Other Postemployment Benefits ("OPEB") FAQ's

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Other Postemployment Benefits or OPEB represents a large liability on the balance sheet of many municipal entities across the United States. As various stakeholders try to understand it, we wanted to answer many of the frequently asked questions to allow you to make better decision on your program.

1. What is OPEB?

Other Postemployment Benefits ("OPEB") refers to benefits, other than pension, offered to employees after they leave employment. The most common benefits are medical, dental, and life insurance.

2. Does OPEB affect my bond/credit ratings?

OPEB is one element that rating agencies consider when they determine your bond rating. S&P and Moodys have recently increased the share of their rating based on municipal debt including General Obligation, Pension & OPEB.

3. How does OPEB impact my financial statement?

With the implementation of GASB 75, your OPEB liability has moved from the notes section of your financial statement to the balance sheet. While this doesn't change your liability, it does make it more visible. Your OPEB assets (if any) may allow for the use of a higher discount rate which serves to reduce this disclosed liability beyond the actual amount of OPEB assets.

4. What are the key assumptions?

- **Discount Rate**
  What interest rate is being used to value liabilities in today's dollars?
- **Termination Rate**
  What percentage of employees are going to leave each year prior to retirement?
- **Retirement Rates**
  What percentage of eligible employees are going to retire each year?
- **Election Percent**
  What percentage of employees are going to elect coverage for themselves in retirement? For their spouse?
- Trend Rate
  How much are medical (and dental) costs expected to increase each year?

5. How is the discount rate determined?

There are five key factors that determine the discount rate:

- **Employer Share of Costs**
  What is the portion of retiree medical, dental, and/or life benefits paid by the Employer each year?
- **Municipal Bond Rate**
  What are high-grade municipal bonds earning as of the Measurement Date?
- **Current Asset Level**
  What is the value of the assets currently held in an irrevocable OPEB trust?
- **Funding Policy**
  How much is expected to be contributed to the OPEB Trust each year?
- **Investment Policy**
  How will OPEB assets be invested (e.g., target % in stocks, bonds, cash, etc.)?

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6. How high of a rate of return on investments should we assume?

The rating agency, Moody's, has been calculating liabilities at a lower discount rate than the actuarial report if they feel the assumed rate of return is higher than can be justified by the investment policy, increasing the liability they use when determining the bond rating. Therefore, we recommend using an assumed rate of return that is in line with your investment policy rather than an overly aggressive rate.

7. What is Service Cost?

Service Cost represents the present value of the benefits to be paid in the future that are earned by active employees in the current year. This can be thought of as deferred compensation that active employees earn during the year that they are expected to receive in retirement (typically in the form of a medical, dental, and/or life insurance benefit).

8. What is the impact of Medicare Supplement plans on my OPEB liability?

Medicare Supplement plans generally represent the majority of your OPEB liability (usually 75% to 85%). While your active plans impact OPEB, most of the costs relate to the payments you make for your active employees rather than your retirees.

9. Why does the employer share of costs differ from what I am paying each year?

This is because your employer share of costs includes an implicit subsidy. The implicit subsidy arises because retirees who are not eligible for Medicare often are charged the same premium as active employees even though they are expected to incur higher medical costs as they age. Consequently, a portion of the premiums being paid for active employees "subsidize" the premiums of retirees. Actuarial Standards of Practice and GASB standards require the liability associated with this implicit subsidy to be valued.

10. Should I fund my OPEB Liability?

While you are not required to fund your OPEB liability, the management of your OPEB liability (including the level of funding) is one element that rating agencies consider when determining a municipality's bond rating. You should consider this, coupled with your other financial needs, when determining whether funding is right for you.

11. Are my peers funding?

While most municipalities are far from fully funded, with the implementation of GASB 74/75, we are seeing many municipalities begin to fund who had not previously done so.

12. What can we do with money in an OPEB trust?

At any time, regardless of your funding status, you can use money in your OPEB trust to pay up to the full amount of expected retiree contributions including implicit cost each year.

13. What else can we do to manage the liability besides funding?

- **Change Medicare Prescription Drug Benefit**
  As most OPEB Plans see 75%-85% of the total liability related to benefits paid after attainment of Medicare eligibility, this is the most impactful area to make changes. We've seen plan sponsors modify their drug formulary which can reduce current medical payments by 20% to 25% and OPEB liabilities by 15% to 20%.

  Make your Plan secondary to Medicare
  If you haven't already done so, you should mandate that those retirees who are eligible for Medicare enroll in it and allow your Plan to become a secondary payor.

- **Change Cost Sharing**
  Under Massachusetts law, the maximum allowable contribution rate is 50%. As you charge retirees more, your cash costs & disclosed liabilities will decrease.

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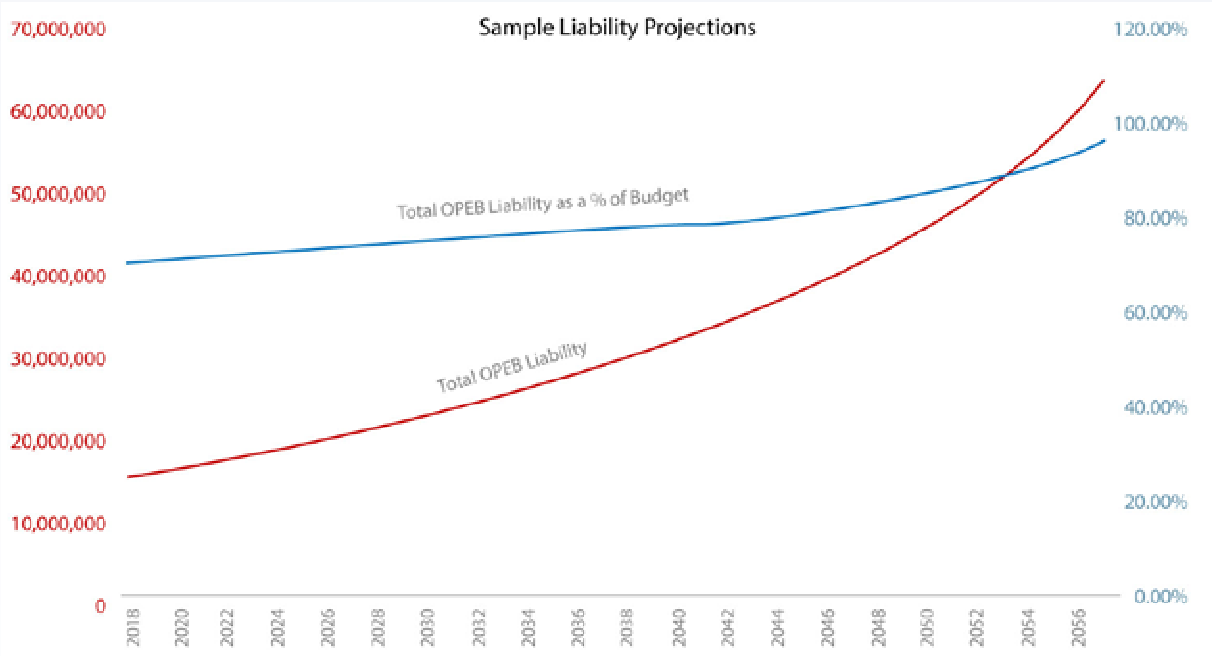
14. How many towns are funding their liability?

As of January 1, 2019, a survey of Odyssey clients shows that 79% of the towns and cities in Massachusetts are funding; however, most of them are not materially funded. Only 53% of the towns and cities are over 1% funded, 19% are over 10% funded and 11% are over 20% funded.

Future Liabilities & Expenses

While your projected future Total OPEB Liability may appear daunting, a more relevant metric is the relation to your budget and your ability to pay. The following graph depicts a sample OPEB Plan and shows the relation of the Total OPEB Liability to the annual budget (assuming your budget increases 3.00% per year). As you can see, while the liability increases significantly, it only increases slightly as a percent of the budget.



The above graph is based on a Total OPEB Liability that is projected to increase from $15 million to $65 million between 2018 & 2056. The Total OPEB Liability as a percentage of budget is projected to increase from 72% to 98% between 2018 & 2056.

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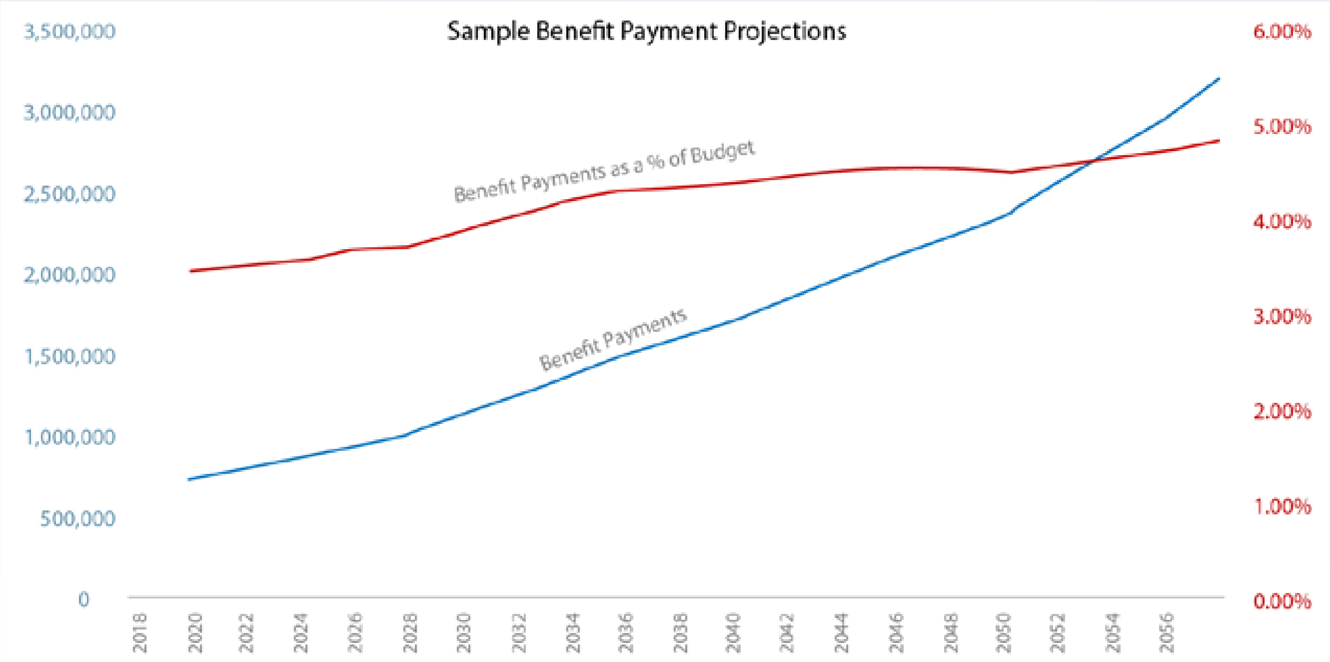
Similarly, while benefit payments (e.g. the portion of premiums that you pay for your retirees) will likely increase significantly in coming years, the increase in costs appears far more manageable when seen as a percentage of the annual budget.



The above graph is based on benefit payments ("Employer share of costs") that are projected to increase from $700 thousand to $3 million between 2018 & 2056. Benefit payments as a percent of budget are projected to increase from 3.5% to 4.9% between 2018 & 2056.

If you have any questions or would like more information, please contact your Odyssey Advisors representative.

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