

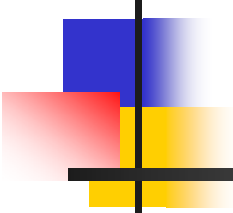
OPEB (Retiree Healthcare)
for the
City of Tallahassee

Assistance and Guidance
Report #1103

January 6, 2011

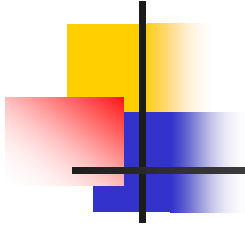


OPEB (Retiree Healthcare) for the City of Tallahassee



Current OPEB Decisions Will Have A
Long-Term Impact – Now is the Time to
Make Fair and Responsible Decisions

Office of the City Auditor
January 6, 2011



Some OPEB History



What is OPEB (Other Post Employment Benefits)?

- OPEB is an exchange of services provided during an employee's working years for post employment benefits (other than pension benefits) to be provided by the employer during the employee's retirement years. To date, the City has helped retirees by paying part of the retiree health insurance premium - an employer subsidized OPEB



Retiree 2010 Health Insurance Premium

Type	Employee	City	Total	Percent Paid
<u>Coverage</u>	<u>Pays</u>	<u>Subsidy</u>	<u>Premium</u>	<u>by City</u>
Individual	3019.92	2098.56	5118.48	41 %
Two party	6450.60	3788.52	10239.12	37 %
Three party +	8677.68	5318.64	13996.32	38%



Retiree 2011 Health Insurance Premium

Type	Employee	City	Total	Percent Paid
<u>Coverage</u>	<u>Pays</u>	<u>Subsidy</u>	<u>Premium</u>	<u>by City</u>
Individual	3287.04	2098.56	5385.60	39 %
Two party	6985.08	3788.52	10773.60	35 %
Three party +	9408.24	5318.64	14726.88	36 %



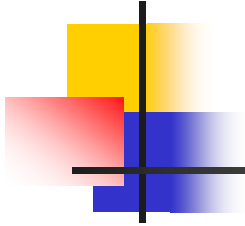
Previous City Funding and Current Accounting for OPEB

- Prior to 2009, City funds were used to subsidize retiree health insurance premium costs.
- The City subsidy was on a pay-as-you-go basis meaning monies came from current year appropriations or reserves.
- New accounting principles now require governments to recognize OPEB cost at the time the employee renders services rather than when the subsidy will be paid.
- Accounting principles cannot require the City to fund the liability, however, the City must record the amount of the liability which, if not actuarially funded, will be passed on to future generations.



What Has the City Done in Response to New Accounting Standards

- In 2009, the City established an OPEB Trust Fund with the intent of actuarially funding the explicit (subsidized) OPEB cost going forward.
- If actuarially funded year after year, the OPEB Trust Fund will accumulate sufficient funds to fully fund any promised OPEB subsidy during the employee's retirement years.
- In 2009, General government (non-union) employees began paying .25% more for their pension.
- In 2010, Fire union employees began paying .25% of salary into the OPEB Trust Fund.
- The police union contract is currently being negotiated



What are the Retiree OPEB Issues that need to be Addressed?



What are the Retiree OPEB Issues that Need to be Addressed?

- There is likely a significant lack of understanding by all employees as to OPEB benefits they have earned and may receive in the future, what the amount they are currently paying represents in relation to total OPEB cost, what the amount paid entitles them to, and what happens to the OPEB subsidy if they leave or retire from the City.
- Each of the above issues needs to be addressed, made clear, and communicated.



What are the Retiree OPEB Issues that Need to be Addressed?

- The September 27, 2009, Agenda Item 18, Statement of Issue, indicates the City Commission addressed OPEB and approved an increase by .25% of the defined benefit **retirement contribution** to be paid by **General, Police, and Firefighter** employees. Changes for fire and police contributions were not immediately implemented as they had to be negotiated through union agreement.
- Subsequently, a fire union contract was approved. Fire union employees are now directly contributing .25% of salary to the OPEB Trust Fund.
- Currently, OPEB funding for general government employees is different than funding for fire union employees. General government employees are not directly contributing to OPEB. They are paying an additional .25% of salary into their defined benefit pension account.
- It is not apparent why these two groups of employees were treated differently.
- At this time, a contract for police has not been approved.



What are the Retiree OPEB Issues that Need to be Addressed

- It is not currently clear what claim a general employee or a fire employee has to an OPEB subsidy when:
 - **The employee vests, does not retire, leaves the City, and receives a refund of pension contributions.**
 - The **general employee** did not pay into the OPEB Trust Fund and will receive a refund of pension payments upon termination. Is the former employee entitled to a health care subsidy at the time they would have reached retirement age had they continued with the City? Yes/no/ In what amount?
 - The **fire employee** paid into the OPEB Trust Fund up to the time of termination and will receive a refund of pension payments upon termination. Is the former employee entitled to a health care subsidy at the time they would have retired had they continued City employment? Yes/No/In what amount?



What are the Retiree OPEB Issues that Need to be Addressed

(cont'd)

- **The employee vests, leaves the City but does not immediately retire, and then retires at a later date**
 - The **general employee** receives a pension at a later date – is the former employee entitled to (1) join the retiree health care program and (2) receive a health care subsidy (even though they never directly contributed to the OPEB subsidy)? Yes/No/ In what amount?
 - The **fire employee** receives a pension at a later date – is the former employee entitled to (1) join the retiree health care program and (2) receive a health care subsidy since they paid into the OPEB Trust Fund up to the time they left? What subsidy amount are they entitled to as years of contributions into the OPEB Trust Fund could vary significantly?

* Please be aware for the above example that under current City policy, although these employees are not receiving a retirement payment, their retirement benefit is still increasing by 3% per year up to the date they officially retire.



What are the Retiree OPEB Issues that Need to be Addressed

- The resolution that accompanied the Ordinance setting up the OPEB Trust Fund indicates the **percentage** of the insurance premium (the subsidy) the City will pay in 2009-2010 budget year. This was the policy at the time fire employees began paying into the OPEB Trust Fund.
- For the 2010-2011 budget year, the City Commission, through the budget process “froze” the OPEB subsidy **amount** for all employees for the following budget year and into the future.
- Since there is some question as to the authority of the City Commission to change the OPEB subsidy from a percentage of premium to a fixed amount of subsidy, a new resolution will be presented to the City Commission in early 2011 to address this issue.
- The authority of the City Commission to freeze this subsidy amount “into the future” in connection with the 2010-2011 budget approval process needs to be opined on by the City Attorney for concurrence or for alternative actions/recommendations.



What are the Retiree OPEB Issues that Need to be Addressed

- Currently, fire employee contributions to OPEB are based on a percentage of salary; however, the health care subsidy is a set or given amount regardless of employee's salary. By comparison, pension contributions are based on salary and pension benefits are based on salary and years of service. To address this issue, **consideration** should be given to the following:
 - Amounts paid by employees into the OPEB Trust Fund should be based on criteria other than salary since the benefit is not based on salary.
 - The OPEB subsidy (benefit) to be received at retirement should be based on years of service.
- Alternatively, the City Commission should consider the advantages versus disadvantages of having all employees contribute additional amounts to their pension and the City fund entirely the OPEB. With this approach the City may be in a better position to change OPEB policies and benefits based on the City's ability to fund and pay benefits.



What are the Retiree OPEB Issues that Need to be Addressed

- Benefits of Years of Service Alternative
 - Currently, general government employees can work for the City for 5 years, retire at age 62, and receive the same OPEB subsidy as an employee who worked for the City for 30 or more years. This approach seems to penalize long-term lesser paid employees whose insurance premium in retirement is a significant part of their retirement benefit.
 - It is likely that fire and police, since they can retire earlier than general government employees, will receive a subsidized OPEB for more years than general government employees.
 - **Consideration should be given to basing the OPEB subsidy on 3% of the subsidy amount for each year of credible service.** As an example, with 33 years of service an employee would receive 99% of the subsidy. This change could result in a more equitable redistribution of available funds. (Please also see slide 39)



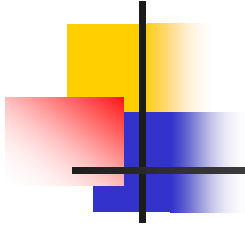
Recommendations that Need Discussion and Actions

- If possible, the approach and process for funding the OPEB subsidy for general government and fire union employees should be the same.
- The Treasurer-Clerk and City Manager should develop recommended policies relating to the OPEB subsidy for review and approval by the City Commission.
- Strong consideration should be given to basing OPEB benefits on years of service rather than just retiree status (single, single plus one, family, Medicare eligibility, etc).



Recommendations that Need Discussion and Actions

- Now is the time to fairly and responsibly make long term decisions that address the above issues. Information to assist in making those decisions should be presented to the Financial Viability of the Government Target Issue Committee and then presented to the full City Commission for discussion and disposition.



Additional Information Relating to OPEB



The OPEB Obligation

- Does the City have a **legal** obligation to provide an OPEB (healthcare) subsidy to its employees?
 - *No – however, if contributions are deposited into the OPEB Trust Fund and identified as coming from or paid on behalf of a certain group, those monies can only be used as provided for in the Trust Agreement.*
- Does the City have a **moral** obligation to provide an OPEB subsidy to its employees?
 - *The OPEB benefit has been provided in the past. OPEB is an exchange of benefits for service. Accordingly, there is a strong case for continuing the benefit to retirees, less obligation to current employees (especially new employees), and likely no obligation to future employees. It would be important to know the conditions of employment as explained and as understood by the City and the employees.*



Modification to OPEB Subsidy Going Forward

- If there is an OPEB obligation, could the OPEB subsidy be stopped or modified for:
 - Current retirees? *Yes – however, most governments are not stopping the subsidy for already retired employees*
 - Current employees? *Yes – however, somewhat difficult to stop or modify as the benefit has been given to employees in the past and to most recent retirees*
 - Future employees? *Yes – easier to stop*

* *The OPEB Ordinance authorizes the City Commission to expand, terminate, and/or modify the plan at any time in the future. In the case of union contracts, the plan would likely be changed at the end of the contract period. This City Commission authority to change program benefits at any time needs to be understood by all retirees and employees.*



Can the City Treat Groups Differently?

- Is the obligation (legal/moral) different for:
 - General employees - *The City stopped the previous (pay-as-you-go) program and is now actuarially funding explicit cost going forward in the OPEB Trust Fund. The City is providing all explicit cost funding for current and retired general government (nonunion) employees.*
 - Fire employees - *As part of the union contract, the agreement states “the **City agrees to provide .25% funding for future OPEB liability incurred from retiree health subsidy.**” The City is additionally contributing to the OPEB Trust Fund and continues to provide a subsidy for retired fire union employees.*
 - Police employees - *There is no current union contract. The issue of an OPEB subsidy may be part of negotiations. The City is currently contributing to the OPEB Trust Fund and providing an OPEB subsidy for retired Police employees. The City may choose to discontinue funding if police chooses not to contribute to the OPEB Trust Fund.*



OPEB and Similarity to Pensions

- Is there agreement that OPEB is like a pension and should be accounted for like a pension?
 - *Yes – all authoritative bodies compare accounting for OPEB as similar to accounting for pensions. The authoritative bodies have said that even if there was no written OPEB agreement in the past, the mere existence of a program constituted an OPEB plan.*
 - *GASB cannot require a government to fund the obligation; however, it can require the government to recognize the obligation in its financial statements. OPEB is an exchange of benefits for services. A model funding program would set aside funds during an employees working years to pay for benefits provided in the employees retirement years. Otherwise, the retiree OPEB cost (the subsidy) is shifted to future generations for which they receive no benefit.*



OPEB and Union Contracts

- Is OPEB part of current union contracts? What is provided for in the contract?
 - *Fire – As part of the most recent fire union negotiations, the union contract states the City agrees to provide .25% funding for the future OPEB liability.*
 - *Police – There is no contract to date. OPEB is likely part of the discussion as it was part of fire negotiations. Currently, police are not contributing toward the cost of OPEB benefits for current employees or retirees.*



OPEB for Fire and Police

- Neither fire nor police are fully funding the explicit liability for OPEB.
- If the City continues to provide an OPEB subsidy, employees should recognize the benefit currently far exceeds the cost to the employee.



OPEB for Police, Fire, and GG Employees

- Police and fire employees can retire with 25 years service whereas GG employees can retire with 30 years of service. This means it likely cost the City more to provide an OPEB subsidy for police and fire than GG employees as they are retired for a longer period. If continued, should this additional cost to the City be quantified and factored into negotiations?
 - *This issue is worthy of discussion. Fire and police employees will likely receive OPEB benefits for more years than General Government employees. Data has not been accumulated on how many years and for how long police, fire, and GG employees continue with subsidized City healthcare after retirement. Basing benefits on years of service would address this issue.*



OPEB and Police and Fire

- Police and fire pensions are different than GG employee pensions. Can the OPEB benefit be different for these groups?
 - *Yes . Whether the City Commission wants to make that distinction is a policy decision. **The City actuary calculates OPEB cost separately for police, fire, and general government employees.***
 - *As the City has changed from an OPEB pay-as-you-go program to an actuarially funded and accounted for program, this is the proper time to consider program benefits and direction. Basing benefits on years of service would address this issue.*



If the OPEB Subsidy Started Today for Police and Fire

- If the City began an OPEB subsidized program today, would there be an expectation to bargain the subsidy for:
 - General Government
 - *There would be no bargaining for GG employees as they are not currently part of a union. However, the expectation would be that the City would live up to its promises.*
 - Police - *Yes – it is likely – Again, a policy decision*
 - Fire - *Yes – it is likely – Again, a policy decision*



If We Add New Unions

- If new unions are formed for other parts of the government, would we expect to negotiate any OPEB subsidy for these new union employees?
 - *Yes – it is likely. A policy issue for the City Commission. The City is under no legal obligation to provide an OPEB subsidy. City funding could be part of union negotiations and included in the union contract.*



Do Current GG Employees Contribute to OPEB?

- *City GG employees are not directly funding OPEB. They are paying more into their individual pension plan. Accordingly, the City is paying less into the pension plan with the idea that the City amount previously going to the pension fund for GG employees will now go to the OPEB Trust Fund. There has been no attempt at this point to link these two actions. If there is no link, one must ask the reason or need for increasing the employee pension contribution amount by .25% of salary.*



Comparison of OPEB Subsidy to Employee Contribution

- **What percent of the total OPEB subsidy are GG and fire employees contributing to OPEB?**
 - *GG employees are not paying for OPEB – they are paying more for their pension.*
 - *For Fire employees, .25% of salary is being contributed into the OPEB Trust Fund. Fire employees appear to have a direct link to the OPEB Trust Fund.*
- * *To place into perspective, an employee earning \$50,000 per year and contributing .25% of salary would contribute \$125 per year as an OPEB assessment. Upon retirement, the subsidy could be as much as \$5,000 per year. **Note - .25 % of salary is an arbitrary amount and was not intended to represent the actuarial cost of OPEB. The City Commission needs to know the % of salary contribution that would fully fund the explicit costs in order to evaluate the true worth of the subsidy.***



OPEB Contribution Expectations

- By requiring GG employees to contribute .25% of salary into the pension fund and Fire employees to contribute .25% of salary into the OPEB Trust Fund, have we set up an expectation the City will continue the subsidy?
 - *The employees likely think so.*
- At the same amount/percentage of premium?
 - *The employees likely do not know the benefit has been frozen in amount going forward.*



Employees Contributing to OPEB

- Since the City funded the OPEB subsidy in the past, what is the significance of now requiring employees to contribute?
 - *It helped to continue the benefit for current retirees and the expectation of receiving a benefit in retirement for current employees.*
 - *The City has changed from a pay-as-you-go plan to an actuarially funded plan.*
 - *One could observe that it is a benefit the City promised employees if they continued working to retirement, did not set money aside for during the employees working years, and now is asking the employees to help to pay for to show good faith to continue the subsidized plan.*

Benefit of Not Requiring Employees to Contribute to OPEB



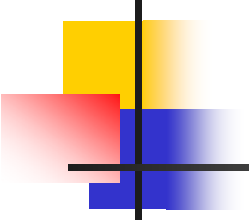
- If employees did not contribute to OPEB wouldn't the City be in a better position to adjust the subsidy amount or percentage of the annual premium at a later date?
 - *For GG employees - yes. Actually, GG employees are contributing to their pension – not to OPEB. It is likely employees are not aware of this fact.*
 - *For Fire employees – this issue may be more difficult as they are now contributing (gave up) .25% salary increase to pay for their OPEB benefits. This issue needs additional discussion.*



Does the OPEB Benefit Vest?

- If a current fire employee contributing to OPEB (pension) leaves the City, is vested, and retires some 6-30 years later, could the employee claim he/she is entitled to the OPEB subsidy in addition to a pension payment when he/she retires?
 - *How this affects Fire employees needs to be discussed. They may have good reason to think they are due an OPEB subsidy. The .25% amount provided for them is described as for OPEB future funding.*

**It has not been made clear to GG employees they are not contributing to OPEB. It also is not clear what the employee is entitled to if they have a break in service and retire in subsequent years.*



Difference Between GG and Fire Employees - Do Employees Understand What They are Paying?

- General government employees are contributing an additional .25% toward their pension. If the employee leaves the City, and request a refund of pension contributions, they **will** get their .25% back as part of their total pension contributions. This supports the view that in substance and form, GG employees are not contributing to OPEB.
- For Fire employees ,the City is contributing .25% of fire salaries (a foregone salary increase) into the OPEB Trust Fund. If the fire employee leaves the City and request a refund of pension contributions, it **will not** include the .25%. That amount was deposited into the OPEB Trust Fund. **Currently, the status or disposition of that .25% is not clear.**



Modifications to OPEB

- Based on what has happened, what can the City do now to stop, adjust, bargain the OPEB subsidy:
 - *The City still has options*
 - *GG employees – needs discussion with a long-term view.*
 - *Fire employees – needs discussion with a long-term view.*
 - *Police employees – no current contract – needs discussion.*



Adequacy of OPEB Funding

- Since establishing the OPEB Trust Fund are we currently fully funding the explicit cost of OPEB?
 - *Not known – We are currently seeking an updated actuary study which could significantly change calculations. Important to the actuary study is whether the OPEB subsidy is frozen into the future. If the City were to decide to increase the subsidy in 5, 10, 15 years, a calculation would have to be made of the unfunded prior OPEB cost and that cost made up going forward. This is a very important point to consider in establishing the annual contribution to the OPEB Trust Fund.*



Going Forward

■ Suggestions

- *Treat OPEB like pensions and factor into funding and compensation accordingly*
- *Whether the City funds OPEB on a full or partial basis, ways should be sought to treat all employee groups the same. In other words, all groups participating should pay into the OPEB Trust Fund or none of the groups should pay into the OPEB Trust Fund. This would allow for consistency in changing or discontinuing the program in the future. If the City fully funds the OPEB subsidy, many of the issues identified earlier go away.*
- *Decide what plan changes need to be made for the long term with a goal of fairness and responsibility*
- *Clearly inform all employees the subsidy is frozen by amount into the future.*



Going forward

- Consider providing the subsidy based on years of service rather than status as single, single plus one, or family.
 - Use a factor of 3% for every year the employee worked times the current premium. This would address employees that retire earlier than other employees, and are more likely to have family coverage for a longer period. For example, an employee with 30 years service will receive 90% of the subsidy compared to an employee with 25 years of service that would receive 75% of the subsidy.
 - The 3 % factor would also address a current inequity. Now, an employee retiring with 5 years of service receives the same health insurance subsidy as an employee retiring with 25 or 30 years service.
 - The above change to base benefits on years of service could result in a more equitable redistribution of available funds.



Importance of OPEB Discussion

- The decisions the City Commission makes now regarding OPEB may have more significant current and long-term impact than any current salary issue.
- Now is the Time to Make Fair and Responsible Decisions