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OPEB Contribution Policies for Public Sector Plans

Starting in FY2018, the GASB 45 accounting standard will be replaced with GASB 75, which focuses on balance sheet (unfunded liability) reporting for OPEB plans. Although GASB 75 mentions disclosure an Actuarially Determined Contribution (ADC) if one is computed, there is no guidance on how an ADC is determined. Presumably this is because there is no GASB requirement to determine an ADC at all and there is no legal requirement to prefund OPEB programs (even though it's not uncommon to do so in the public sector). Accordingly, a government can consider a variety of contribution policies that range from pay-go funding to adopting a funding policy similar to that of a defined benefit pension plan, with a goal of accumulating a trust holding assets equal to the accrued liabilities within a reasonable period of time, typically up to 30 years.

What should a plan sponsor consider in determining an ADC?

The Benefit Promise: The nature of the promise made by the plan sponsor should be considered when determining an appropriate funding policy. Some plans pay a fixed dollar OPEB benefit. The fixed dollar benefit can be used for any medical insurance. These plans are really pension plans (except that the benefit is not taxable) and should consider prefunding benefits in the same way as a pension plan. On the other hand, some plans only provide access to coverage at the published rates. The benefits end at age 65, and the costs are minimal. These plans can reasonably use pay as you go funding. There is a wide range of plan designs between these two extremes that may fit into one or more potential funding regimes.

Sustainability: Many OPEB plans provide a subsidy percentage (e.g. they pay 80 percent of the premium for life to retirees). We call this kind of a plan a **traditional OPEB Plan**. The pay-go costs for these plans are generally projected to increase faster than government revenue for two reasons. First, because medical costs are projected to increase faster than inflation. Second, there are often a growing number of retirees per employee. While the current level of spending may be affordable, will it also be affordable in the future? The government needs to be out in front on this issue. **Once pay-go benefits become unaffordable, the only option is to reduce the benefits for retirees.** This should be a last resort solution, as the retiree may have worked for 30 or more years to earn this benefit and when the promised benefit is eliminated or reduced, the retiree may no longer be able to work to make up the shortfall.

Uncertain Nature of the Benefit: The costs for a traditional OPEB benefit are much less certain than the costs of a traditional pension plan. Currently, costs are lower than most actuaries would have predicted 10 years ago. **Governments with traditional OPEB Plans should consider a contribution target of less than 100 percent of the accrued liability to reduce the possibility of overfunding the plan.** Funding toward a significant percentage of the accrued liability (perhaps 80% or 90%) still promotes benefit security while reducing the risk of overfunding of OPEB benefits.

Affordability: The contribution needs to fit into the government budget. There is no longer a requirement to fund over 30 years or less and to target 100 percent funding. Governments can consider time horizons longer than 30 years and targeting less than 100 percent of the liabilities. **If the contribution is still not affordable, perhaps benefits should be adjusted now rather than after more employees have retired, so that they are affordable.**

Each situation is different and there are many factors to consider. We encourage governments to take a closer look at their contribution policy for their OPEB benefit. The move from GASB 45 to GASB 75 is an opportune time to reassess whether the current funding policy strikes an appropriate balance among the frequently competing objectives of sustainability and affordability, taking into consideration the nature of the promise made to employees and the inherent uncertainty in the long-term cost of providing OPEB benefits.