City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 4, 2006

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER

SUBJECT: BUDGET MEMO #70: RETIREE HEALTH INSURANCE – RECENT ARTICLE CONCERNING OTHER JURISDICTIONS

In the emerging area of accounting for retiree health insurance costs to be required by GASB 45 accounting standards, Council has been previously provided information and reports (Budget Memo #108) as well as a work session briefing. Attached is an article from this week's *Bond Buyer* which discusses the issue and what some jurisdictions are facing in regards to fiscal liability for retiree health care costs and how they are planning to respond.

Attachment

Panelists at The Bond Buyer's OPEB Conference call for teamwork. **Page 6**

U.S. banks' muni portfolios grew more than 11% last year, their fastest pace since 1998. **Page 40**

THE BOND BUYER

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Cook County believes it's not legally responsible for OPEB benefits awarded by its pension board in 2002, says CFO Tom Glaser.

OPEBs a Top Priority

State Law, Labor Deals Provide Guidance

BY YVETTE SHIELDS

CHICAGO – As more local and state governments calculate and disclose the long-term costs of other post-employment benefits such as health care, state law and labor contracts may dictate the political and financial solutions governments adopt.

Individual governments vary as to where they are at in calculating and then disclosing their other post-employment benefits, primarily health care-related, to comply with the Governmental Accounting Standards Board's Reporting Rule No. 45. The rule requires governments to shift from accounting for that liability on a pay-as-you-go basis to a long-term accrued basis by fiscal year 2008.

While some governments have proposed solutions, such as establishing and funding a trust fund to move towards fully funding the liability, others are still in the early stages of reviewing the extent of their obligations. In solving the funding issues, governments need to review their obligations under existing labor contracts and applicable state law.

"Ultimately, there needs to be a solution, whether it's legislative or financial," **Chapman and Cutler** attorney **James Spiotto** said during a panel discussion on defining, identifying and solving OPEB liabilities at The Bond Buyer's OPEB Liability Conference in Chicago yesterday. "Just identifying the liability and not who is obligated ... may not be sufficient if you don't have a solution it bothers everyone."

The obligation to fund pensions is built into some state constitutions, such as **Illinois**, while others, like **Indiana**, have laws on the books that bar the

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Local Governments Look to State Law, Labor Contracts for OPEB Guidance

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impairment of contracts. In some cases, the courts have weighed in on the extent to which a government must abide by its contract and cover benefits. A **Michigan** Supreme Court ruling found that OPEB liabilities are not constitutionally protected while an **Alaska** court ruling held the opposite.

While some states may constitutionally protect OPEB benefits, some local governments need to delve deeper to determine whether the benefit is actually guaranteed by that individual government.

Though still reviewing the applicability of GASB 45, **Cook County**, Ill. believes it is not on the hook legally to cover the cost of providing OPEB benefits awarded by its pension board in 2002, according to Cook chief financial officer **Thomas Glaser**. That's because the pension board that manages the system is a separate legal entity from the county. "It is a liability to be funded by the members of the pension plan," he said during the panel discussion.

Glaser said the pension board, made up of the county treasurer, comptroller, three annuitants and four employees, adopted an OPEB benefit in 2002 without consulting the county board.

Glaser, who must cope with an unfunded pension liability of $2.7 billion, did not learn of the new health care benefit until reviewing the pension board's financial statements that year which showed the diversion of $13 million in general pension payments to cover the annual cost of the new OPEB liability.

"It seems to me that those folks have a fiduciary responsibility to manage the assets ... I don't believe they can stay silent or should stay silent as this has happened." The county's annual contribution to fund its general pension system is set by state statute and is based on a percentage collected in employee contributions.

It's unclear how the pension board will seek to address the liability once it's determined though it's likely will eventually fall on taxpayers' backs.

At least 11 states have disclosed their unfunded OPEB liabilities. They range from $40 to $70 billion for **California** on the higher end, to Michigan with $30 billion and **Utah** at $540 million on the lower end, according to **Donald J. Rueckert**, a senior vice president at **AON Consulting**.

To achieve cost savings, governments could seek to alter benefits, reduce the benefits of employees who retire before 65, vary benefits based on length of service or cap benefit increases. If not addressed, governments will have to disclose a growing balance on their financial statements, which in turn could impact credit ratings, he warned.

Rhode Island's budget officer **Rosemary Booth-Gallogly**, who began reviewing the state's potential OPEB liability three years ago, warned governments that haven't made much headway in their calculations to get moving because of the extensive time her office has spent reviewing the issue.

The head-start led the state to take early steps to address what's estimated to be an unfunded liability of $566 million in the main state employee fund although that's being updated to reflect recently adopted pension reforms.

Atlanta CFO Janice Davis says her city is still reviewing the total costs of its unfunded liability.

In anticipation of the rule change, the state adopted pension reforms last year that should trim the long-term liability and it moved away from a "blended premium rate' that included rates subsidized by active employees to determine the "real" retiree benefit costs.

Gov. **Donald L. Carcieri** has proposed establishing a trust fund to be fund the benefit. Booth-Gallogly said "funding annually on an actuarial basis is the right course to follow." However, she warned that it's politically difficult to strike a "delicate balance" that's fair to taxpayers and retirees because of competing budgetary demands.

In a separate panel discussion on the implications of the new rule for governments, **Robert Mears**, director of finance for **Fairfax County**, Va., said board officials there too are weighing a proposal to establish a trust fund at a level that fully meets the annual required contribution [ARC] to fund the liability over the long-term.

The county has a $191 million liability and currently pays $6 million to cover annual healthcare benefits. The county would add $10 million to that payment. "The county has proposed a balanced budget that fully funds the ARC," he said.

Janice Davis, chief financial officer of **Atlanta**, said her city is still reviewing the total costs of the city's unfunded liability which will compete for funding with other budget demands and that the city also is also still reviewing Georgia law to determine the full extent of its obligation. ❑

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