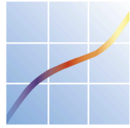

SEAL COVE FINANCIAL

OPEB: A New Liability for Public Funds to Report

By Lauryn Agnew April, 2009

Governmental entities are now required to disclose their unfunded OPEB liabilities. Medical cost inflation and retirees' longevity are creating a future, growing obligation that must be managed prudently.

OPEBs, or Other Post Employment Benefits, are predominantly post retirement health care costs that employers have promised their employees for their retirement. In many situations, particularly in government plans, these promised benefits have not been funded, and their future values are skyrocketing with medical cost inflation and retirees' longevity. It is now required that governmental entities report their unfunded OPEB liability on their balance sheets. If they can demonstrate a funding plan to meet those liabilities, the employer may be able to avoid a downgrade of their credit rating. Large unfunded pension and OPEB liabilities can make future borrowing (issuing bonds) more expensive if credit ratings are lowered.

To qualify for the benefits of applying reserves' balances to the unfunded liability, employers must set aside funds in qualified irrevocable separate trusts. This allows their actuary to include the balances in the calculations towards funding status. Assets must be appropriately invested in a diversified portfolio, including equities, much like the pension fund's asset allocation since the time horizon and risk tolerance for these long lived funds are similar. Some institutions may consider issuing OPEB bonds to raise money to create an OPEB fund. Such a fund would fall under the same financial and fiduciary
obligations as the employer's defined benefit plan. To collect, invest and grow the assets necessary to meet the post employment benefits, the assets would require an investment policy statement, a diversified portfolio of investment managers and a prudent monitoring system.

Some institutions may resort to renegotiating the level of support for postemployment health care benefits. Most institutions facing large liabilities for retiree health care costs are strapped for the resources to fund their current pension obligation, after the market's decline resulted in larger contributions on basic pensions. It is feared that the rising medical care costs, with the increasing longevity of our retirees, will create a hole that can be difficult to adequately fund. Converting an open ended or unlimited post retirement health care benefit to one that is finite, either in terms of coverage or indexed to a simple (not health care) CPI can offer a compromise goal. Benefits that can bridge the time between retirement and when Medicare becomes available is another option to contain
the magnitude of the obligation. Offering an optional deferred health care account can help employees set aside funds to augment the employers' benefit. Just as some DB plans were converted to DC, so can OPEBs be converted to a plan where the employer does not bear all the risk of medical cost inflation and
increasing longevity. Plan sponsors need a plan to cope with their OPEB. It is problem that looms large but will not go away.