



August 22, 2014

Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

RE: Project No.34-1E
Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions

Dear Board and Staff:

The Ohio Public Employees Retirement System is pleased to have the opportunity to respond to the Governmental Accounting Standards Board (GASB) Exposure Draft (ED) document on "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions."

Overview of OPERS

The Ohio Public Employees Retirement System (OPERS or the System) is in a non-Social Security state. OPERS is a multiple-employer cost-sharing system with approximately 1.1 million members, including 196,594 retirees and 227,008 covered lives. OPERS provides pension benefits through three pension plans:

- A pure defined benefit plan in which employee and employer contributions are used to provide a formula benefit on retirement,
- A pure defined contribution plan in which the employee and employer contributions are deposited into a member's individual account and the investment of these funds is managed by the member, and
- A hybrid plan in which employee contributions are deposited to a defined contribution account and the employer contributions are used to fund a (reduced) defined benefit.

OPERS began offering health care for retirees in 1974 and has pre-funded health care since that time. OPERS provides health care to members of the defined benefit and hybrid plans through a 401(h) trust and provides health care to members of the defined

contribution plan through a Retiree Medical Account administered through a VEBA trust. Health care for active members is provided by their employer.

OPERS' health care trust fund of approximately \$13 billion is one of the largest health care trust funds in the U.S. The investment portfolio supporting the trust fund has been segregated from the pension trust fund since approximately 2005 with an investment policy that recognizes the shorter time horizon of the health care funds.

OPERS has more than 3,700 participating employers that remit a statutory contribution rate of which a portion of the employer rate *may* be used to fund health care. The portion of the employer contribution rate allocated to fund health care is at the sole discretion of OPERS and has ranged from 1% to 7%, depending on the amount required for pension contributions. Increases in funding would need to be approved by the Ohio legislature. There has long been a political climate that prohibits increases in the contribution rate, but rather has focused on decreasing benefits to maintain sustainable benefits.

Health care is not a statutorily guaranteed benefit. The Ohio Revised Code grants the OPERS Board the authority to establish a plan if desired and thus the Board has the authority to modify the plan as needed or eliminate the plan. The OPERS Board is solely responsible for administering the health care plan and making decisions on funding and benefits. Health care is the only other postemployment benefit (OPEB) provided by OPERS. Employers have no control over the health care plan for their employees or the funding of these benefits. In addition, employers do not have the authority to "opt out" of participation in the OPERS provided benefits.

OPERS manages the health care plan by modifying the health care plan design to align with available resources. In the last 13 years, OPERS has *significantly* modified the health care plan design five times. The most recent modification approved in September 2012 reduced the unfunded liability by \$12 billion (from \$19 billion to \$7 billion).

OPERS measures the financial strength of the plan using multiple measures, including:

Funded ratio – 64% as of 12/31/12 (the date of the latest actuarial valuation)

Solvency period – infinity or an indefinite period measured as in excess of 100 years (measures how long the current funds are expected last based on the expected expenditures)

Self-funded ratio – 4.0% (measures the portion of the employer contribution rate that would be required to fund health care indefinitely without regard to the time period required to pay off the unfunded liability)

OPERS most recent health care plan changes increased eligibility requirements for health care from ten years to twenty years of service and added a minimum required age of 60,

or thirty years of service and any age (prior eligibility requirements were 10 years of service and no age requirement). Active members were not grandfathered into existing criteria. As such, some members may have been eligible for health care prior to the effective date of the changes, but were ineligible after the effective date of the changes.

OPERS administers the plan granting eligible members an allowance that varies by age and years of service. Members may use their allowance towards OPERS provided health care for the under 65 population or to select a Medicare advantage or Medicare supplemental plan for Medicare eligible members.

Concerns with the Exposure Draft

- **Comments on Assignment of the Liability and the Proportionate Share**

Nature of Liability Versus State Statutes and Historical Operation

We understand the philosophy associated with the allocation of the liability for cost-sharing employers. We strongly support the concepts of transparency and alignment of the liability and expense with the period in which it is earned. However, we think it is important to understand the variances in state laws such as Ohio and to consider an approach that recognizes differences in states and better reflects the nature of the transaction.

As noted previously, health care in Ohio by statute is a totally discretionary benefit, subject to complete revision or elimination based on the decision of the retirement system Board. The funding for this benefit comes entirely from an allocation of the employer contribution rate determined by the retirement system Board and associated interest earned on the health care trust. The health care allocation of the employer contribution rate has ranged from 1% to 7%.

The model used in Ohio for health care is essentially to designate an allocation of the employer contribution rate each year, which is used to fund the trust. Also, annually, OPERS and our actuaries review the long term projection of the plan funding and determine if plan adjustments need to be made to maintain expenses within the available resources. Increases to the employer contribution rate are not and cannot be considered. Increases to the employer contribution rate would be required to be approved by the Ohio legislature and the likelihood of any such consideration in the current or foreseeable future is remote. Similarly, members currently do not contribute to the health care plan and would likely not ever be a consideration due to the risk of any vesting privileges associated with the member contributions.

To further demonstrate the OPERS' health care model in which the plan design is the variable, OPERS' health care plan has experienced five major redesigns in the past thirteen years. These plan design changes have impacted every aspect of the plan from allowance and eligibility to plan sponsorship versus member procurement. The most recent plan design change approved in September 2012 reduced the health care unfunded liability from \$19 billion to \$7 billion and dramatically changed the eligibility requirements without grandfathering for current active members and included other significant changes for retirees. Additionally, OPERS was very transparent with members and the Ohio legislature during the recent pension plan changes that one of the major drivers of the pension reform was to allow a larger portion of the employer contribution rate to be used to fund health care. At that time, OPERS shared with members and the Ohio legislature, the plan that would be used to spend down the health care trust over a ten year period at which point health care would cease other than a minimal plan based on pay as you go funding.

Thus, the liability criteria as defined in Concepts Statement Number 4 of legal enforceability or social or moral or economic enforceability are not met. OPERS' health care plan is not contractually required or socially obligated and the Board actions to modify the plan demonstrate that lack of obligation. Employers participating in OPERS are collectively responsible for the employer contribution and are not obligated for any additional component. As such, we believe the better representation of the Ohio plan is to expense the portion of the employer contribution rate allocated to fund health care and allow footnote disclosure of the trust and expected life of the fund along with the plan design structure.

Allocation of Liability

We understand that the GASB has given considerable thought to the application of the proposed standards to agent and single employer plans, and in these instances the standards will result in an appropriate recognition of a liability under the control of the employer.

However, multiple-employer cost-sharing plans present greater challenges. Cost-sharing plans such as OPERS' plan in which the plan design is the variable factor based on funding levels function less like traditional OPEB plans. The cost of these future retirement benefits is pooled, much like the risk pool of an insurance company, and cannot be separated with reliable accuracy to reflect the actual experience of a given employer.

The proposed allocation of the aggregate liability to participating employers will result in OPEB expense and net OPEB liability values that suggest a greater level of accuracy and dependability than truly exists. Additionally, based on the plan design modifications, the liability and expense are likely to be volatile making them difficult to understand and to rely on for long term decision making.

Proportionate Share

The proposed standards provide for allocation of the net OPEB liability to employers based on the projected future contribution requirements of the employer as a ratio of the total projected future contribution requirements of all employers, similar to the requirements of GASB 67/68. As the GASB staff is aware, OPERS conducted a complete mock implementation of the pension standards immediately after the final standards were published. OPERS used this mock implementation to identify implementation issues with the standards and shared our results with GASB staff for consideration in their work on the Implementation Guide.

As an outcome of this effort, OPERS uses a slightly modified approach to allocation which considers the member and employer contribution rate given that member rates vary among division. Our modified approach provides a more appropriate allocation methodology given our environment.

Using the proportionate share methodology proposed in the exposure draft presents some concerns based on our environment. As noted previously, members are not eligible for a health care allowance unless they meet the new 20 year service threshold and a retirement age requirement. Consequently, projections indicate a substantial portion of our population (approximately 54% of our employers representing 13% of our members) will not be eligible for a health care allowance. OPERS' health care eligibility criteria are somewhat akin to pop-up eligibility and thus we know a substantial number of our 3,700 employers will not have any employees that will be eligible for health care. Thus, an allocation of a proportionate share based on the proposed methodology would not be a fair representation of the financial economics.

In addition to the eligibility issue, the GASB proposed allocation method will result in disproportionate shares of the OPEB expense and liability being allocated to smaller general government. Specifically, OPERS has over 1,700 employers with a workforce of 10 employees or less, most of which will never have employees that are eligible for a health care allowance.

With respect to the current retiree and beneficiary population, OPERS' databases do not track employer data once a member retires, thus costs associated with retirees cannot be assigned back to an employer. Additionally, many of our members work for multiple OPERS' participating employers over the course of their career.

Additionally, the proposed allocation method distributes the burden of liabilities arising from workforce downsizing, dissolution of a governmental entity, and I or privatization of governmental functions, as well as the liabilities arising from employees from other Ohio retirement systems who retire under OPERS' covered benefits to all remaining OPERS' employers. When a governmental entity is dissolved (as has happened in Ohio), there is no payment of the unfunded liability by the entity or other type of termination benefit calculation. Instead, the OPEB liability for these former employers is shifted to the remaining employers in the fund.

Thus, we have concerns that the proposed allocation methodology is more problematic for OPEB liabilities and expenses and results in an inaccurate representation of the financial responsibility. We would suggest an improvement would be to allocate only the portion of the liability that is related to those members eligible for health care.

Volatility

OPERS' funding allocation to the health care plan has fluctuated from 1% to 7% of employer contributions, including multiple changes to allocation percentages occurring within a year. When analyzing sensitivity data for the 2013 financial information used for the GASB test implementation, a range of 0% to 4% resulted in significant changes in the net OPEB liability of \$1.4 billion, or 22%, and associated OPEB expense of \$244 million, or 32%.

Modifying plan design to not exceed projected available resources results in significant volatility to the net OPEB liability and associated activity. For example, in the valuation period ended December 31, 2010, the net OPEB liability was \$14.6 billion and funding during that year was 5% of employer contributions. In the following year 2011, the net OPEB liability increased \$4.8 billion and associated expense was \$2.3 billion, in most part due to a decrease in the funding rate by 1%. In 2012, significant health care plan changes were passed by OPERS Board resulting in the net OPEB liability decreasing by approximately \$12 billion to \$6.4 billion, while the funding rate remained constant at 1%. Under the proposed standards, in 2012, due to the decrease in the net OPEB liability, associated OPEB

income allocated to employers, rather than expense, would have been \$10 billion. Under these exposure drafts, the proportionate share of the net OPEB liability and associated expense or income would create significant volatility within the employers' financial statements from one year to the next. While this information is interesting, without some likelihood of an expectation that the employers may have an additional obligation, the information is more confusing than helpful for users of employer financial statements.

- **Complexity / Other Concerns**

As a result of OPERS' participation in the GASB field test, the following additional concerns were identified regarding the complexity of the proposed disclosures that require clarification or amendment.

Actuarial Issues

Taxes or Other Assessments

Paragraph 42 states that projected benefit payments should include taxes or other assessments expected to be imposed on benefit payments. During the field test, our actuaries were unable to estimate such assessments (i.e. excise or Cadillac tax). Currently, not enough information and activity exist to permit reasonable estimates. Our data indicates this activity will be difficult and potentially burdensome and costly to determine estimates that are likely inaccurate.

Impact of Subsidies

Paragraph 42 also states that projected benefit payments should not be reduced by subsidies expected to be received for making benefit payments other than those received for providing Medicare benefits. The exposure draft clarifies that Medicare Part D that is addressed in Technical Bulletin 2006-1 should not reduce projected benefit payments. Employers offering a high quality prescription drug program for retirees and their beneficiaries are eligible for a federal subsidy under either the Medicare Part D program or a qualified prescription drug program (PDP). The Medicare PDP is structured as a direct subsidy rather than a Medicare Part D type reimbursement. It is unclear if the exposure draft would permit recognition of federal subsidy offset to the plan expenses.

Actuarial Issues:

We understand a goal of the GASB in implementing new standards in the measurement of OPEB liability is to introduce conservatism in comparison to industry standards. The significant determining factors in the calculation of the OPEB liability are the actuarial cost method and the discount rate.

Actuarial Cost Method

The Entry Age Normal (EAN) cost method already has conservatism built in and supports the long-term nature of an on-going plan as the accrued liability is determined by taking into account future service and future pay, as compared to other cost methods that does not take these projected amounts into consideration. OPERS agrees that the usage of the EAN cost method is appropriate in measuring the OPEB liability.

Blended Discount Rate

In accordance with current GASB standards, OPERS uses a blended discount rate of 5.0% in determining our liabilities for financial reporting and valuation purposes. Results from using the proposed blended rate methodology in the test implementation yield blended discount rates in the range of 5.3% to 6.0% under all sensitivity scenarios. This higher discount rate results in a lower, less conservative, net OPEB liability than the current standards.

Additional Employer Considerations

The volatility discussed above creates difficulty for employers in budgeting and providing reasonable projections of their financial statements. Significant swings between health care expense and income between years in one of the most significant liabilities on the employer's financial statements could cloud the real issues of the employer's financial statements that are within their control. Employers lack the data to project the assigned liability and related income or expense and the corresponding information necessary to estimate their proportionate share percentages. This will contribute to an erosion of confidence by the public in the financial management of employers.

Additionally, numerous audit issues are currently arising with respect to the new pension standards and these same issues will exist with the proposed health care standards.

Currently many employers are experiencing issues with at least one bond rating agency. The insistence of the bond rating agency on using its own criteria and methodology to re-value the liabilities adds to the confusion and lack of confidence.

Implementation of the proposed standards will add additional cost to both the retirement systems and the participating employers as demonstrated by the new pension standards. Increases are occurring in actuarial, audit and consulting

services along with internal staff resources used to communicate information to stakeholders in an effort to clear up some of the confusion. Based on our experience with the implementation of the new pension standards, the estimated additional costs provided to GASB during the test implementation of the pension standards were grossly understated. References in GASB related material indicate an assumption that these additional costs are passed on to participating employers, however some states (such as Ohio) do not permit additional costs to be passed on to employers. Accordingly, OPERS would be responsible for paying these additional costs, which could be construed as a violation of Internal Revenue Code's "exclusive benefit rule" (IRC 401(a)(2)).

Timing

We request that the GASB reconsider the proposed effective dates of these exposure drafts. Implementation of the new pension standards are still in process and states are working through a myriad of implementation issues. The pension standards were issued over two years ago and as of the date of these OPEB exposure drafts we have yet to see authoritative guidance from the audit associations to address the outstanding issues or to allow the development of the reporting checklists. Additionally, the newly proposed fair value standards will become effective and require implementation during this time period. Plans and employers need time to fully implement all of these standards to make the fundamental operational and control environment changes to allow successful accounting and reporting before addressing the new proposed changes under the OPEB exposure drafts.

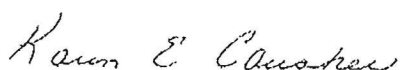
Recommendations

We understand and support the intent of the new reporting requirements in the GASB exposure drafts; however we believe GASB should consider the significant variances between states and allow for other options in cases where the participating employer will not be expected to assume the unfunded liability. We believe it is more important that governments are paying the statutorily dictated contributions on time and that they are effectively managing their operating budgets. Employers have no control over costs and liabilities attached to OPEB and there is no associated direct cash outlay regarding these amounts that would be required to be recognized by these exposure drafts – but yet these liabilities will be considered as a factor in bond rating determinations. We would welcome the opportunity to discuss and explore acceptable means of assurances including legislation, etc. In the event the GASB Board is unwilling to consider alternatives, we would like to offer the following recommendations as the exposure drafts relate to multiple-employer cost-sharing plans:

- 1) The aggregate OPEB expense and net OPEB liability could be reported on the face of the financial statements of the System, with potential note disclosures in the financial statements of the employers. This approach places the OPEB liability and related activity with the only entity responsible for funding the discretionary plan.
- 2) We recommend only the portion of the liability relating to employees that will receive a benefit should be allocated to employers. The portions of the liability associated with “non-eligible” members or retired members should remain with the System.
- 3) We recommend the GASB allow the usage of a blended rate methodology that produces a discount rate no greater than that being used by systems as calculated under proposed standards. Under test implementation, using OPERS’ current blended rate methodology, the net OPEB liability is 15% more conservative than using the blended rate methodology proposed in the Exposure Draft.
- 4) The complexity and implementation concerns associated with the proposed standards are significant, as has been evidenced by the similar pension standards issued in 2012. We recommend the issuance of these proposed standards be delayed and follow the implementation of the pension standards by our employers to allow time for fully vetting still unresolved issues that exist or may exist with the pension standards that have yet to be implemented and identified. This would prevent subsequent amendments to these OPEB standards after issuance.
- 5) Finally, we strongly urge the GASB to evaluate the decision usefulness of the proposal as it relates to cost-sharing systems, relative to the significant additional costs that will be incurred to implement and the ongoing cost of compliance.

We appreciate the opportunity to comment on the exposure drafts, and the opportunity to testify at the September 12, 2014 hearing. Questions may be directed to Karen Carraher, Executive Director (kcarraher@opers.org), or to Jenny Starr, Director of Finance (jstarr1@opers.org).

Sincerely,



Karen Carraher, CPA Executive Director, OPERS