

Mountain or Molehill?

Putting OPEB in Perspective for West Virginia

Wood County Commission

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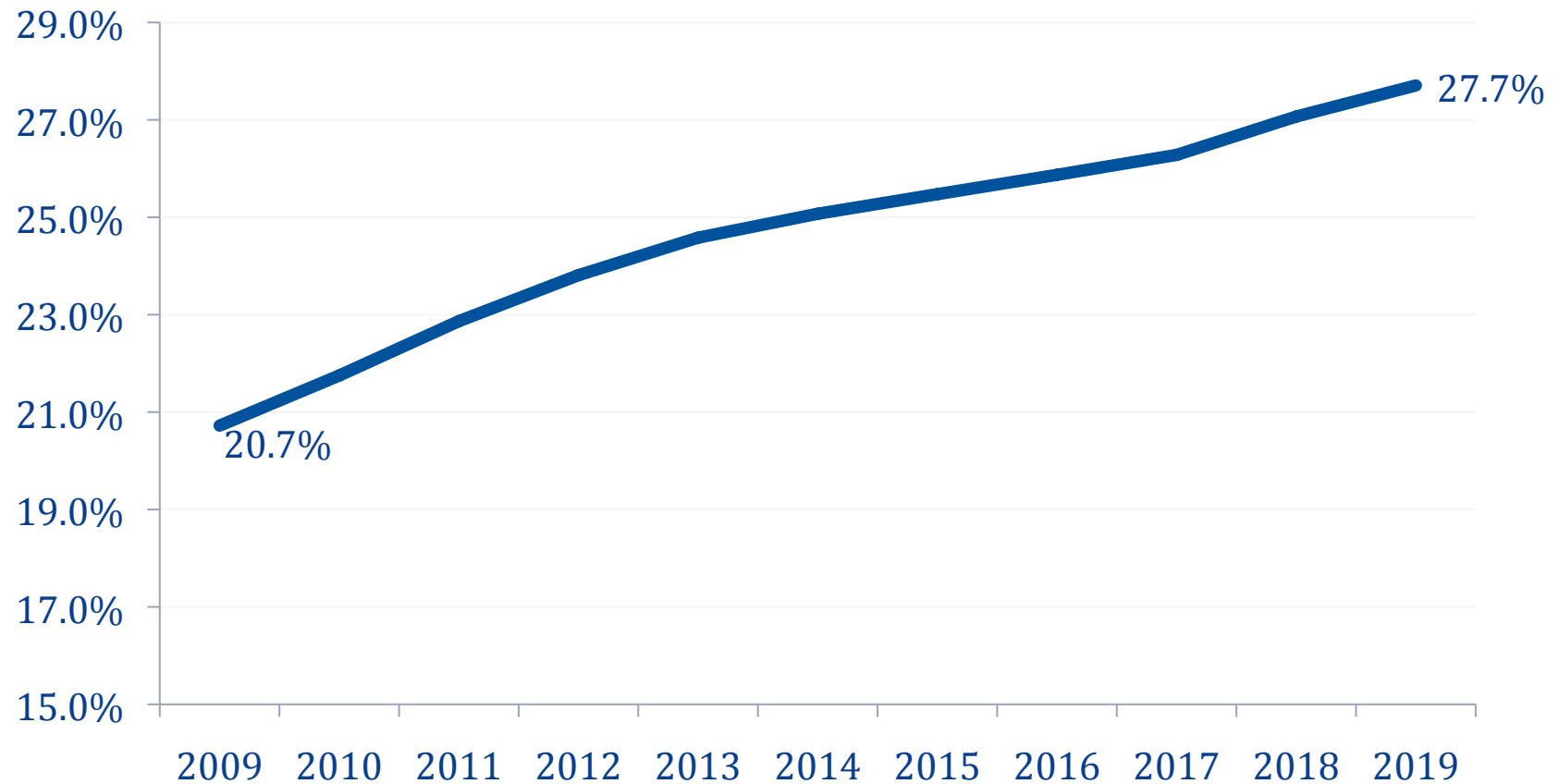


Overview of Presentation

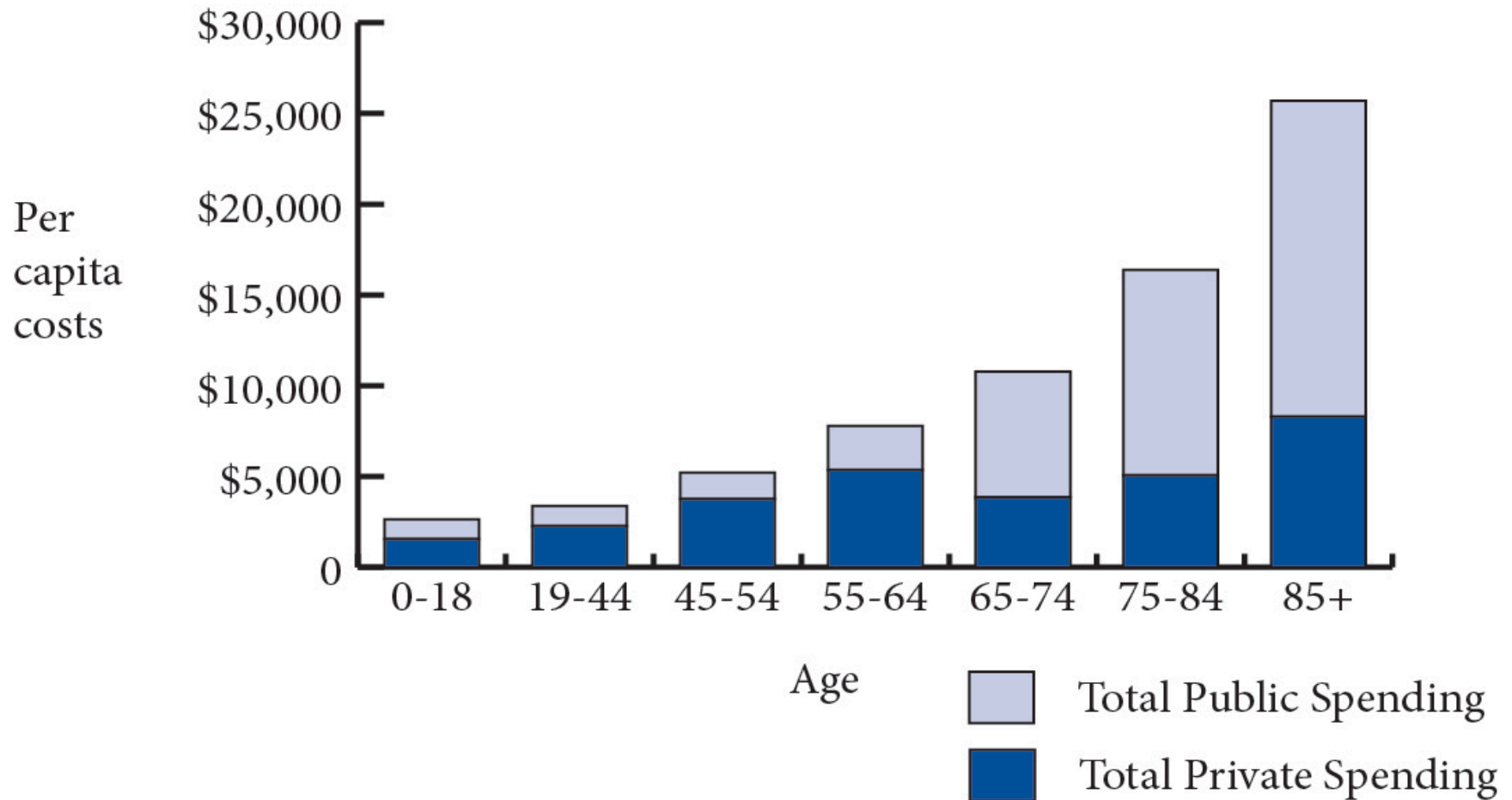
- ✧ The growing cost of health care and retirees
- ✧ How PEIA funds retiree health care
- ✧ Accounting for retiree health care in West Virginia
- ✧ West Virginia's reaction to GASB 45
- ✧ Problems and misconceptions with OPEB liability
- ✧ Should governments entities pre-fund retiree health care?

Health Care Places Growing Pressure on Budgets

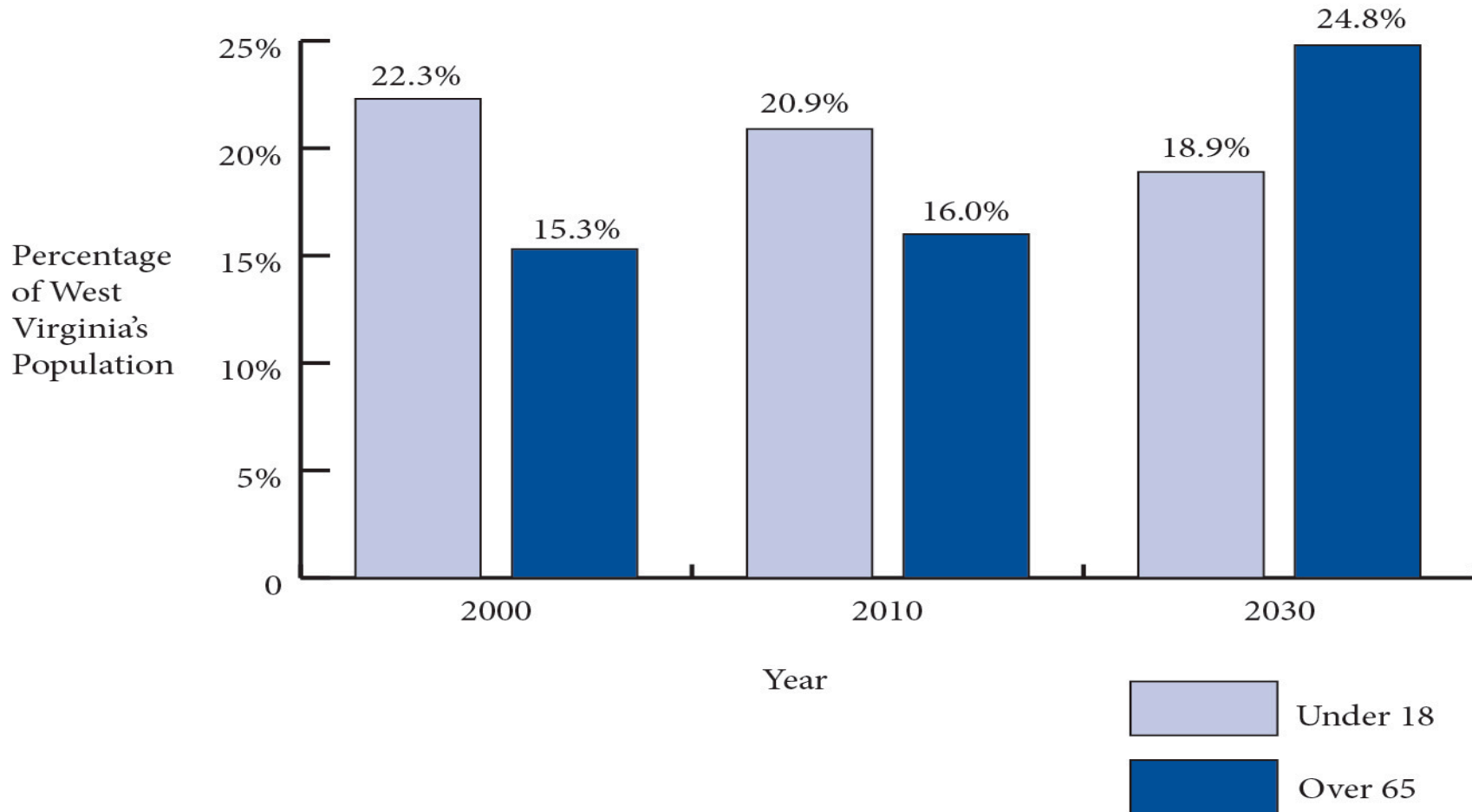
Projected WV Health Care Insurance Spending As a Share of GSP



Health care spending increases with age



West Virginia projected to become grayer by 2020



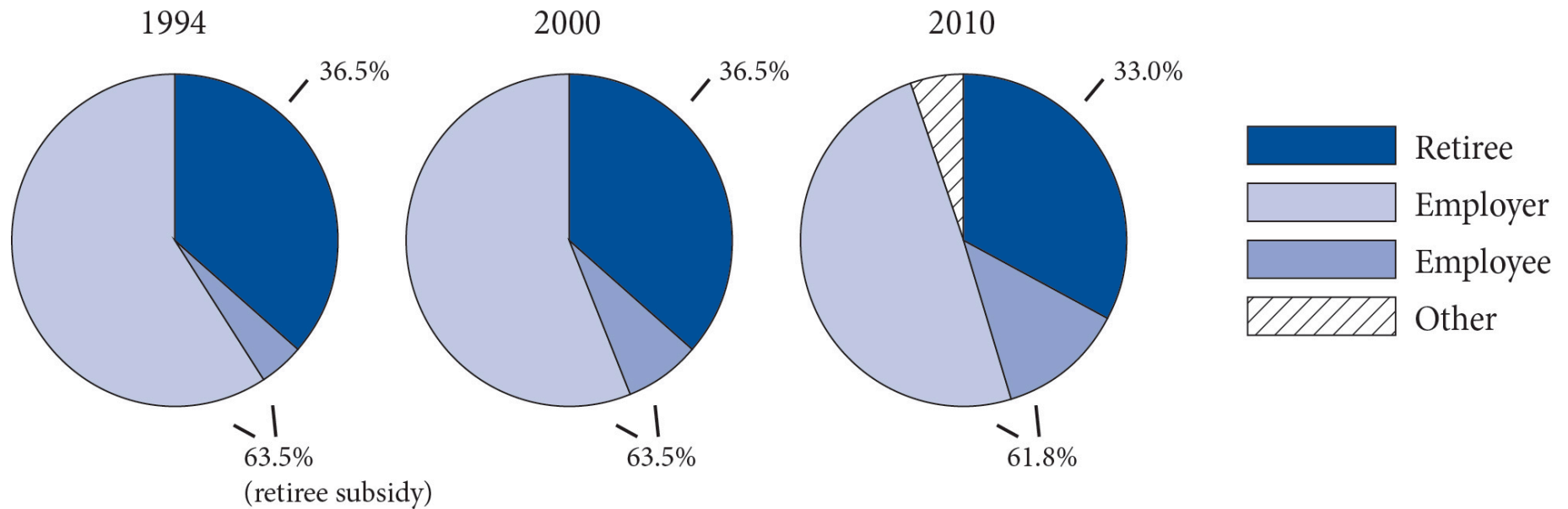
Funding retiree health care, pre-2007

- ✧ **Eligibility for Retiree Health Subsidy:**
 - ✓ 60 years old + 5 years of service, or
 - ✓ 55 years old + the number of years of public service equals 80.
- ✧ **Premium subsidy based on years of service.** (e.g. a non-Medicare retiree with 25 years would have a monthly premium of \$252. If only 15 years of service = \$436.

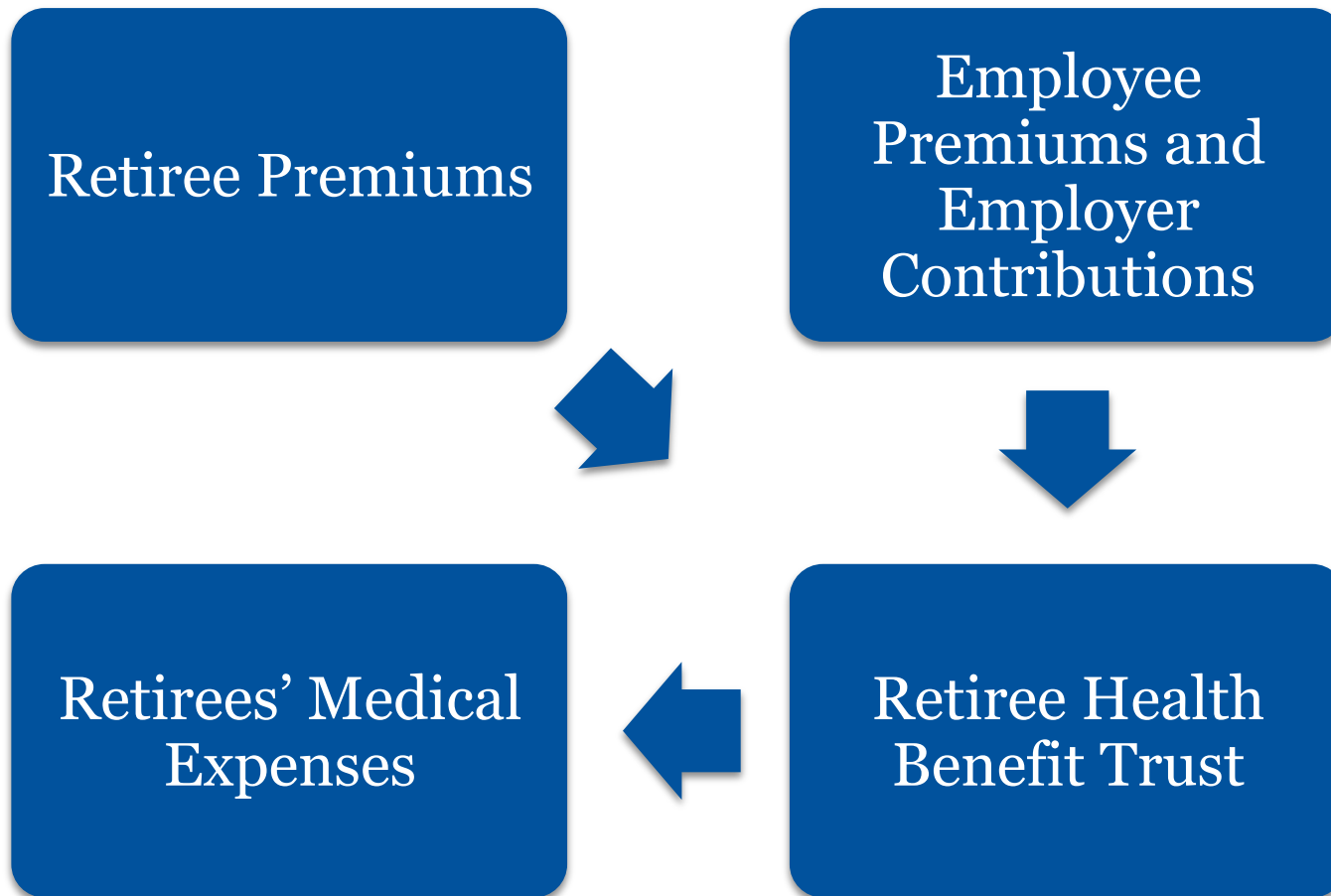
Determining the PEIA retiree subsidy, FY 2002

| | |
|-------------------------------|----------------------|
| Total retiree expenses | \$122,800,962 |
| Total revenue from retirees | -\$37,888,326 |
| Retiree subsidy allocation | \$84,912,636 |

Who Pays for PEIA retiree health care?

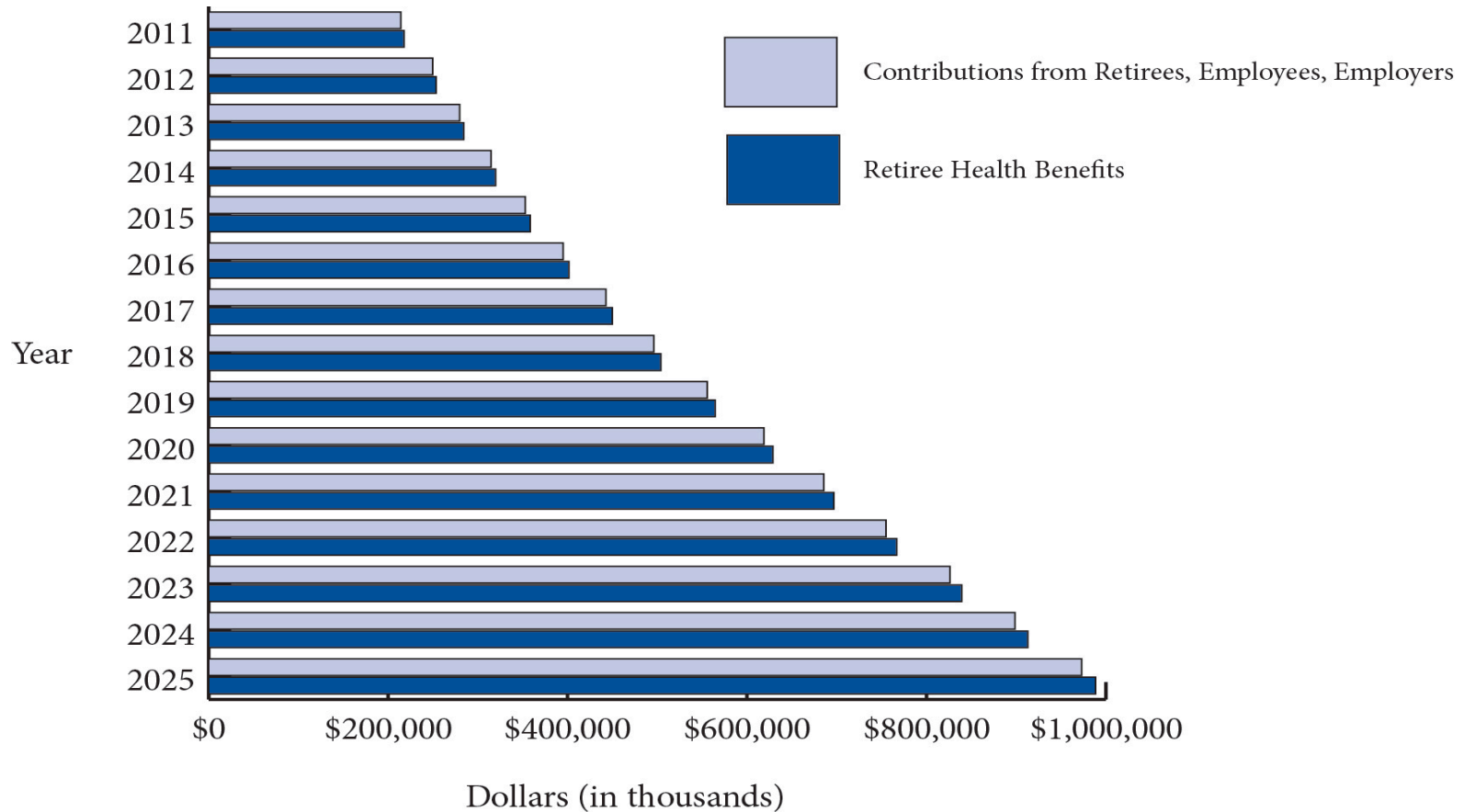


PEIA moves to a trust fund model



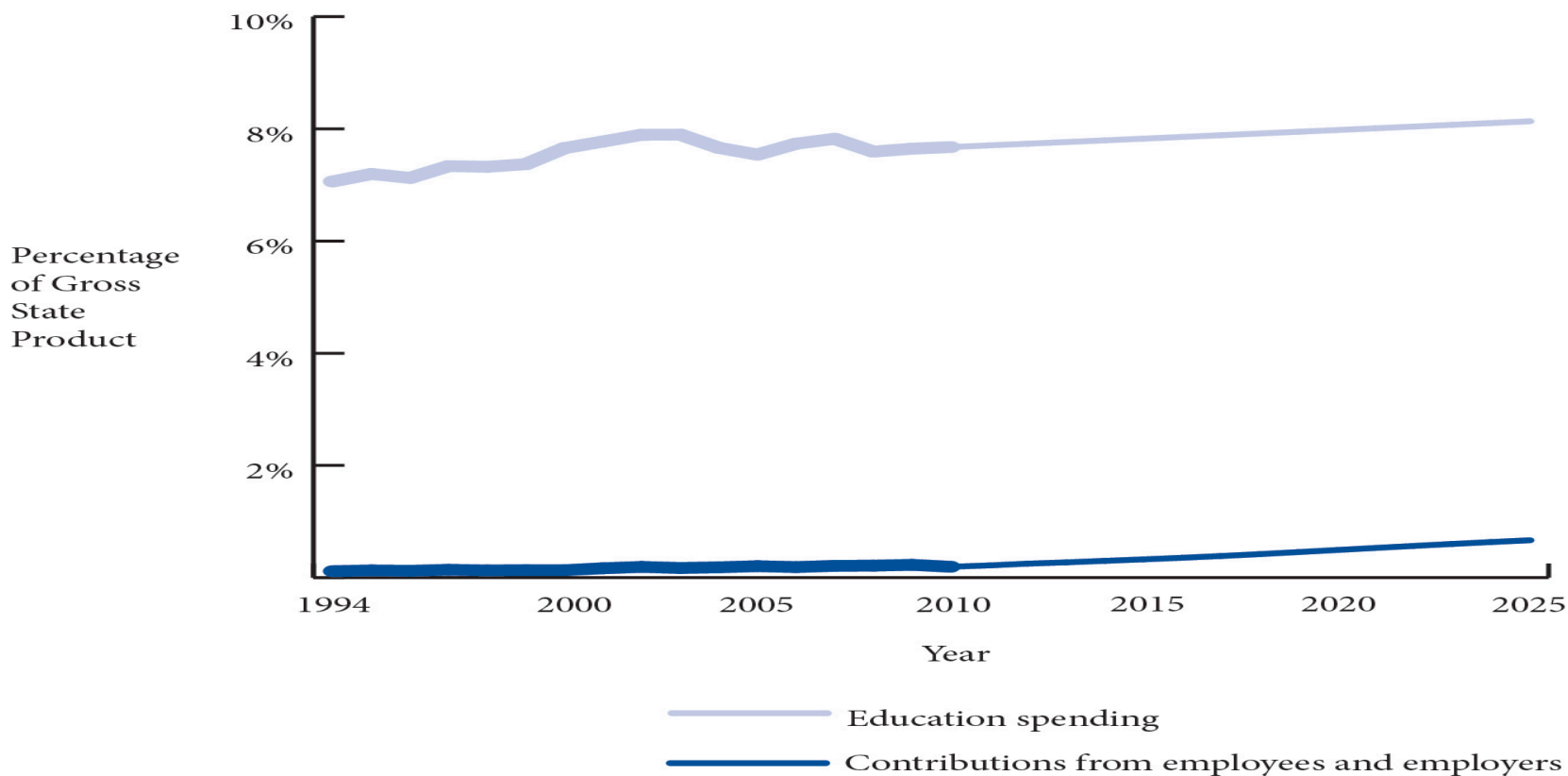
Long-range projections

PEIA revenue and costs projected to grow in future



Long-range projections *continued*

PEIA retiree subsidy only small part of state's economy



Accounting for retiree health care

- ❖ **GASB 45:** Requires state and local governments to switch from PAYGO to accrual method for calculating costs of other post-employment benefits (OPEB).
- ❖ **ARC:** PEIA is required to bill state and local employers for their portion of the Annual Required Contribution (ARC) or the amount to fully fund the liability over time.
- ❖ **ARC is not required:** The ARC is an estimate based on a number of assumptions and long-range projections. It is not an actual required dollar amount.

The ARC compared with the Minimum Payment

| | Total | Per Policy | Per Policy, Per Month |
|------------------------------------|---------------|-------------|-----------------------|
| Annual Required Contribution (ARC) | \$795,199,000 | \$10,855.07 | \$904.59 |
| Minimum Annual Employer Payment | \$122,797,568 | \$1,676.28 | \$139.69 |
| Unfunded ARC | \$672,401,432 | \$9,178.79 | \$764.90 |

West Virginia's OPEB liability

How much of West Virginia's (PEIA) current liability is funded?

| | 2008 | 2009 | 2010 |
|-----------------------------|-----------------|-----------------|-----------------|
| Actuarial Accrued Liability | \$6,362,640,000 | \$7,410,241,000 | \$8,048,300,000 |
| Assets in Trust Fund | \$254,818,000 | \$397,414,000 | \$416,543,000 |
| Unfunded Liability | \$6,107,823,000 | \$7,012,826,000 | \$7,631,766,000 |
| Funded Ratio | 4.00% | 5.36% | 5.18% |

Reaction to GASB 45

- ✧ PEIA eliminated retiree health care subsidy for new hires.
- ✧ 50 of West Virginia's 55 county school boards sued the state over the OPEB liability. The state has assigned 40 to 45 percent of the liability to the school boards.
- ✧ Interim Legislative Committee (Chaired by Sen. McCabe and Del.Kominar) recommend dozens of revenue options, including tapping the Rainy Day fund and redirecting personal income and severance tax collections.
- ✧ Delegate Walters (R-Kan) offers Drop/Crop proposal or the Deferred Retirement Option Plan and the Concurrent Retirement Option Plan.

Putting the OPEB liability in perspective

1. **The \$8 billion OPEB liability is not a fixed dollar amount owed today.**

- ✧ This figure is based on assumptions and trends that change from year to year and from actuary to actuary.
 - ✓ In Travis County, Texas, the auditor found that the liability could range from \$89 to \$380 million simply by using different underlying assumptions.
- ✧ A change in one variable, such as the discount rate, can increase or decrease the liability without the state taking any real action.
 - ✓ From 2007 to 2008, the liability rose by \$1.6 billion simply because the discount rate was lowered from 5.22 to 3.72 percent.

Putting the OPEB liability in perspective

2. Unlike pensions, retiree health care is not a guaranteed, defined benefit.

- ✧ Pensions for public employees are legally protected in West Virginia, while retiree health care is not.
- ✧ Under WV Code, the PEIA Finance Board has discretionary authority to modify or eliminate subsidized retiree health care. Therefore, the state's commitment to pay for retiree health care is not 100 percent.
 - ✓ The Board already decided to eliminate this benefit for new hires.

Putting the OPEB liability in perspective

3. The OPEB liability needs context

- ✧ The estimated liability does not reflect a cost that must be paid today.
 - ✓ Since it accounts for future health care costs of retirees, the liability reflects the possible cost of benefits paid out over the next 50 or more years.
- ✧ The growth of retiree health care costs is not happening in a vacuum; state and local budgets also will grow during this same time period.
 - ✓ Contributions from employees and employers, the main sources of revenue for the health care subsidy, likely will consume only a small part of the state's economy by 2025 - approximately 0.7 percent of West Virginia's GDP.

Putting the OPEB liability in perspective

4. **Having an unfunded OPEB liability does not necessarily bring down a state's credit rating.**

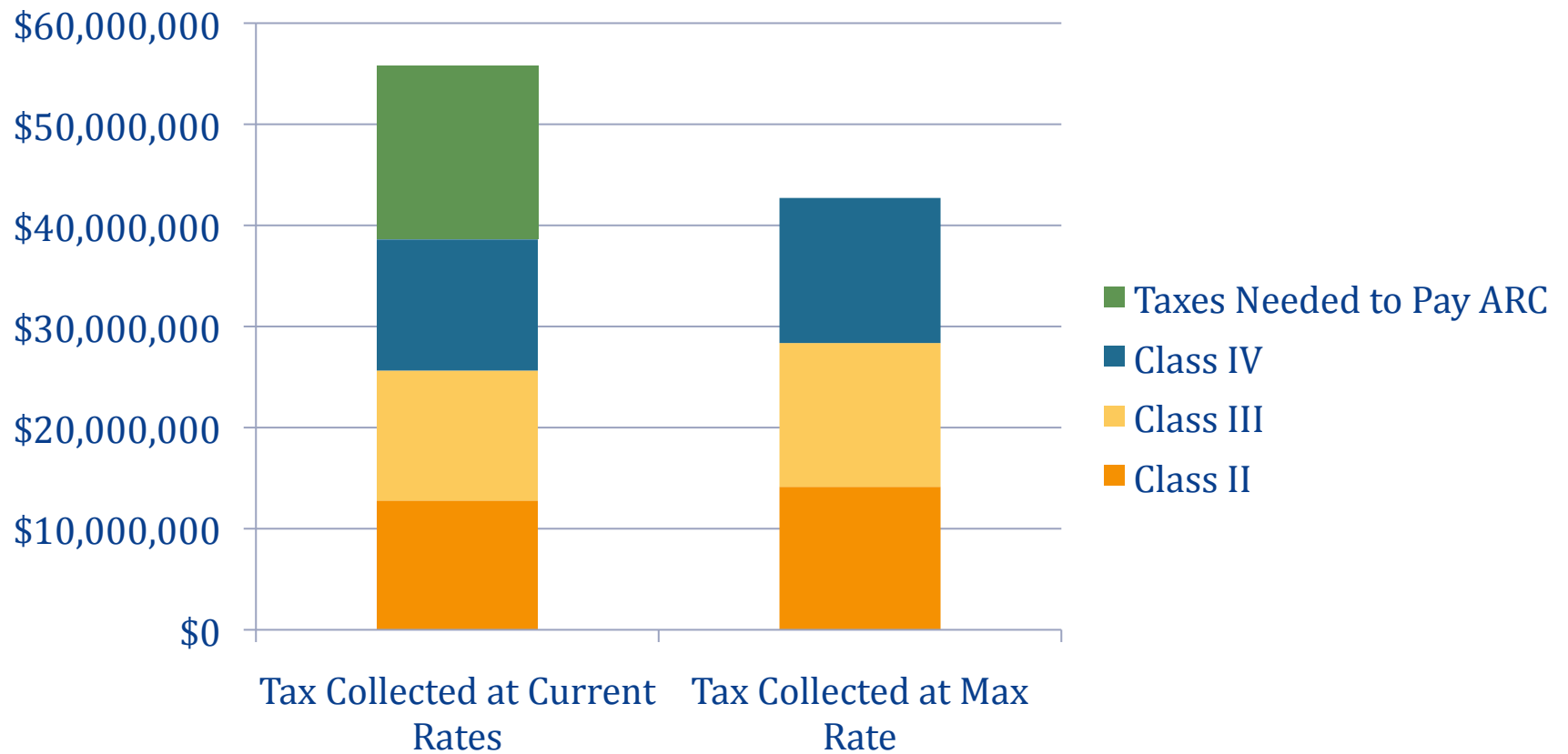
- ✧ Although companies such as Standard & Poor's do take the OPEB liability into account when rating the creditworthiness of a state, it is only one small determinant of a state's rating.
 - ✓ Moody's calls OPEB a valid liability, but not debt-like. As such, it does not "affect the debt-component of certain credit-relevant ratios."
- ✧ There does not appear to be a connection between a state's unfunded OPEB liability and its rating.
 - ✓ In 2008, seven of the 11 states with the highest rating (AAA) had a funded ratio under one percent.

Putting the OPEB liability in perspective

5. **Paying the full Annual Required Contribution (ARC) is neither required nor feasible.**

- ✧ Despite its name, the ARC is not actually required PEIA is only required by law to collect the minimum annual employer payment from state and local agencies.
 - ✓ Individual agencies currently have no incentive to contribute more than the minimum payment required by law. If an agency decides to pay its full portion of the ARC, the money goes into the Retiree Health Benefit Trust but is not earmarked for the employees of that agency.
- ✧ Paying the total ARC is an expensive proposition for state and local agencies.
 - ✓ In 2010, the ARC was nearly 6.5 times larger than the payment made by most employers. If agencies began paying the ARC, then they might be unable to pay for other important services and programs or for payroll.

Paying ARC not viable option for Wood County School Board



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