

OPERS testimony before the Governmental Accounting Standards Board

September 12, 2014

San Francisco

Mr. Chairman and GASB Board Members: I'm Karen Carraher, the Executive Director of the Ohio Public Employees Retirement System. I have with me Sherry Chan, our Chief Actuarial Officer, and Jenny Starr, our Chief Financial Officer. We want to thank you for the opportunity to comment on the OPEB exposure draft.

We know you received a lot of letters from Ohio. I think there are about 50 of them so far. I hope you don't discount some of them because they are similar, but many of our groups worked together on their letters.

All the Ohio letters have a similar theme, that is that we believe Ohio has a unique structure and thus the OPEB structure in our state does not meet the definition of a liability. Ohio statutes are clear and our materials and training are clear to our members and our employers that health care coverage is discretionary and is subject to change or elimination at sole full discretion of the OPERS Board.

OPERS began offering health care for retirees in 1974 and is unique in that we started pre-funding health care at that time. The funding for the current health care plan comes from an allocation of the employer contribution rate, which is fixed in statute, and interest earned on the trust funds. The OPERS Board has the sole authority to determine the portion of the employer contribution rate allocated to health care, and it determines the allocation every year after establishing the appropriate pension funding necessary from the employer contribution rate. The portion of the employer contribution rate allocated to health care has ranged from 7% at a high and down to 1% planning to go to 0% at a low.

In Ohio, the employer and member contribution rates are fixed in statute and would require a legislative change to increase or decrease these rates. Thus, the model for the management of our health care trust fund is that we adapt the plan design and benefit structure to live within the projections of the funding available through the trust. If the funding is insufficient, we modify plan design.

In Ohio, the discretionary benefit isn't just language in statute. As our letter indicates, we can demonstrate that practice in our operations. I have been with OPERS for 13 years and in that time we have modified our plan design 5 times and these were very significant plan design changes which impacted every aspect of the plan design, including eligibility. In fact our most-recent plan changes, which we expect barring any significant unexpected event, should allow our current fund to last for over 100 years, included design changes that increased the eligibility requirement from 10 years of service to 20 years of service without grandfathering for our current members.

The changes included revisions to the allowance (which is the amount of funding we provide towards health care) that reduced some current retirees' health care from having OPERS cover 100% of their health care to dropping it down to OPERS covering 75%, all while phasing out the coverage for spouses. So we can demonstrate that we will make changes to both the active members through the eligibility requirements and to retirees through actual changes. These changes were not insignificant and as a matter of fact reduced the unfunded liability from \$19 billion down to \$7 billion ... a \$12 billion reduction.

Concepts Statement 4 defines the liability criteria based on the expectation of legal enforceability or social or moral or economic enforceability, and we do not believe the Ohio model meets these criteria. In Appendix B paragraph 23 of the exposure draft the GASB Board recognizes that Concepts Statement 4 paragraph 17 defines liabilities as a present obligations to sacrifice resources that the government has little or no discretion to avoid. The GASB Board indicated it felt the obligation existed and was a present obligation because it was created as a result of an employment exchange that already occurred. In Ohio,

there is a clear understanding that there is no such promise of a benefit to be received in the future based in exchange for their services and it is reinforced by OPERS, by their employers and by the Ohio General Assembly. OPERS will do the best job it can to manage the funding to provide health care, but it must do so within the existing funding structure, and there clearly is no “obligation” for employers.

I know in Appendix B paragraph 24 of the exposure draft that the GASB Board took the position that reducing OPEB potentially results in adverse consequences for the employer or increases in other compensation costs, and therefore determined that it would be inappropriate to limit the employer’s liability to the legal obligation. But, regardless of whether anyone considers this a good or bad business model, it is nevertheless the true picture of the business model in Ohio. Thus, to require our employers to record a liability that goes beyond their legal obligation we feel results in a misrepresentation of their true financial picture.

Not only do we have the clear statute language, the clear mandate from the Ohio General Assembly that we will manage with the funding we have and design the plan to fit that funding, we also have the clear acceptance of the responsibility by our Board, and the clear understanding throughout our employers and members, as you can see from the letters you received from Ohio which came from employers, elected officials and even individual members. But, in Ohio we might have the unique distinction of having this model tested in litigation history and thus have legal decisions that support our position and allow us the full discretion to change the plan. One of the five Ohio statewide pension systems was sued years ago after they made changes to the eligibility requirements, and the courts strongly re-affirmed the Ohio position and management of health care by allowing modifications to plan design to fit the existing funds.

Thus, with respect to the Ohio model, we do not believe the current exposure draft works for the unique situation and would request the Board re-consider the approach for Ohio. Specifically, we agree with the intent for transparency and understandability, but we believe the more important goal is to capture the true nature of the transaction, and in Ohio’s case there is not and will not be any future liability with respect to health care for employers. The funds they have remitted have fully satisfied their obligation. With respect to the obligation to provide health care in exchange for services rendered, that obligation does not exist. There is no social, legal or moral requirement or duty or contract or promise. Thus there is no obligation that must be satisfied by the ultimate delivery of health care to members. But, most importantly, the employer does not bear the primary responsibility for the portion of the benefit obligation in excess of the current funding as described in Appendix B paragraph 20. The employer is not responsible for any portion of funding beyond what they have remitted in terms of their employer contribution rate, and to include a portion of any unfunded liability on their financial statements creates a misleading presentation of their true financial obligations. Thus, we would request the Board re-consider the allocation of the liability to employers in cases such as Ohio and instead require recognition of the liability by the System which is the entity that ultimately bears the risk and the responsibility for the decisions and ultimate fulfillment or elimination of the liability.

While we stand firmly that there should be no liability assigned to our employers, I want to briefly describe some issues with the proposed allocation in the exposure draft. OPERS is participating in the field test for OPEB and have run our allocation the GASB prescribed method and also allocating to employers using a similar allocation method, but one that only allocates to employers that have employees that would be eligible to participate in health care under the current plan criteria. We have over 3700 employers and have noted the differences are huge. We have one employer that would have one employee eligible to participate in health care and under the GASB model, they would be assigned a liability of \$6.7 million while under the OPERS method, the liability approximates \$257K. We have one employer with no eligible employees and they would be assigned a liability of \$3.1 million under GASB. Thus, we think the allocation methodology should either have enough flexibility specified in the standard to allow allocation to only employers with eligible employees or to specifically indicate such in the standard. Again, without such potentially creates a financial picture that isn’t truly representative by assigning a liability that doesn’t exist, which ultimately distorts the accuracy and dependability of the statements.

I'm going to have Sherry discuss our discount rate comments.

There are two topics we want to ask GASB to consider. The first is the blended discount rate methodology. OPERS is in a unique situation where the proposed blended rate methodology produces a *higher* discount rate than the current methodology. This higher discount rate generates a *lower* liability. This occurs because OPERS is in the process of phasing in some OPEB changes such as cutting back on health care benefits while ratcheting up the health care contribution rate. The current blended rate methodology weights the discount rates by the percentage of the Annual Required Contribution that is actually contributed. It only takes into account our current contribution levels, not our ultimate level which will be higher, so it yields a more conservative (i.e. lower) discount rate. The proposed blended rate methodology weights the discount rates based on projected cash flows, which take into account the full effect of OPERS' health care plan changes (i.e. lower future benefit payments), and hence yields a less conservative (i.e. higher) discount rate. The net OPEB liability is approximately 15% lower using a blended discount rate under the proposed methodology, as compared to the current methodology. We propose GASB to allow a blended rate methodology that yields a rate no greater than what is generally accepted under the current standards.

The second item we want to discuss is the sensitivity scenarios. OPERS feels having nine scenarios is excessive. That number of scenarios inundates financial statement readers, it adds cost and time on top of the additional time and cost that will already be necessary to put the proposed standards in place, and it generates redundant scenarios since moving the discount rate and health care trend rate in the same direction by the same magnitude yields approximately the same liability. OPERS proposes reducing the scenarios to just two in addition to the baseline scenario. One scenario would be to increase the discount rate by one percent while decreasing the health care trend rate by one percent. The other scenario would be to decrease the discount rate by one percent while increasing the healthcare trend rate by one percent. The remaining six scenarios can be interpolated from these two, along with the baseline.

I'm going to have Jenny discuss our timing.

We request the GASB reconsider the proposed effective dates of these drafts until plans and employers fully implement the pension standards and potentially the newly proposed fair value standards as well.

Our organization, as the Board is fully aware, has been working on the pension standards since 2011 when they were in exposure draft form and we participated in the test implementation at that time. To fully understand the pension standards and their impact, and better position ourselves and educate and inform our employers, last summer we performed a mock implementation using a volunteer employer group. From this we were able to create our own internal implementation guide and roll out webinars to our employers by the end of last year.

However, we are sitting here today over three years after the process began on the pension standards still not having all of the implementation issues ironed out despite all our efforts.

We have to implement the pension standards this year, and audit associations have yet to release accounting and auditing guides covering the new pension standards. As a result, reporting checklists and agreement with external auditors and our auditor of state on audit approach have been delayed. We also anticipate more issues will be uncovered as our employers implement starting next year.

We recommend the issuance of these OPEB proposed standards be delayed at least three years from the proposed effective dates. For plans this would be fiscal years beginning after Dec. 15, 2018, and for employers this would be fiscal years beginning after Dec. 15, 2019.

Now, Karen is going to wrap-up our comments.

OPEB is different than pension, and we request your consideration of these differences and specifically the structure in Ohio. We have worked hard to provide a plan that everyone understands is not

guaranteed and to use the existing model to fund health care for our members. Consequently, we have one of the larger OPEB trust funds at \$13 billion, and at 69% funded are well on our way to managing the liability indefinitely. But more important than the funding ratio, we have created other ways to manage this fund and create safeguards to ensure the funding will be sufficient and at such point it isn't, we will adjust the plan design to fit the available funds.

We have also demonstrated a history of providing GASB with feedback both during the comment process and after with implementation and would volunteer to provide GASB any information, suggestions, etc. for an exception to the standard that works for Ohio.

I would wrap up with two final comments. First, the key question is will the employer ever be required to fund more than it has already remitted, and the answer for Ohio is a resounding "absolutely not." Second, while we believe our current statutes are sufficient to demonstrate that there is no possibility of future expectation of funding by the employers and thus no liability, I stand here today with the support of the Ohio General Assembly who would be willing to modify statute if that's what it takes to satisfy GASB that there is no future liability for the employer, so I would ask you what the GASB would need to see to satisfy them.

Thank you for your time and consideration.