



# EMPLOYER NOTICE

## Rating agency outreach demonstrates OPERS' commitment to core values

### SITUATION OVERVIEW

OPERS is recognized as an industry leader, due to its many exemplary standards, policies and practices. It embraces responsibility, proactively prepares for anticipated challenges, and takes responsible actions to position itself as a strong pension system for all its stakeholders.

One way in which OPERS establishes itself as a leader among other public pension funds is by reaching out to bond rating agencies each year to share important insights and boost transparency. In fact, OPERS is the only public pension system in the United States that maintains this type of open relationship with the major bond rating agencies.

Outreach to rating agencies is an ideal expression of OPERS' commitment to its core values. Exceptional teamwork, respected partnerships and stakeholder advocacy all join to provide this unique opportunity to provide value to OPERS' participating public employers, and, by extension, Ohio taxpayers.

### BACKGROUND

In 2012, the Governmental Accounting Standards Board (GASB) issued two new standards, Nos. 67 & 68, changing the accounting and financial reporting requirements for public pensions. The standards require each public employer to account for a portion of its public pension plan's unfunded liabilities on its balance sheet.

Two additional standards GASB issued in 2015, Nos. 74 & 75, changed the accounting and financial reporting requirements for Other Post-Employment Benefits (OPEB), also referred to as OPERS health care.

The standards were intended by GASB to enhance the pension-related and OPEB-related information in the financial reports of participating employers by providing greater transparency and standardizing the valuation practices from entity to entity. If a pension system is over 100 percent funded, employers must recognize an asset rather than a liability; to the extent the pension system is not 100 percent funded, employers must report liabilities for the unfunded portion of the pension benefits and OPEB earned by employees. GASB believes that since employers are technically responsible for pension and health care payments, those unfunded liabilities should be reflected on their financial statements, which it was not previously. Therefore, the standards not only require separate accounting and financial reporting for pension systems like OPERS, but also call for employers to recognize a net pension asset/liability and net OPEB asset/liability on their financial statements.

Recognizing the impact pension standard requirements would have on employers, OPERS staff worked closely with OPERS-reporting and contributing employers to ensure that they were well positioned to comply with the standards. That included performing a test implementation involving a cross section of employers, delivering education on the standards, and working with external auditors and the state auditor's office to finalize and execute audit procedures. In the end, OPERS was recognized as a national leader in the testing and implementation of these standards.

#### WHAT PROMPTED OUTREACH TO RATING AGENCIES?

Some employers that participate in OPERS (counties and municipalities, for example) issue bonds to finance some of their activities. With the implementation of these new government accounting standards and the accompanying financial reporting disclosures by employers, rating agencies increased their consideration of these liabilities and associated funding commitments, particularly for OPEB, in their bond rating assessments for local and state employers. All else equal, an employer with higher employee benefit liabilities and, hence, higher expected future funding costs, is considered a higher risk when borrowing money via bond issuances. This added risk leads to higher borrowing costs by way of a higher yield rate.

Rating agencies viewed the standards as an opportunity to improve credit analysis. For example, Moody's stated in April 2016 that added disclosure of pension liability exposure for state and local governments would enable improved credit analysis of the relative strength or weakness of government contributions in paying down part of reported unfunded pension liabilities. While underlying credit risk from pensions would remain, its analytical approach to pensions would only be affected minimally.

After the standards were issued, some employers were concerned about receiving downgrades to the ratings assessing their ability to meet principal and interest payments on their bond issuances. In some cases, employee benefit liabilities were generally referenced as one of several factors that could lead to rating downgrades.

Moreover, if the bond rating agencies wanted to ask questions about future plans and other key questions about funding the debt, the employers would not have the knowledge to answer the questions. Therefore, we believed we were in the best position to help put these liabilities in perspective with the bond rating agencies and assist the various employers.

Note that OPERS is one of several government pension and health care sponsors to public employers in Ohio; the rating agencies do not specify which sponsoring system(s) influence their rating changes.

We believe that we manage our system in a prudent and fiscally responsible manner and that the liabilities associated with OPERS do not pose a material risk to our participating employers. This prompted us to begin conversations in 2015 with representatives of the three major rating agencies that assess the financial strength of government and corporate entities --- Fitch Ratings, Moody's, and S&P Global Ratings. Our goal is to provide insights related to underlying annual changes in key financial metrics so that the agencies fully understand the reported trends, any plans to address funding and upcoming events or studies and to keep the rating agencies apprised of OPERS funding structure, policies and ongoing management initiatives that collectively mitigate OPERS' funding risks.

## WHAT DO THE RATING AGENCY CALLS COVER?

During these annual calls, OPERS Analytics & Research staff elaborate on the system's pension and health care funding structure, safeguards, strategies and trends, offering context and insight into the current and future financial conditions of OPERS' plans, and, by extension, the financial conditions of participating employers. In order to provide a complete picture of the system's financial health, we provide supplemental information beyond what is contained in published financial and actuarial valuation reports; management goals; desired changes to plan design and associated risks, such as the significant changes to the system's health care program that are presently occurring; and the upcoming experience study that is conducted periodically to review the actuarial methods and assumptions used in the annual actuarial valuations. For example, after health care plan changes were approved, the unfunded liability was expected to decrease by approximately \$6 billion. While the report that would show that decrease would not occur for a year (due to the timing of reports and analyses), we could share this information with the rating agencies so they knew what to expect.

Furthermore, we remind the rating agencies of the important distinctions between OPERS and other states' pension funds, particularly in OPERS' statutorily defined contribution structure and the non-guaranteed nature of the system's health care benefits.

The calls also afford a valuable opportunity for staff to answer any questions the rating agencies might have and to ask the agency representatives about changes in their rating methodologies.

## IS THIS OUTREACH WORKING?

Since the calls have begun, the rating agencies consistently express how informative the calls are in increasing their understanding of not only OPERS, but also public pension systems in general, since public pension plans share many common characteristics and risks. It has also proven to be beneficial in the bond rating process. By helping rating agencies better understand the system, its funded status and projected funding needs, OPERS facilitates their ability to determine a more accurate bond rating. We are able to provide clarity to items that otherwise may be identified as potential concerns and negatively influence bond ratings. This affords government entities the opportunity not only to achieve lower interest rates on bond issuances, but also to bring attention to their strengths that outweigh any challenges associated with underfunded pension liabilities.

## WHOM TO CONTACT FOR MORE INFORMATION

For comments or questions, contact Employer Outreach at 888-400-0965 or by email at [employeroutreach@opers.org](mailto:employeroutreach@opers.org).

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For a current listing of OPERS Board members, please visit [opers.org](http://opers.org)

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