Premiums above:

Rate Tier	Blue Choice	HMO Blue	Harvard Pilgrim Healthcare HMO	Tufts	Advantage Blue
Retiree	\$55.07	\$57.10	\$35.03	\$29.57	\$57.10
Retiree + Family	\$55.07	\$57.10	\$94.94	\$88.31	\$57.10

Medicare Part B Premiums

Retirees and spouses receive a reimbursement of their Medicare Part B premiums from the City. Retirees and spouses who were Medicare eligible prior to January 1, 2008 receive a 99% City reimbursement. Retirees who retired between January 1, 2008 and October 1, 2009 receive a 90% city reimbursement when they become Medicare Eligible. Retirees who retire after October 1, 2009 will receive an 85% reimbursement when they become Medicare eligible. The City reimburses the standard amount only (along with any penalty for late filing). The 2009 Medicare Part B monthly premium is \$96.40.

Life Insurance

A fully funded, \$5,000 life insurance benefit is available to eligible retirees at the rate of \$1.90 per thousand per month with the City paying 75% of the premiums.

Valuation Date

January 1, 2009

Measurement Date

July 1, 2009

Discount Rate

4.50%

Payroll Growth Assumption

3.50% per year

Census Data

The census data was provided by the City represents the City census as of December 31, 2008.

Actuarial Cost Method

Projected Unit Credit with benefits attributed from the date of hire to expected retirement age.

Amortization Method

The Unfunded Actuarial Accrued Liability is amortized over the maximum acceptable period of 30 years on a closed basis. It is calculated assuming a level percentage of projected payroll.

Health Care Cost Trend Rate

Health care cost trend rates apply to plan premiums, retiree contributions, and per capita health claim costs. The following annual trend rates are applied on a select and ultimate rate basis:

Benefit	Select	Ultimate	Annual Decrease
Medical Plan	11.00%	5.00%	0.50%
Medicare Part B Premium	6.00%	5.00%	0.25%

Per Capita Health Claim Costs

Per capita health claim costs are developed from a historical claims experience from January 2007 to December 2008, age-adjusted to age 60 and 70. The age 60 and 70 per capita health claim costs are presented in the table below:

Per Capita Cost	Blue Choice	HMO Blue	Harvard Pilgrim Healthcare HMO	Tufts	Advantage Blue
Age 60 Retiree/Spouse	\$12,481	\$12,836	\$9,655	\$10,625	\$12,019
Age 70 Retiree/Spouse	\$17,933	\$18,484	\$13,904	\$15,302	\$17,309

Age Based Morbidity

The assumed per capita health claim costs are adjusted to reflect expected increases related to age. The increase in per capita health claim costs related to age are assumed to be the following:

Ages	Increase	Age	Increase
42 – 46	3.19%	65 – 69	3.00%
47 – 51	3.89%	70 - 74	2.50%
52 – 56	3.58%	75 – 79	2.00%
57 – 61	4.52%	80 – 84	1.00%
62 - 64	5.06%	85 - 89	0.05%

Retirement Age

Annual retirement probabilities have been determined based on the Pension valuation for the City of Cambridge as of 2008. Retirement ages and associated probabilities are as follows:

Groups 1 & 2 (Excluding Teachers)		Group 4	
Age	Retirement	Age	Probability
45-54	2.0%	45-49	2.0%
55	5.0%	50	5.0%
56	2.0%	51	2.0%
57	2.0%	52	2.0%
58	2.0%	53	2.0%
59	2.0%	54	2.0%
60	5.0%	55	25.0%
61	2.0%	56	2.0%
62	25.0%	57	2.0%
63	5.0%	58	2.0%
64	5.0%	59	2.0%
65	10.0%	60	25.0%
66	10.0%	61-64	10.0%
67+	100.0%	65+	100.0%

Teachers

YofS	<20		20-29		30+	
Age	M	F	M	F	M	F
45-49	0%	0%	0%	0%	0%	0%
50-53	0%	0%	1%	1%	1%	1%
54	0%	0%	2%	1%	4%	4%
55	2%	2%	3%	4%	6%	6%
56	4%	4%	3%	4%	18%	18%
57	7%	7%	5%	5%	30%	30%
58	8%	8%	7%	7%	40%	40%
59	9%	9%	10%	11%	40%	40%
60	12%	12%	20%	16%	35%	35%
61	15%	15%	30%	20%	35%	35%
62	18%	18%	35%	25%	40%	40%
63	15%	15%	35%	25%	35%	25%
64	25%	25%	30%	30%	30%	30%
65	40%	40%	50%	40%	50%	40%
66	40%	40%	30%	30%	30%	30%
67	40%	40%	30%	25%	30%	25%
68	40%	40%	30%	35%	30%	35%
69	40%	40%	40%	35%	40%	35%
70	100%	100%	100%	100%	100%	100%

Mortality

RP 2000 (Teachers) applied on a gender specific basis.

1994 Group Annuity Mortality table (other employees) applied on a gender specific basis.

Termination

The rate of withdrawal for reasons other than death and retirement has been developed from the Pension valuation for the City of Cambridge as of 2008. The annual termination probability is dependent on an employee’s age and department. Sample rates of withdrawal are provided in the table below:

Teachers

YofS	0-4		5-9		10+	
Age	M	F	M	F	M	F
20	9.0%	6.0%	4.0%	9.0%	1.0%	4.0%
30	10.8%	11.6%	4.3%	9.0%	1.0%	4.0%
40	9.3%	11.4%	4.9%	7.0%	1.5%	3.1%
50	5.9%	6.8%	4.2%	4.5%	1.9%	1.9%

Others

	All Other Dept	Group 4
20	7.94%	0.00%
25	7.72%	0.00%
30	7.22%	0.00%
35	6.28%	0.00%
40	5.15%	0.00%
45	3.98%	0.00%
50	2.56%	0.00%
55	0.00%	0.00%
60	0.00%	0.00%

Plan Participation Percentage

100% of all future retirees and their dependents who are eligible for benefits are assumed to participate in the postemployment benefit plan.

Spousal Coverage

Employees with spouse coverage at the valuation date are assumed to elect coverage for their spouse at retirement. Spouse ages are based on spouse dates of birth provided by the City.

Dependent Composition

Dependents other than spouses have not been included in this valuation.

Plan Coverage

Future non-Medicare eligible retirees are assumed to elect coverage in the non-Medicare eligible plans based on the following percentages:

Plan	Election Percentage
Blue Choice	60%
HMO Blue	9%
Harvard Pilgrim Healthcare HMO	12%
Tufts	5%
Advantage Blue	14%

Future Medicare eligible retirees are assumed to elect coverage in the Medicare eligible plans based on the following percentages:

Plan	Election Percentage
Medex II	N/A
Managed Blue for Seniors	62%
Blue Medicare PFFS	2%
First Seniority Freedom	8%
Tufts Medicare HMO	28%
Tufts PFFS	0%

Medicare Eligibility

7% of actives hired prior to 1984 and 7% of current retirees under age 65 are assumed to not be eligible for Medicare at age 65 and continue coverage in a non-Medicare plan.

Medicare Part D Prescription Drug Subsidy

Based on GASB Technical Bulletin No. 2006-1, an employer should apply the measurement requirements of GASB Statement 45 to determine the actuarial accrued liabilities, the annual required contribution of the employer, and the annual OPEB cost *without reduction* for RDS payments. For this reason, we have excluded the Medicare Part D employer subsidy from this valuation.

A summary of the current active employee and retired population for the City is provided in the tables below:

Age Group	ACTIVE POPULATION			RETIRED EMPLOYEES*
	Fully Eligible	Not Fully Eligible	Total	
<40	4	935	939	1
40-44	23	342	365	11
45-49	135	224	359	24
50-54	179	235	414	50
55-59	316	129	445	225
60-64	159	53	212	525
65-69	44	15	59	426
70-74	12	2	14	353
75-79	5	0	5	303
80-84	2	0	2	300
85+	0	0	0	257
Total	879	1,935	2,786	2,168

*4 currently only receiving life insurance and 1,433 retiree's current receiving the Medicare Part B Subsidy.

A summary of the current active employees based on years of service is provided in the table below:

Age	0-4	5-9	10-14	15-19	20-24	25-29	30+	Total
<40	569	244	93	24	3	1	0	934
40-44	103	92	78	63	23	0	0	359
45-49	68	74	55	62	69	25	3	356
50-54	58	90	50	43	85	45	40	411
55-59	51	71	39	39	66	40	130	436
60-64	13	39	29	28	28	20	54	211
65-69	7	7	7	7	13	6	11	58
70-74	0	2	3	1	2	1	5	14
75-79	0	0	0	0	1	3	1	5
80-84	0	0	0	0	2	0	0	2
85+	0	0	0	0	0	0	0	0
Total	869	619	354	267	292	141	244	2,786

Applicability of Accounting Standards

The Governmental Accounting Standards Board (GASB) released Statement No. 43 – Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans (“GASB 43”) in April 2004 and Statement No. 45 – Accounting and Financial Reporting by Employers for Postemployment Benefit Plans Other Than Pension Plans (“GASB 45”) in June 2004. These two statements establish uniform accounting and financial reporting standards for state and local governmental entities related to postemployment benefits other than pensions (“OPEB”).

The required effective date for adoption of the standards by an employer varies depending on their total annual revenue. For the purposes of defining the effective date of the standards, GASB 43 and 45 use the terms *phase 1 government*, *phase 2 government*, and *phase 3 government*. The following table shows the definition of the three phases for plans and employers and their respective effective dates. The employer is required to report under the standards no later than the first fiscal year beginning after the date shown.

Phase	Total Annual Revenues	Plans	Employers
1	\$100,000,000 or more	12/15/05	12/15/06
2	\$10,000,000 - \$100,000,000	12/15/06	12/15/07
3	Less than \$10,000,000	12/15/07	12/15/08

Actuarial Cost Methods

One of the following actuarial cost methods can be used: Unit Credit, Entry Age Normal, Attained Age, Aggregate, Frozen Entry Age, or Frozen Attained Age. These methods can be used on a service (level dollar) or earnings (level percentage) basis.

Calculation Definitions

- Actuarial Accrued Liability (“AAL”) – The AAL is the portion of the actuarial present value of the total projected benefits allocated to years of employment prior to the measurement date.
- Unfunded Actuarial Accrued Liability (“UAAL”) – The UAAL is the difference between the AAL and the actuarial value of plan assets.

Reporting Requirements

- Annual Required Contribution (“ARC”) – The ARC is equal to the normal cost and the amortization of the Unfunded Actuarial Accrued Liability plus interest. The normal cost is equal to the actuarial present value (“APV”) allocated to one year of service.
- Net OPEB Obligation (“NOO”) – The NOO is the cumulative difference between the ARC and employer’s contributions to the plan. For unfunded plans, the employer’s contribution would be equal to the annual benefit payments less employee contributions. At transition, the NOO may be set at zero.
- Required Supplementary Information (“RSI”) – The RSI will require historical trend information from the last three valuations, including disclosure information about the

UAAL and the progress in funding the plan. At transition, the RSI may include only the first year of information.

Disclosures

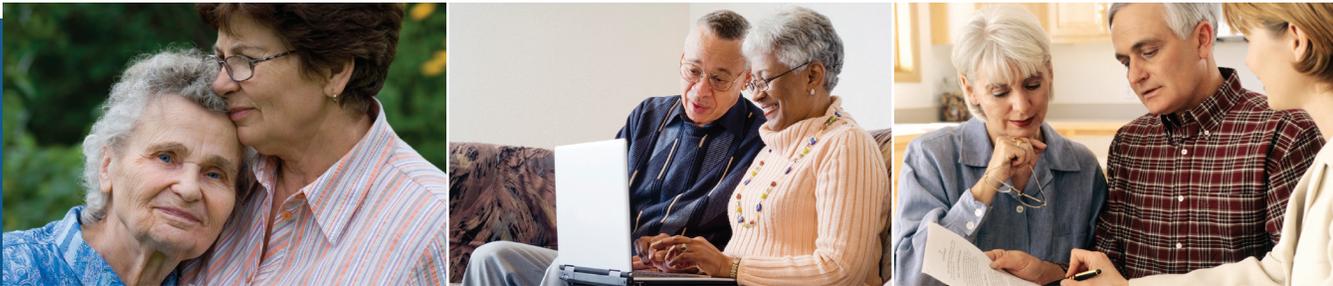
The following information is required to be disclosed:

- Plan description, including:
 - Type of employer – single employer, multiple-employer, etc.
 - Classes of employees covered and the number of plan members
 - Brief description of benefit provisions
- Summary of significant accounting policies, including a brief description of how fair value of investments is determined.
- Contributions and reserves, including:
 - City under which the obligations of plan members, employer(s), and other contributing entities who contribute to the plan are established or may be amended.
 - Funding policy.
 - Required contribution rates of actives and retirees in accordance with the funding policy.
 - Brief description of the terms of any long-term contracts for contributions to the plan and disclosure of the amounts outstanding at the reporting date.
 - The balance in the plan's legally required reserves at the reporting date.
- Funded status and progress
 - Information about the funded status as of the most recent valuation date, including:
 - Actuarial Valuation Date
 - Actuarial Value of Assets
 - Actuarial Accrued Liability (“AAL”)
 - Total Unfunded Actuarial Accrued Liability (“UAAL”)
 - Funded ratio – actuarial value of assets as a percentage of the actuarial accrued liability
 - Annual Covered Payroll
 - Ratio of Unfunded Actuarial Liability to Annual Covered Payroll
- Disclosure of information about actuarial methods and assumptions used in valuations on which reported information about the ARC and the funded status and funding progress of OPEB plans are based.



ISSUE BRIEF

The Crisis in State and Local Government Retiree Health Benefit Plans: Myths and Realities



2009 Update

November 2009

The Crisis in State and Local Government Retiree Health Benefit Plans: Myths and Realities: 2009 Update

ROBERT L. CLARK*

All states and many local governments provide health benefit programs for their retired employees. These programs vary widely in their provisions, degree of government subsidy, the cost to the government, and the method of funding. Some states and localities require retirees to pay the full cost of participating in the health plan¹, while others offer health insurance that does not require any premium payment by the retiree. As a result of these differences, the annual cost of providing retiree health insurance varies substantially among public employers. The annual cost per retiree can range from a modest subsidy associated with allowing retirees to buy into the health plan for current employees to the full cost of medical insurance for retirees, which can exceed \$10,000. In a study that examined the Comprehensive Annual Financial Reports of the New England states, the Federal Reserve Bank of Boston (2007) found that annual benefit payments per eligible retiree in 2006 ranged from \$3,300 in Maine to \$11,000 for Connecticut.

Recently, retiree health plans in the public sector have become the target for closer scrutiny and concern for their financial impact on budgets and debts. The annual government expenditure on these plans has been increasing rapidly due to the general rise in medical costs and the increase in the number of retired public employees. Even as state and local leaders have struggled to find the funds to finance the annual cost of retiree health insurance, changes in accounting standards have shifted policy debates from the current cost of these programs to the long-term liabilities associated with the promise of health insurance in retirement to today's public employees. To some, the recently reported estimates of unfunded liabilities associated with retiree health benefit plans represent a fiscal crisis for many states and municipalities.

This issue brief reports the financial status of retiree health plans covering general state employees as presented in their Governmental Accounting Standards Board (GASB) 45 actuarial statements. As part of a grant from the Center for State and Local Government Excellence, we have obtained the actuarial reports from each state and compiled data illustrating the financial status of these programs. This report focuses only on the plans that cover general state employees and does not include the additional liabilities associated with plans covering other types of public sector workers. In addition, some of the most important perceptions associated with retiree health plans and the new GASB accounting standards are explored, and we assess whether these beliefs are myths or realities. Sorting fact from fiction is central to determining the optimum public policies and the likelihood that retiree health benefit plans will remain an important component of the compensation for public sector employees.

GASB 45 and Accounting for Retiree Health

On June 21, 2004, the Government Accounting Standards Board approved Statement No. 45 (GASB 45). This statement requires public employers to produce an actuarial statement for retiree health benefit plans using generally accepted accounting standards as set forth by GASB.² In general, GASB 45 requires states and local governments to report the present discounted value for the future liability of health care promises to current workers as these benefits are accrued along with the present value of these promises to current retirees.³ In addition, the actuarial report must indicate the annual required contribution that is needed to pay the normal cost of the plan plus the amount needed to amortize current unfunded liabilities.

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A common belief is that GASB 45 requires public sector employers to establish trust funds for their retiree health plans and to move toward full funding. This is a myth. GASB 45 does not require public employers to establish irrevocable trusts or to begin moving toward full funding of their liabilities. The goal of GASB 45 is to provide a transparent assessment of the liabilities associated with health care promises to public employees. However, establishing a trust fund and contributing sufficient monies to cover current costs and accrued liabilities may be prudent public policies as it requires today's taxpayers to bear the full cost of today's public services.

This issue brief focuses on the current financial status of state retiree health plans and reports *unfunded actuarial accrued liabilities* (UAAL), *annual required contributions* (ARC), and the current method of financing these plans. The UAAL is the difference between all *actuarial accrued liabilities* (AAL) and any assets that the employer has set aside in an irrevocable trust. Obviously, if the plan is completely pay-as-you-go, the UAAL is equal to the AAL because there are no assets held by the employer with which to pay for the future health insurance of today's employees. The UAALs for many states and local governments are large in absolute value and relative to total state expenditures, debt, and state per capita income.

Annual required contributions are how much the employer would need to contribute to cover this year's normal cost of the plan plus the amount needed to amortize the existing unfunded liability over a 30-year period. Thus, if a government were to establish a trust fund for its retiree health benefit plan and contribute monies each year equivalent to the ARC, the state or locality would be on pace to fully fund the plan. Obviously, this level of financing will exceed the pay-as-you-go cost of these programs in the short run but will reduce the new funds needed in future years as returns on the trust fund will help finance future payments.

ARCs and UAALs have been growing over time in most states and are now a major public policy issue for many. For example, in California, the annual cost to the state for retiree health and dental benefits more than tripled between 1998–99 and 2006–07 as the retiree health expenditure rose by an annual average rate of 17 percent, which was more than five times the rate of growth of state spending. The costs were expected to exceed \$1 billion in 2006–07 (Legislative Analyst's Office, California, 2006).

The present value of promised benefits based on current provisions of the health plans is determined by projecting the future age and service structure of the state labor force and retired state employees, and the cost of the health care promises made to these workers and retirees. The future liabilities are then discounted back to the date of the report. The actuarial accrued liabilities (AAL) represent the total cost associated with providing health insurance to current retirees and the expected cost of retiree health insurance earned to date by current employees.

In addition to the demographic projections, key assumptions used by the actuarial consulting firm or the in-house actuaries to calculate the UAAL and the ARC are the rate of medical inflation and the discount rate used to determine the present value of future retiree health benefits. Assumptions made by the actuary have a large impact on the projected discounted liabilities of retiree health plans. All actuarial statements project a rapid decline in the rate of medical inflation. Such declines are more likely to be wishful thinking or a myth. The rate of inflation for health care is uncertain and will depend on national health care policies. There is a common belief, which reflects current practice allowed by GASB 45, that funding reduces the UAAL because trust funds prudently invested will yield higher returns than the risk-free discount rate used when there is no fund. This is a myth, as actual expenditures in future years are unchanged. However, using a higher discount rate associated with pre-funding these plans lowers the reported discounted liabilities. The impact and desirability of using higher discount rates to determine UAALs is currently being debated by practicing actuaries and financial economists. Clark (2008) discusses how these assumptions are made and their importance in determining the projected liabilities of retiree health benefit plans.

The AAL indicates the amount of money needed to pay all these future liabilities. Alternatively, this means that if the state or local government had a dedicated fund with assets equaling the AAL, then all currently accrued liabilities could be paid from the fund without any further contributions from the state. This is similar to having a fully funded pension plan or stating that the pension has a funding ratio of 100 percent. GASB 45 does not require that governments actually establish trust funds for these programs; however, several states have enacted trust fund legislation for their retiree medical plans as well as those of local entities in the state. Data in the state GASB 45 actuarial reports indicate that

ten states have assets in existing funds, with seven of these having funding ratios over 10 percent.⁴

GASB requires that the actuarial statements assume that the current provisions of the retiree health plan will remain in effect. *There is a common belief that retiree benefits are protected by law and cannot be altered. This is a myth.* Most states have been amending their health plans for active workers and retirees in response to rising health care costs. Changes include higher premiums, higher deductibles, higher co-payments, and more years of service to qualify for retiree health plans. The ability to modify retiree health plans provides states with some options to moderate their projected costs and thus reduce the UAAL and ARC presented in these actuarial statements.

GAO (2008) reports that all states have legal protections for their pension plans that limit the ability of a legislature to substantially alter the generosity of the pension. The majority of states have constitutional provisions that describe how their retirement plans are to be “funded, protected, managed, or governed.” However, retiree health plans are not accorded similar status. Reductions in or the elimination of retiree health benefits may be constrained by collective bargaining contracts but, in general, legislatures have more flexibility to reduce and modify retiree health benefit plans for public sector employees. Clark and Morrill (2009) provide evidence that some states have made modifications to their plans that have substantially lowered their UAALs. If governments can significantly reduce benefits and thus liabilities, should these promises be considered liabilities at the same level as state and municipal bonds?

Is There a Funding Crisis?

Recent press reports spawned by GASB 45 statements and other assessments of the unfunded liabilities associated with retiree health have painted a picture of a major fiscal crisis. This is a reality in some states while in others it is simply a myth. There are substantial differences in the total liabilities of state retiree health plans stemming from the generosity of the plan and the size of the public sector.⁵ To assess the reality of a funding crisis, we consider only the data reported in the actuarial statements that have been completed in response to the GASB requirements by the 50 states.

We have obtained and examined the actuarial reports for plans covering general state employees for 49 states.⁶ States with the lowest unfunded liabilities

are North Dakota (\$31 million), Wyoming (\$72 million), South Dakota (\$76 million), Iowa (\$220 million), Oregon (\$264 million), Kansas (\$293 million), and Idaho (\$362 million). In comparison, New Jersey (\$68.8 billion), New York (\$49.7 billion), California (\$47.9 billion), North Carolina (\$23.8 billion), Illinois (\$24.2 billion), Connecticut (\$21.7 billion), Louisiana (\$19.6 billion), Ohio (\$18.2 billion), and Texas (\$17.7 billion) have the highest UAALs. A complete listing of the UAALs and the ARCs for each state is presented in Table 1 (page 6).

The substantial variation in unfunded liabilities is a function of the size of the state workforce, the generosity of the retiree health plan, the portion of the total cost of the health program paid for by the state, and what type of employees are included in the plan. For example, the retiree health plans of some states also include teachers and local government retirees while in other states only the retired employees of the state are included in the plan. In these states, teachers and local retirees may be included in other plans. Clark (2009a) examines the importance of including teachers in the state plans and the unfunded liabilities of teacher-only plans. On average, teachers account for about half of the UAAL when they are included in state retiree health plans.

To better illustrate the size of these liabilities and their importance to the various states, we examine the magnitude of the UAAL and ARC relative to various important financial variables. Several of the actuarial statements indicate the UAAL and the ARC as a percent of payroll. The highest reported values for UAAL as a percent of payroll are found in Hawaii (359.6 percent), Maryland (351.1 percent), and Rhode Island (292.5 percent). The highest values for the ARC as a percent of payroll are Maryland (26.9 percent), Hawaii (26.2 percent), and Rhode Island (24.9 percent). These latter numbers are particularly impressive as they indicate the proportion of state payroll needed to pay for the normal cost of retiree health plans and the cost of amortizing the unfunded liability. Thus, to move toward a fully funded plan, these three states would have to allocate funds equal to one quarter of their annual cash payroll to finance the retiree health plan. These data indicate that for some states the annual cost and the unfunded liabilities associated with retiree health plans represent a major fiscal challenge.

We derive two additional measures of the relative size of the cost of retiree health benefit plans. The unfunded liability per capita and the ARC per capita

Table 1. State Liabilities for Retiree Health, Summary Information*

State	Unfunded Liability (millions)	ARC (millions)	Rank UAAL	State	Unfunded Liability (millions)	ARC (millions)	Rank UAAL
	(1a)	(2a)	(3a)		(1b)	(2b)	(3b)
Alabama	\$3,104	\$211	28	Montana	\$449	\$42	11
Alaska	3,139	370	29	Nebraska	Minimal	n/a	1
Arizona	438	104	9	Nevada	2,295	273	24
Arkansas	1,224	167	18	New Hampshire	2,859	235	25
California	47,878	3,593	48	New Jersey	68,834	5,840	50
Colorado	1,033	71	17	New Mexico	4,110	383	30
Connecticut	21,681	1,598	45	New York	49,663	3,810	49
Delaware	3,100	286	27	North Carolina	23,786	2,390	46
Florida	3,082	201	26	North Dakota	31	4	2
Georgia	15,035	1,262	41	Ohio	18,723	2,046	43
Hawaii	9,679	705	36	Oklahoma	814	87	16
Idaho	362	34	8	Oregon	264	41	6
Illinois	24,210	1,743	47	Pennsylvania	8,659	720	35
Indiana	442	46	10	Rhode Island	480	41	12
Iowa	220	23	5	South Carolina	10,048	777	37
Kansas	293	34	7	South Dakota	76	9	4
Kentucky	4,833	397	32	Tennessee	2,146	212	22
Louisiana	19,609	2,069	44	Texas	17,675	1,482	42
Maine	4,756	356	31	Utah	569	54	14
Maryland	14,543	1,114	40	Vermont	1,419	113	19
Massachusetts	13,287	1,062	38	Virginia	1,616	123	21
Michigan	13,925	879	39	Washington	7,495	634	33
Minnesota	565	56	13	West Virginia	7,761	824	34
Mississippi	570	43	15	Wisconsin	1,473	148	20
Missouri	2,186	159	23	Wyoming	72	6	3

*The reports included in this table are for retiree health plans that cover general state employees. Some of these plans also cover teachers and other public sector employees in the state.

Source: Actuarial reports prepared by the various states to conform to GASB 45 requirements. Nebraska chose not to prepare a GASB 45 statement.

Table 2. UAAL and ARC: Total and Per Capita

State	UAAL (millions)	Rank UAAL	UAAL Per Capita	Rank UAAL Per Capita	ARC (millions)	Rank by ARC	ARC per capita	Rank ARC Per Capita
Alabama	\$3,104	28	\$683.76	24	\$211	24	\$46.48	23
Alaska	3,139	29	4,689.20	47	370	30	552.72	48
Arizona	438	9	73.59	5	104	17	17.47	14
Arkansas	1,224	18	441.53	21	167	22	60.24	25
California	47,878	48	1,330.30	30	3,593	48	99.83	29
Colorado	1,033	17	221.02	14	71	15	15.19	12
Connecticut	21,681	45	6,218.58	48	1,598	43	458.34	46
Delaware	3,100	27	3,688.03	44	286	28	340.25	44

Table 2. UAAL and ARC: Total and Per Capita (continued)

State	UAAL (millions)	Rank UAAL	UAAL Per Capita	Rank UAAL Per Capita	ARC (millions)	Rank by ARC	ARC per capita	Rank ARC Per Capita
Florida	3,082	26	173.77	11	201	23	11.33	7
Georgia	15,035	41	1,650.80	33	1,262	41	138.56	33
Hawaii	9,679	36	7,635.80	49	705	34	556.18	49
Idaho	362	8	253.88	17	34	7	23.84	16
Illinois	24,210	47	1,903.37	34	1,743	44	137.03	32
Indiana	442	10	70.64	3	46	12	7.35	3
Iowa	220	5	74.44	6	23	5	7.78	4
Kansas	293	7	106.87	8	34	7	12.40	10
Kentucky	4,833	32	1,158.71	28	397	32	95.18	28
Louisiana	19,609	44	4,361.75	46	2,069	46	460.22	47
Maine	4,756	31	3,624.39	43	356	29	271.30	42
Maryland	14,543	40	2,609.47	41	1,114	40	199.89	41
Massachusetts	13,287	38	2,066.68	35	1,062	39	165.19	34
Michigan	13,925	39	1,377.63	31	879	38	86.96	27
Minnesota	565	13	110.48	9	56	14	10.95	5
Mississippi	570	15	196.52	12	43	11	14.83	11
Missouri	2,186	23	377.69	20	159	21	27.47	19
Montana	449	11	479.81	23	42	10	44.88	22
Nebraska	No report	1	No report	1	No report	1	No report	1
Nevada	2,295	24	952.7	27	273	27	113.33	31
New Hampshire	2,859	25	2,193.98	37	235	26	180.34	36
New Jersey	68,834	50	7,950.84	50	5,840	50	674.56	50
New Mexico	4,110	30	2,144.72	36	383	31	199.86	40
New York	49,663	49	2,578.22	40	3,810	49	197.79	39
North Carolina	23,786	46	2,740.61	42	2,390	47	275.37	43
North Dakota	31	2	48.75	2	4	2	6.29	2
Ohio	18,723	43	1,633.80	32	2,046	45	178.54	35
Oklahoma	814	16	230.21	16	87	16	24.60	17
Oregon	264	6	72.73	4	41	9	11.29	6
Pennsylvania	8,659	35	700.15	25	720	35	58.22	24
Rhode Island	480	12	449.98	22	41	9	38.44	21
South Carolina	10,048	37	2,361.46	39	777	36	182.61	38
South Dakota	76	4	97.43	7	9	4	11.54	8
Tennessee	2,146	22	358.31	19	212	25	35.40	20
Texas	17,675	42	773.73	26	1,482	42	64.87	26
Utah	569	14	227.14	15	54	13	21.56	15
Vermont	1,419	19	2,289.68	38	113	18	182.34	37
Virginia	1,616	21	213.82	13	123	19	16.28	13
Washington	7,495	33	1,195.22	29	634	33	101.10	30
West Virginia	7,761	34	4,298.23	45	824	37	456.35	45
Wisconsin	1,473	20	265.86	18	148	20	26.71	18
Wyoming	72	3	142.14	10	6	3	11.85	9

for each state are reported in Table 2 (pages 6–7) along with the ranking by state. The total UAAL and ARC are also presented in the table, thus allowing a direct comparison of the relative size of the liabilities by state to the total unfunded liability. States with the lowest UAAL per capita are North Dakota (\$49), Indiana (\$71),

Oregon (\$73), Arizona (\$74), and Iowa (\$74). In stark contrast, the states with the highest UAAL per capita are New Jersey (\$7,951), Hawaii (\$7,636), Connecticut (\$6,219), Alaska (\$4,689), Louisiana (\$4,362), and West Virginia (\$4,298). A similar ranking is observed for the ARC per capita.

Table 3: Percent of Premium Paid for High and Low UAAL States

State Name	UAAL Per Capita	Description of Coverage from State Actuarial Reports
Ten States with the Lowest UAAL Per Capita		
Nebraska	N/A	State deemed that the liability for its retiree medical plan were too small to justify the expense of producing a report.
North Dakota	\$48.75	Partially subsidized, contributions are required for both retiree and dependent coverage.
Indiana	\$70.64	Implicit subsidy only.
Oregon	\$72.73	Under 8 years of service, no explicit subsidy; 8–9 years 50% of the explicit subsidy; 100% of the explicit subsidy for those with 30 years of service.
Arizona	\$73.59	Capped benefit set to \$150 per month if the retiree is under age 65 and \$100 per month if the retiree is 65 or over. Dollars amounts reduced for less years of service.
Iowa	\$74.44	Retirees over age 65 are in a separate risk pool and pay full premium, no explicit subsidy.
South Dakota	\$97.43	Separate risk pool for retirees, only partial subsidy.
Kansas	\$106.87	Retirees pay full cost of premiums if age 65 or older, otherwise partial subsidy.
Minnesota	\$110.48	Implicit subsidy only for retirees under the age of 65. Medicare eligible retirees are a separate pool, so no implicit or explicit subsidy.
Wyoming	\$142.14	Implicit subsidy only.
Ten States with the Highest UAAL Per Capita		
New Jersey	\$7,950.84	Retired teachers pay no premium; retired state employees pay 2% of the cost of the health insurance.
Hawaii	\$7,635.80	If hired before 1996, state pays between 50% and 100% coverage based on years of service. For retirees hired after 1996, the state pays between 0% and 100% for retirees.
Connecticut	\$6,218.58	For retirees after 1997, some plans require 3% contribution. All other retirees pay no premium.
Alaska	\$4,689.20	The Retirement Systems pay the medical premiums for recipients hired before July 1, 1986. Employees hired after 1986 with five years of service pay the full monthly premium if they are under age 60 (and do not have 30 years of service) and receive benefits at no premium cost if they are over age 60.
Louisiana	\$4,361.75	Retirees pay a scaled portion of the premium.
West Virginia	\$4,298.23	Retirees pay a scaled portion of the premium.
Delaware	\$3,688.03	Retirees pay a scaled portion of the premium.
Maine	\$3,624.39	Qualified retirees pay no premium. Retirees pay a scaled portion of the premium if they have less than 10 years of service or are teachers.
North Carolina	\$2,740.61	Qualified retirees pay no premium. Retirees hired after 2006 need 20 years of service to qualify.
Maryland	\$2,609.47	Retirees with 16 years of service receive 100% subsidy from state; otherwise retirees pay a scaled portion of the premium. Persons who retired prior to 1984 receive 100% subsidy.

The significant differences in the absolute and relative magnitudes of the liabilities for retiree health plans clearly indicates that some states face major financial challenges to continue these programs in the future, while in other states the impact of retiree health on public debt is rather minor. In total, there is a large and growing unfunded liability associated with nonfederal public sector retiree health plans. In states and localities with generous plans, retiree health plans represent an expanding problem for the fiscal health of the states and cities. GASB 45 statements in these states represent a wake-up call for policy makers to consider their options in how to deal with these liabilities. However, for many other states the reality is that the GASB statements certified that they have small liabilities associated with these plans and there is no cause for alarm.

The primary determinant of the differences in the relative size of the UAALs across the states is the proportion of the premium paid by the state compared to that paid by the retiree. States that require the employee to pay the full premium have very low UAALs associated only with the implicit subsidy. In contrast, states that pay all or most of the insurance premium for a large proportion of retirees have much higher UAALs. Table 3 (page 8) presents the description of coverage and premium data for the states with the 10 lowest and 10 highest UAAL per capita. The information in the table clearly indicates the importance of the decision by a state concerning the proportion of the premium that it will pay. See Robinson, et al (2008) for a more detailed description of the benefits provided by each state plan.

Myths, Realities, and Policies

In comparison with the private sector, state and local governments tend to provide their employees with more generous retirement benefits. Most public employees are covered by defined benefit pension plans and retiree health benefit plans. Funding rules and expectations for pension plans are clearly defined, liabilities are recognized, trust funds have been established, and state constitutions and laws limit or restrain changes in the plans that would reduce retirement benefits. In contrast, retiree health plans are a more recent employee benefit, typically no trust fund has been established, and the extent of the unfunded liabilities has only recently been recognized in conjunction with GASB 45.

Recent events have created a series of perceptions about the financial status of these plans; some are myths and some are realities. This issue brief has identified some of the most important perceptions concern-

ing retiree health plans in the public sector and has shown some to be fact, while others are merely myths based on a lack of data or understanding of key aspects of these plans.

Myth: All states face a funding crisis associated with their retiree health plans.

Reality: Many states face substantial future liabilities associated with these programs; however, for many other states, the unfunded liabilities are relatively small, should be easily manageable in future years, and do not require any major new policies to cope with these plans.

Myth: GASB 45 requires public sector employers to establish irrevocable trusts for their retiree health plans.

Reality: GASB standards do not require the establishment of trusts nor do they require full funding for those with such trusts. To date, relatively few states have established trust fund legislation to help finance these future costs and even fewer are making use of laws that allow funding. A more interesting public finance question is whether, in light of the GASB 45 requirements, governments should move toward full funding of their retiree health plans.

Myth: The explicit recognition of the unfunded liabilities reported in the GASB 45 statements will adversely affect the bond rating of governments and investors will exert market pressure for state and local governments to begin to prefund these plans.

Reality: The key determination of whether this perception is fact or fiction depends on whether the retiree health liabilities were already known to market analysts and had previously been factored into the bond ratings. If so, one could argue that these liabilities do matter but that the GASB 45 statements do not matter because investors already were aware of them. Moody's Investors Service (2005) stated that "Moody's does not anticipate that the liability disclosures will cause immediate rating adjustments of a broad scale" and that "Moody's therefore will exclude OPEB liabilities from calculations of state or local debt burdens, but include them as a factor in the overall credit assessment of an issuer. This practice is consistent with Moody's approach to municipal pension liabilities." The reality of the impact of GASB 45 statements will become more apparent in the next few years.

Myth: Retirement benefits are protected by state laws and provisions in state constitutions.

Reality: In general, no such protection exists for retiree health plans. Public sector employers have constantly been making changes to these plans that reduce the generosity of the benefits and raise the cost to retirees. The expectation is that public sector employers will continue to amend their plans in ways that reduce their cost to the government. However, political realities limit the ability of government to reduce compensation for public sector employees and promised benefits to retirees.

Several other important issues remain concerning public perceptions of the cost and liabilities of retiree health plans. GASB 45 requires an assessment and acknowledgement of the cost and accrued liabilities associated with retiree health plans using approved accounting standards. Estimates of the annual required contributions and the unfunded actuarial accrued liabilities provide an important benchmark for evaluating these plans and determining future policy decisions. One should keep in mind that these are estimates of future costs. Obviously, future projections can be altered by amending the plans or by future national health insurance initiatives. The projections will be much higher if medical inflation does not decline as assumed in the reports and pre-funding would alter the need for new tax monies to be devoted to these plans.

These substantial liabilities pose a serious financial problem for many states and municipalities. These unfunded liabilities will confront policy makers with difficult choices in the future. In 2006, the annual cost to state and local governments for retiree health plans averaged about 2 percent of employee salaries. If public sector employers continue to pay for these benefits on a pay-as-you-go basis, the cost of retiree health plans is projected to rise to 5 percent of payroll in 2050 (GAO, 2008).

As the annual cost rises, the ability to finance these programs may cause other priorities to be unmet and the overhang of billion dollar retiree health insurance liabilities may influence future bond ratings. There are a number of options that states can adopt to address the impending financial burden. The choices are clear for those state and local governments that have large liabilities. Governments can either increase total revenues to support the current programs, shift funds from other priorities to finance retiree health plans, or reduce benefits associated with these programs.

In response to GASB 45 and the financial pressures associated with retiree health plans, states and local governments are considering many policy responses.

For some governmental units, the unfunded liabilities and the annual cost of retiree health plans are very large and threaten their financial stability. These public employers are likely to focus on reducing the future cost of their retiree health plans even as they struggle to pay for the promises made to current workers and retirees. States and municipalities with less generous benefits are under much less fiscal pressure. Understanding the realities of the current financial status of individual plans is a key to developing new policies. We should expect that these policies will vary across governmental units and that they will reflect the substantial differences in the generosity of today's plans and the accompanying liabilities.

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Endnotes

- 1 Typically, the "full cost" of a retiree health plan paid by retirees would be the average cost of all participants in the health plan for active workers and retirees. Due to age-related differences in the cost of health insurance, allowing retirees to pay the same premium for participating in the plan involves an implicit subsidy. The new GASB standards require measurement and reporting of this subsidy to retirees.
- 2 *GASB Statement 45, Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions (OPEB)* was issued by the Governmental Accounting Standards Board in 2004. Basically, GASB 45 requires public employers to account for the cost of retiree health plans using the same methods used to estimate the liabilities associated with pensions. The complete standard can be seen at <http://www.gasb.org/st/summary/gstsm45.html>. Earlier in 2004, GASB issued Statement No. 43, *Financial Reporting for Post-employment Benefit Plans Other than Pension Plans*. GASB 43 sought to establish uniform reporting standards for retiree health plans.
- 3 Vicente (2006) provides a useful explanation of the new accounting standards and a summary of the issues raised by GASB 45.
- 4 The GASB 45 actuarial statements of the following states indicate that they have assets (measured in billions) for use by their retiree health plans and we have calculated funding ratios for these plans: Alaska: \$3.2 billion, 50 percent funding ratio; Arizona: \$1.2, 73 percent; Colorado: \$0.2, 17 percent; Delaware: \$0.03, 0.01 percent; Kentucky: \$0.9, 15 percent; New Mexico: \$0.2, 7 percent; North Carolina: \$0.1, 0.6 percent; Ohio: \$12.0, 39 percent; Oregon: \$0.3, 50 percent; Virginia: \$0.2, 11 percent. Since none of the other states report any assets, their funding ratios would be zero.
- 5 Studies that have estimated the UAAL and ARC for state retiree health plans include Goldman Sachs (2007), Pew (2007), Standard & Poor's (2007), and Zion and Varshney (2007). Also see GAO (2007).
- 6 Nebraska decided not to commission a GASB 45 report because of the limited liability associated with its program. Early retirees are eligible to stay in the state health plan by paying the full premium until they reach age 65 and qualify for Medicare. Thus, there is an implicit subsidy for retirees under age 65. It is likely that the UAAL associated with this subsidy is similar to states with UAALs of less than \$100 million.



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