



Navigating the Changing Seas of Retiree Finance

Presented by: Michelle M. Watterworth, Partner, Plante
Moran

What's happened?





Impact of government accounting standards



What changed with the accounting rules?

- ▶ GASB-Governmental Accounting Standards Board
- ▶ New accounting standards
 - ▶ GASB 67, "Financial reporting for pension plans"
 - ▶ GASB 68, "Accounting and Financial Reporting for Pensions"
- ▶ Why should I care?
 - ▶ Previously, our unfunded pension liability was simply disclosed in the financial statements
 - ▶ Now, our unfunded pension liability is recorded on the face of our financial statements

GASB 68: The great GASB divorce



Net pension liability recorded

(full accrual only)





What **might** this affect?

- ▶ Financial position of the government
- ▶ Credit ratings
- ▶ Attitudes and awareness of the public and those charged with governance

Maybe/Maybe NOT

Government #1 – 86% Funded

| | 2013 | 2013, with GASB 68 |
|----------------------------------|-----------------------|--------------------------|
| Assets: | | |
| Cash and investments | \$ 43,578,759 | \$ 43,578,759 |
| Receivables | 25,959,949 | 25,959,949 |
| Inventories & prepaids | 5,434,732 | 5,434,732 |
| Net pension asset | 2,240,191 | - |
| Capital assets | <u>735,087,871</u> | <u>735,087,871</u> |
| Total assets | <u>812,301,502</u> | <u>810,061,311</u> |
| Liabilities: | | |
| Accounts payable/ Accruals | 18,582,860 | 18,582,860 |
| Noncurrent liabilities | 19,951,682 | 19,951,682 |
| Net pension liability | - | <u>27,147,595</u> |
| Total liabilities | <u>38,534,542</u> | <u>65,682,137</u> |
| Net position: | | |
| Net investment in capital assets | 733,587,871 | 733,587,871 |
| Restricted | - | - |
| Unrestricted | <u>40,179,089</u> | <u>10,791,303</u> |
| Total net position | <u>\$ 773,766,960</u> | <u>\$ 744,379,174</u> |

Government #2 – 74% Funded

| | 2013 | 2013, with GASB 68 |
|----------------------------------|----------------------|-------------------------|
| Assets: | | |
| Cash and investments | \$ 3,926,428 | \$ 3,926,428 |
| Receivables | 2,941,259 | 2,941,259 |
| Inventories & prepaids | 1,012,098 | 1,012,098 |
| Capital assets | <u>74,856,786</u> | <u>74,856,786</u> |
| Total assets | <u>82,736,571</u> | <u>82,736,571</u> |
| Liabilities: | | |
| Accounts payable/ Accruals | 1,845,267 | 1,845,267 |
| Noncurrent liabilities | 1,205,475 | 1,205,475 |
| Net pension liability | <u>-</u> | <u>6,004,033</u> |
| Total liabilities | <u>3,050,742</u> | <u>9,054,775</u> |
| Net position: | | |
| Net investment in capital assets | 74,530,990 | 74,530,990 |
| Restricted | 5,154,839 | - |
| Unrestricted | <u>-</u> | <u>(849,194)</u> |
| Total net position | <u>\$ 79,685,829</u> | <u>\$ 73,681,796</u> |

Government #3 – 63% Funded

| | 2013 | 2013, with GASB 68 |
|----------------------------------|-----------------------|-----------------------|
| Assets: | | |
| Cash and investments | \$ 9,458,513 | \$ 9,458,513 |
| Receivables | 11,719,950 | 11,719,950 |
| Inventories & prepaids | 1,287,234 | 1,287,234 |
| Net pension asset | 244,194 | - |
| Capital assets | 264,536,923 | 264,536,923 |
| Total assets | <u>287,246,814</u> | <u>287,002,620</u> |
| Liabilities: | | |
| Accounts payable/ Accruals | 6,465,182 | 6,465,182 |
| Noncurrent liabilities | 9,091,172 | 9,091,172 |
| Net pension liability | - | 19,812,198 |
| Total liabilities | <u>15,556,354</u> | <u>35,368,552</u> |
| Net position: | | |
| Net investment in capital assets | 256,870,243 | 256,870,243 |
| Restricted | 6,320,062 | 6,320,062 |
| Unrestricted | 8,500,155 | (11,556,237) |
| Total net position | <u>\$ 271,690,460</u> | <u>\$ 251,634,068</u> |



BUT.....

This does not change our actual financial position – it only tells a different story because it is measuring things differently.

- Closer to a true measurement of the cost of providing the benefits
- If we are in a negative net position (or negative unrestricted), it was also just as true a year or two or three ago, it's just that the balance sheet wasn't telling us the entire story (we had to look to the footnotes to obtain that information)



How did these liabilities get so big?

- ▶ Liability represents the pension promises made to both active employees and retirees that have already been earned by these members
- ▶ Liability is impacted by:
 - ▶ Pension returns
 - ▶ Funding policies
 - ▶ Employee lifecycles
 - ▶ Benefits currently in force
 - ▶ Capital market assumptions



Ripped from the headlines

Moody's:

Modest credit impact for GASB pension changes (March 16, 2015)

New Pension disclosures under GASB 67/68 will have limited impact on US state and local government ratings (June 30, 2014)

“While GASB 67 and 68 impose many new rules related to pension accounting disclosure, our approach to evaluating credit risk stemming from public pension remains fundamentally unchanged” {Moody's Assistant VP, Thomas Aaron in “New Pension Accounting Increases Clarify of Funding Trajectories)



Recent trends

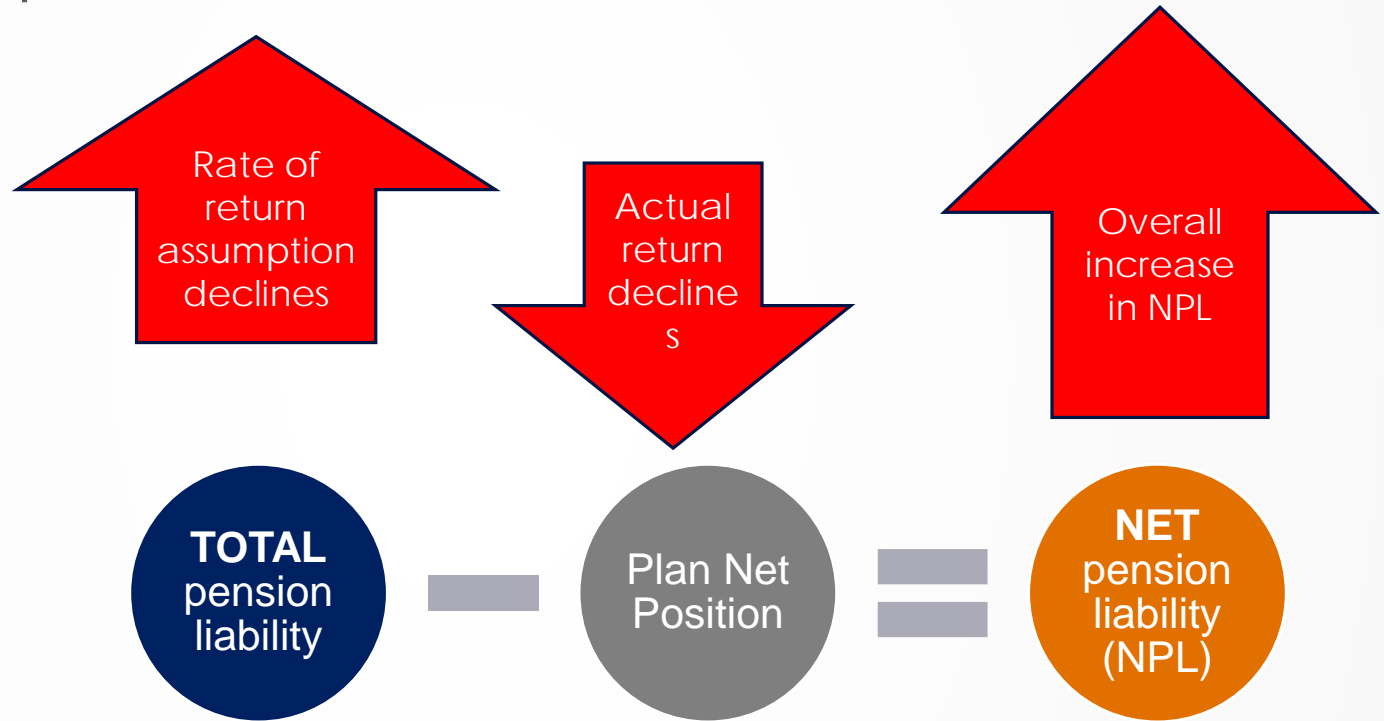
► Downward trend assumptions about long-term expected rates of return

- Public Fund Survey:
 - 126 plans measured.
 - More than half have reduced their investment return assumptions since FY 2008.
 - Median return assumption is now 7.75, down from 8.0
- As of 12/31/2014, according to NASRA, average plan return's assumption was 7.69% (down from 8% as of 2008)
- Pension&Investments: "Public pension funds taking a new look at return assumptions" (August 2015)

► Downward actual returns

- Pension&Investments: "High-return era ends for many big public pension funds" (August 2015)
 - Median returns for June year end plans range from 3-4%

Impact of recent trends



Looking forward



- ▶ First pensions, next up..... **OPEB**
- ▶ OPEB=Postemployment Benefits other than Pensions (e.g., healthcare)
- ▶ New accounting standards issued June 2015 which will dramatically change accounting for OPEB



After adoption of new OPEB standards.....

- ▶ GASB No. 74, *"Financial Reporting for Postemployment Benefit Plans other than Pensions"* .
- ▶ GASB No. 75, *"Accounting and Financial Reporting for Postemployment Benefits other than Pensions"* .

Ultimately, the impact of these OPEB accounting rules will be very similar to what we saw with the pension standard changes.

Government #1 – 86% Funded

| | 2013 | 2013, with GASB 68 | Add in OPEB impact |
|----------------------------------|-----------------------|-----------------------|-----------------------|
| Assets: | | | |
| Cash and investments | \$ 43,578,759 | \$ 43,578,759 | \$ 43,578,759 |
| Receivables | 25,959,949 | 25,959,949 | 25,959,949 |
| Inventories & prepaids | 5,434,732 | 5,434,732 | 5,434,732 |
| Net pension asset | 2,240,191 | - | - |
| Capital assets | 735,087,871 | 735,087,871 | 735,087,871 |
| Total assets | <u>812,301,502</u> | <u>810,061,311</u> | <u>810,061,311</u> |
| Liabilities: | | | |
| Accounts payable/ Accruals | 18,582,860 | 18,582,860 | 18,582,860 |
| Noncurrent liabilities | 19,951,682 | 19,951,682 | 19,951,682 |
| Net OPEB liability | - | - | 56,136,559 |
| Net pension liability | - | 27,147,595 | 27,147,595 |
| Total liabilities | <u>38,534,542</u> | <u>65,682,137</u> | <u>121,818,696</u> |
| Net position: | | | |
| Net investment in capital assets | 733,587,871 | 733,587,871 | 733,587,871 |
| Restricted | - | - | - |
| Unrestricted | <u>40,179,089</u> | 10,791,303 | (45,345,256) |
| Total net position | <u>\$ 773,766,960</u> | <u>\$ 744,379,174</u> | <u>\$ 688,242,615</u> |



So, where do we go from here?

Michigan local government officials'
views on
pension and OPEB obligations:
A statewide overview from the MPPS

Presented at the
MML Fall Conference
September 18, 2015

What is the Michigan Public Policy Survey?

- **A census survey** – all counties, cities, villages, and townships in Michigan
- **Respondents** – chief elected and appointed officials
- **Administered** – online and via hardcopy
- **Timing** – Spring and Fall each year
- **Topics** – wide range, such as fiscal health, budget priorities, economic development, intergovernmental cooperation, employee policies, labor unions, state relations, environmental sustainability, citizen engagement, much more.

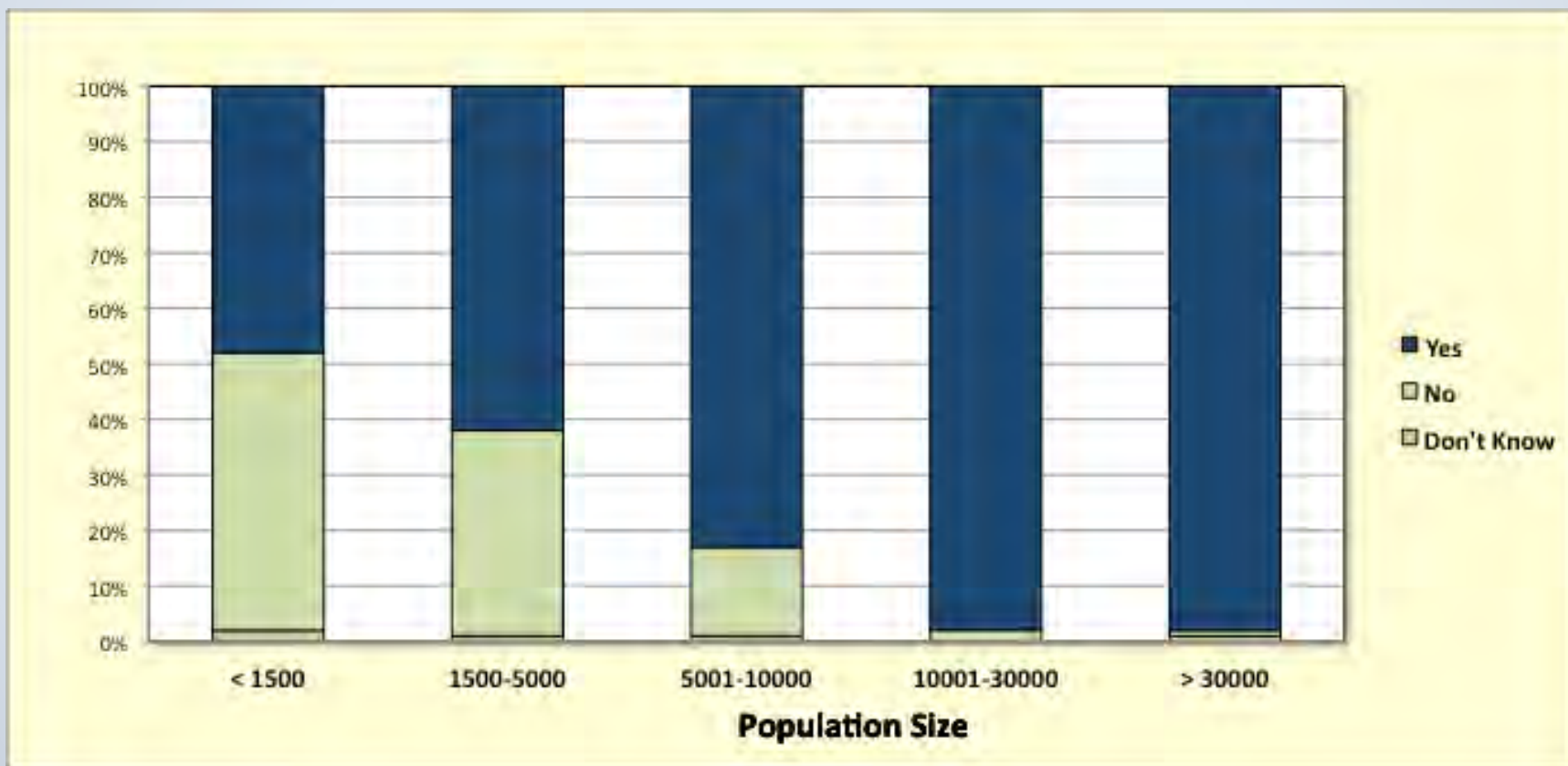
Why the MPPS is not a typical opinion poll

- 70+% response rates
- **Transparency**
 - Questionnaires online
 - Pre-run data tables online
 - Sharing of (anonymized) datasets with other researchers
- Brings in expert advisors on questionnaire content, including MML, MTA, and MAC
- Borrows from other proven sources such as NLC and ICMA

Michigan local governments' Retirement Income Benefits

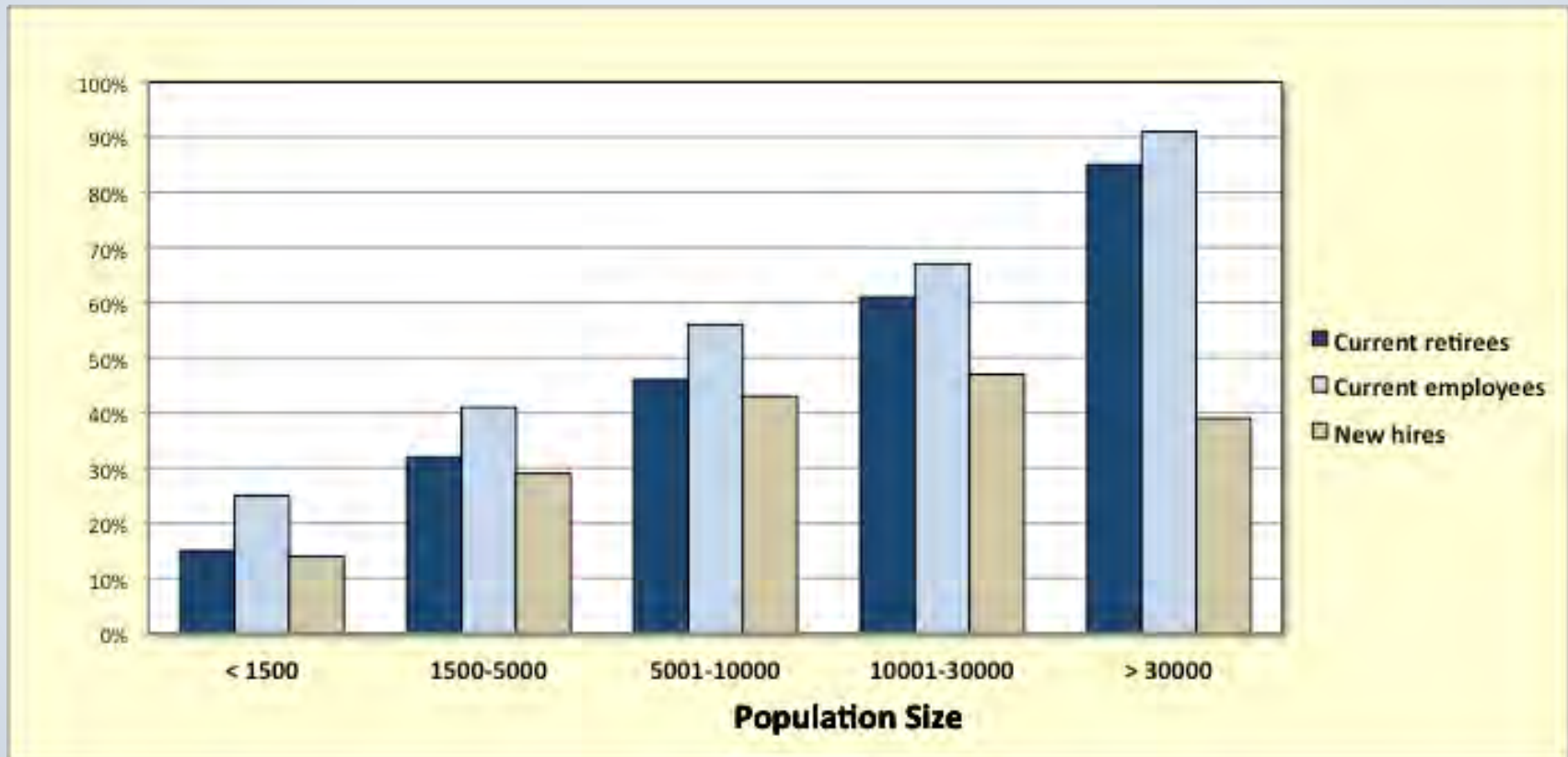
Who offers pensions?

Does your jurisdiction offer any kind of retirement income benefits (defined benefit pensions, defined contribution plans such as an IRA, 401a, 457b, or 401k-type plan, etc.) to any current or former employees and/or elected officials?



Who offers defined benefit/hybrid plans?

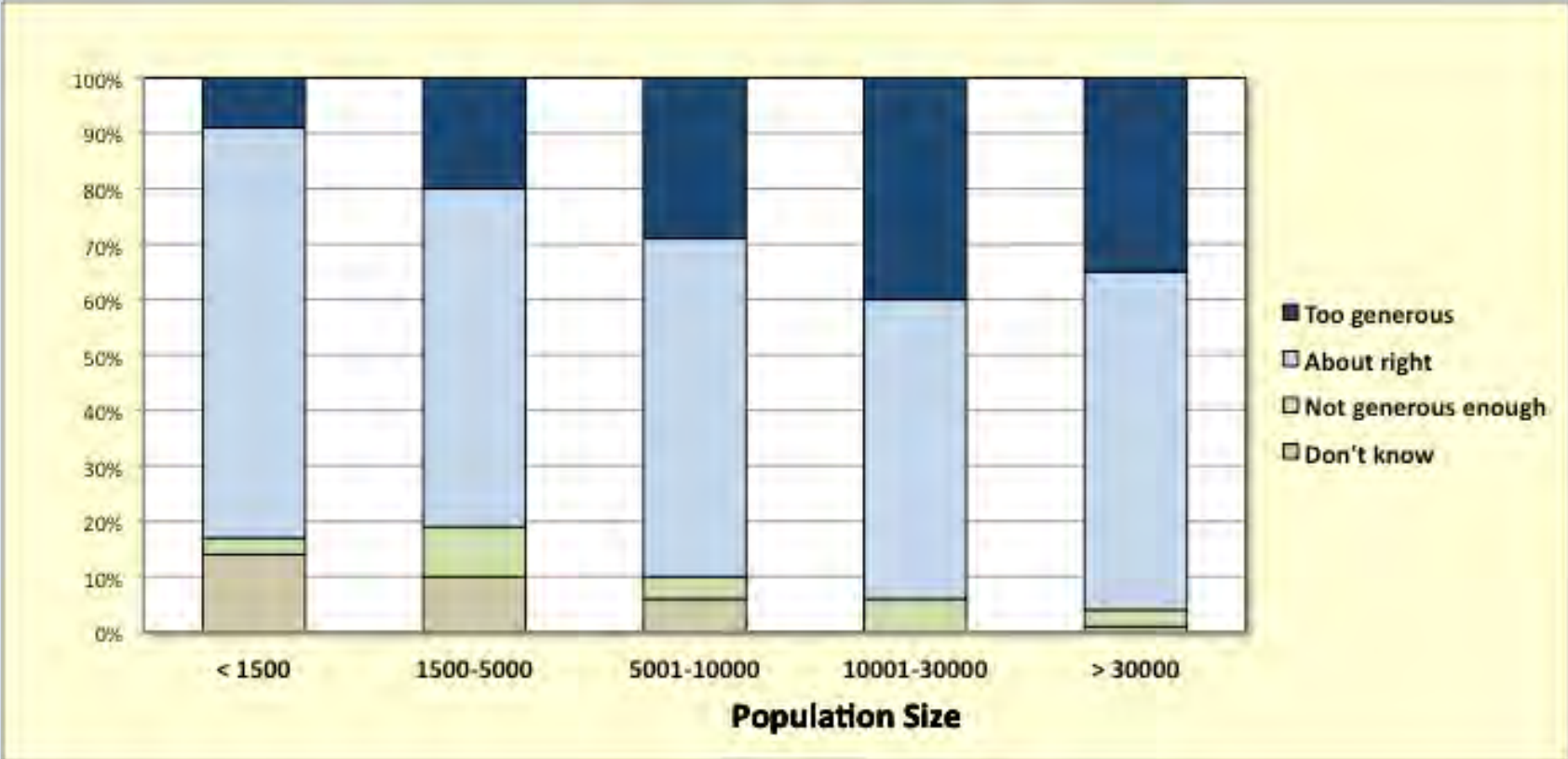
Which type(s) of retirement income benefits, if any, does your jurisdiction offer to...?



(Among those who offer pension benefits)

Who thinks their benefits are too generous?

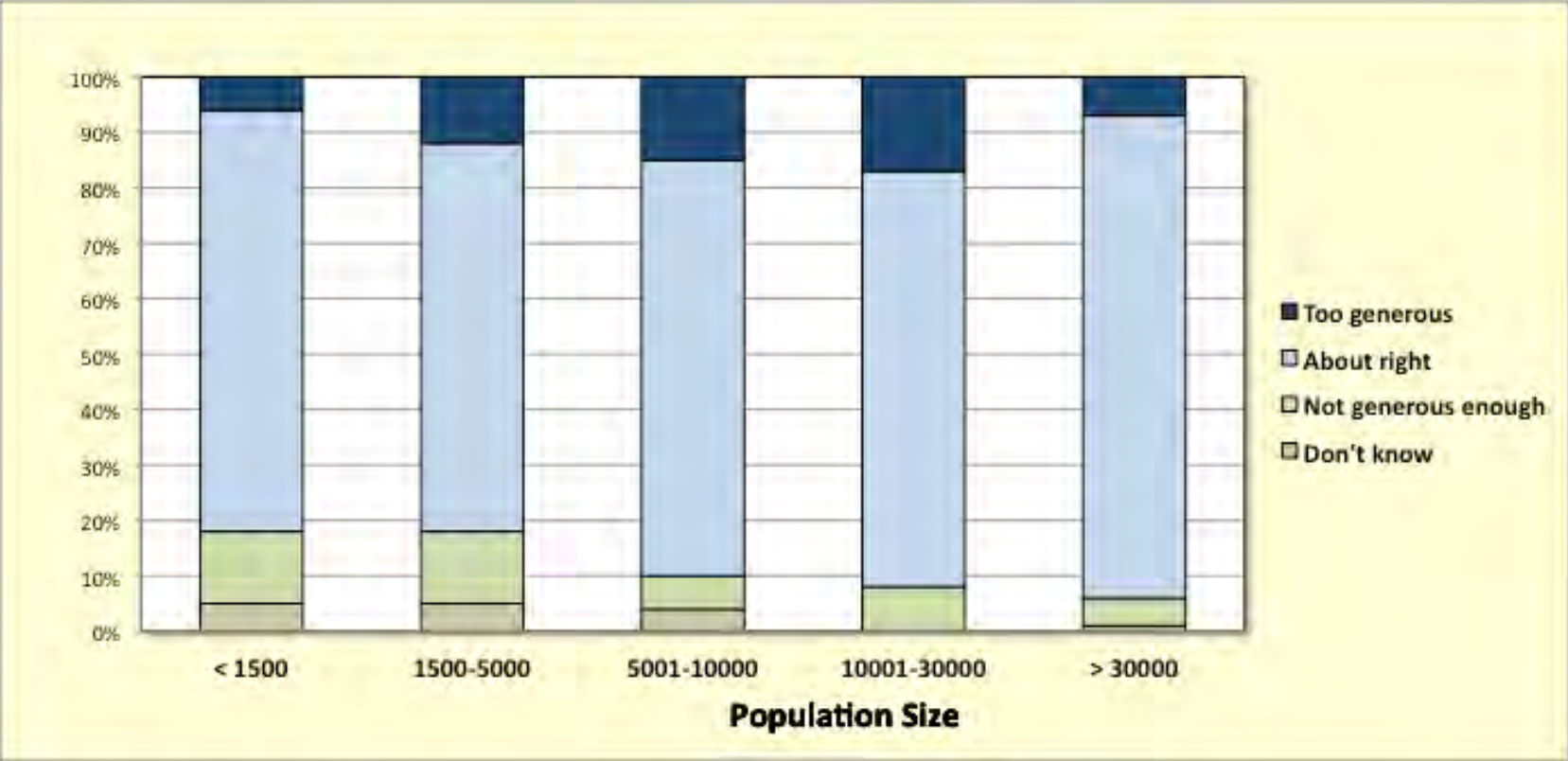
Overall, do you consider your jurisdiction's retirement income benefits - or lack thereof - for **current retirees** to be too generous, about right, or not generous enough?



(Among those who offer pension benefits)

Who thinks their benefits are too generous?

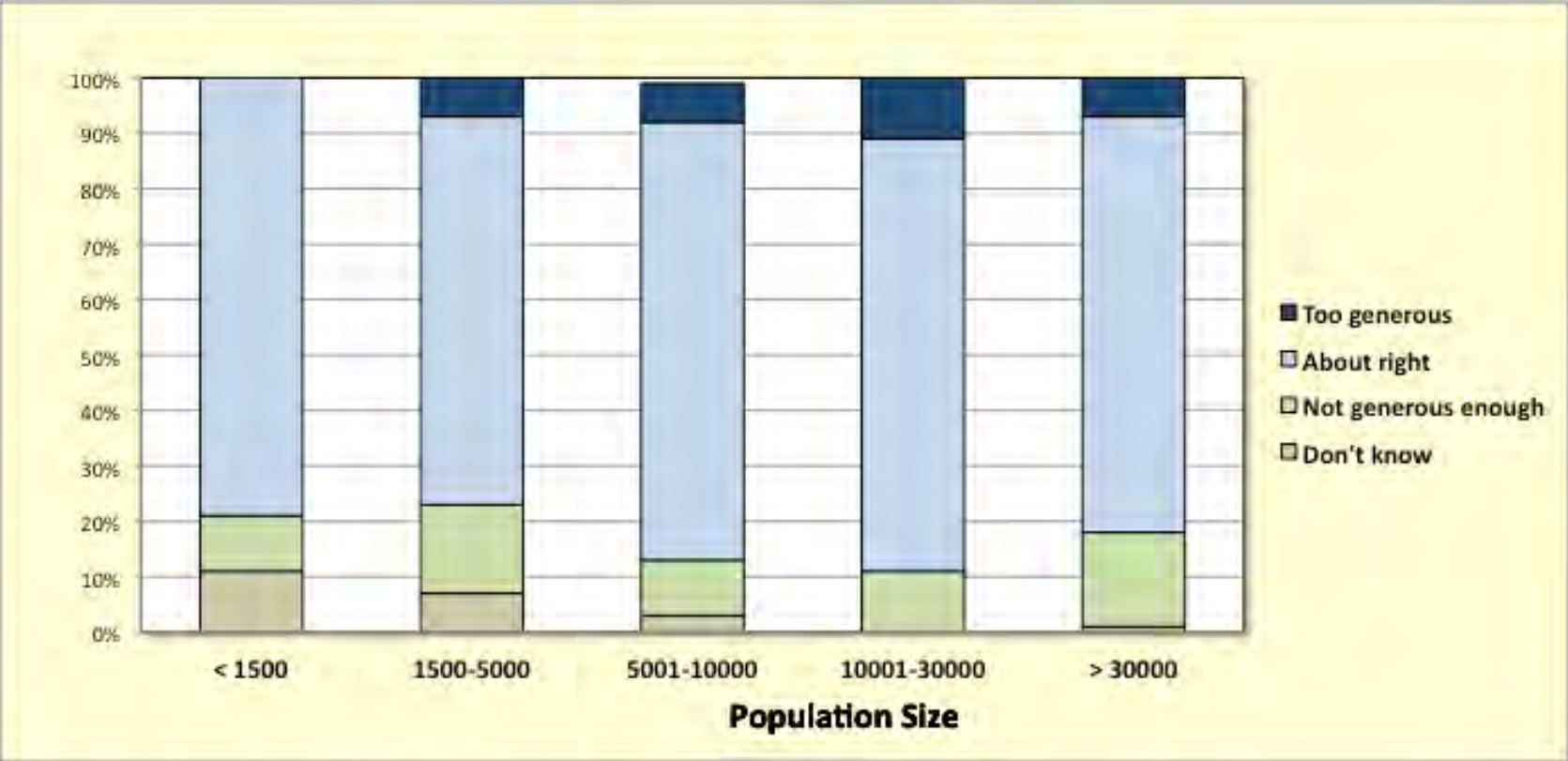
Overall, do you consider your jurisdiction's retirement income benefits - or lack thereof - for **current employees** to be too generous, about right, or not generous enough?



(Among those who offer pension benefits)

Who thinks their benefits are too generous?

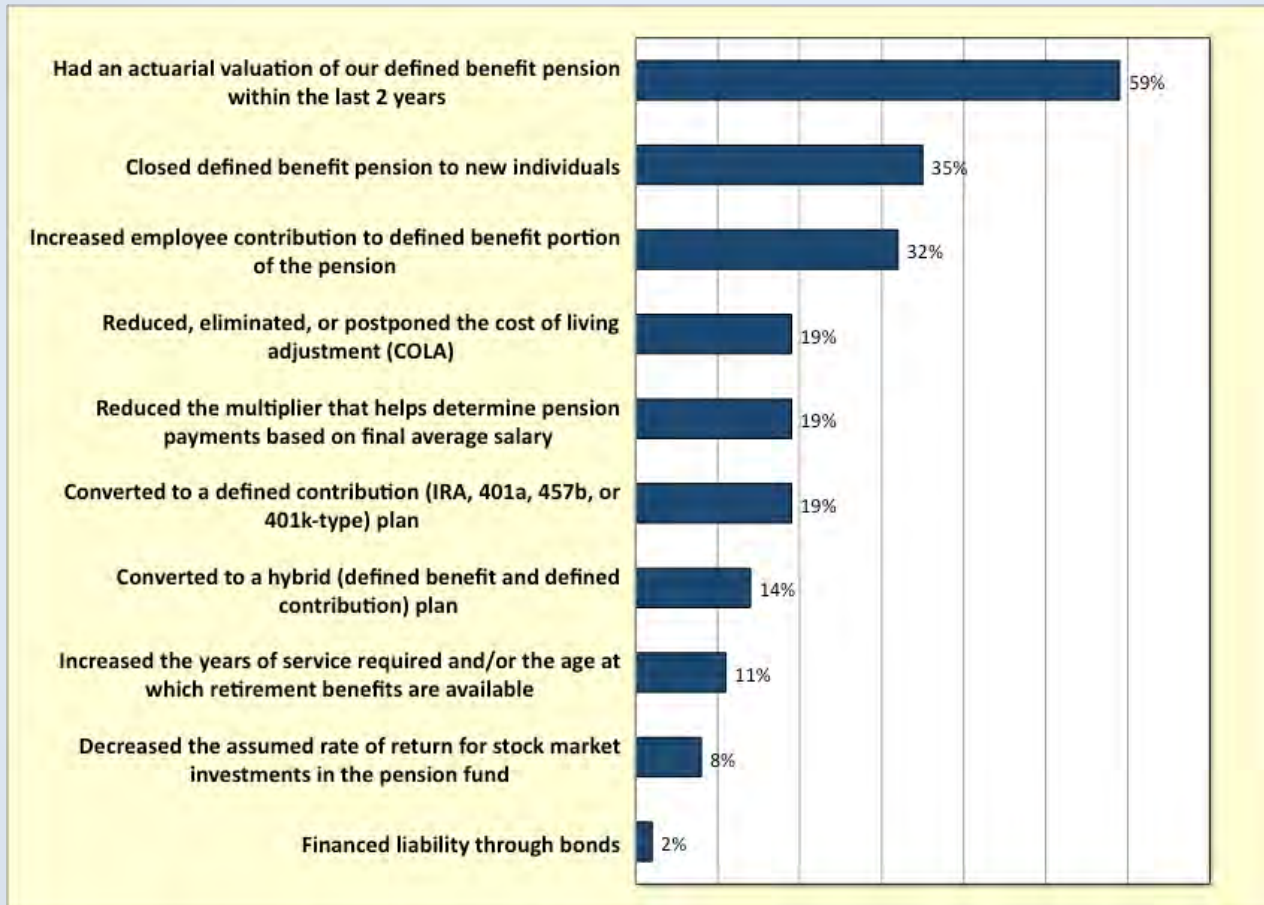
Overall, do you consider your jurisdiction's retirement income benefits - or lack thereof - for **new hires** to be too generous, about right, or not generous enough?



(Among those who offer pension benefits)

Who has taken action to control costs?

Which of the following actions, if any, has your jurisdiction taken so far regarding its defined benefit and/or hybrid pension plans for any of its employees, elected officials, or retirees?



(Among those taking action on pension costs)

Who has taken action to control costs?

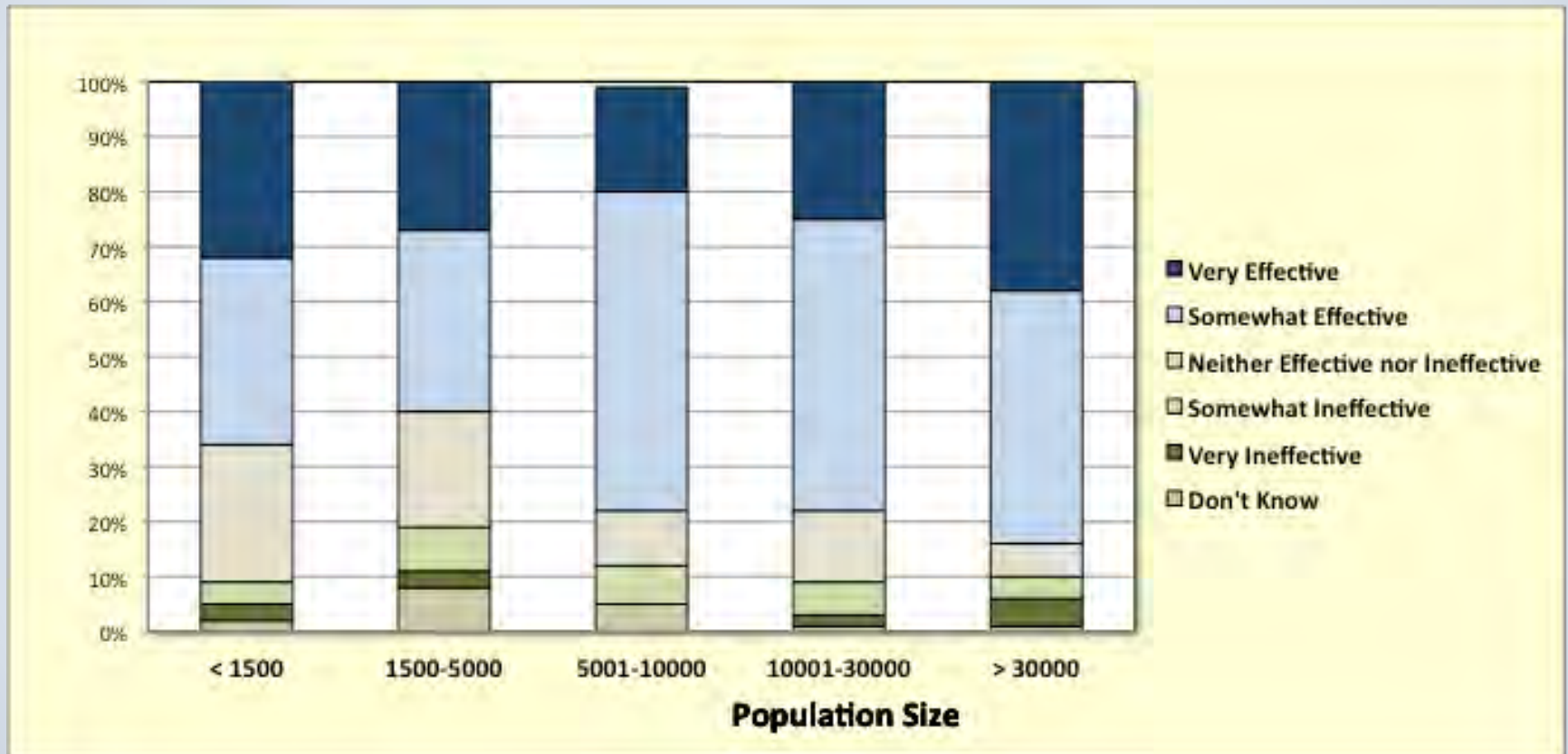
Which of the following actions, if any, has your jurisdiction taken so far regarding its defined benefit and/or hybrid pension plans for any of its employees, elected officials, or retirees?

| | Population <1500 | Population 1500-5000 | Population 5001-10000 | Population 10001-30000 | Population >30000 |
|--|---------------------|-------------------------|--------------------------|---------------------------|----------------------|
| Had an actuarial valuation of our defined benefit pension within the last 2 years | 32% | 48% | 68% | 79% | 83% |
| Closed defined benefit pension to new individuals | 16% | 24% | 32% | 45% | 67% |
| Increased employee contribution to defined benefit portion of the pension | 9% | 26% | 31% | 47% | 49% |

(Among those taking action on pension costs)

Who thinks their pension cost controls are effective?

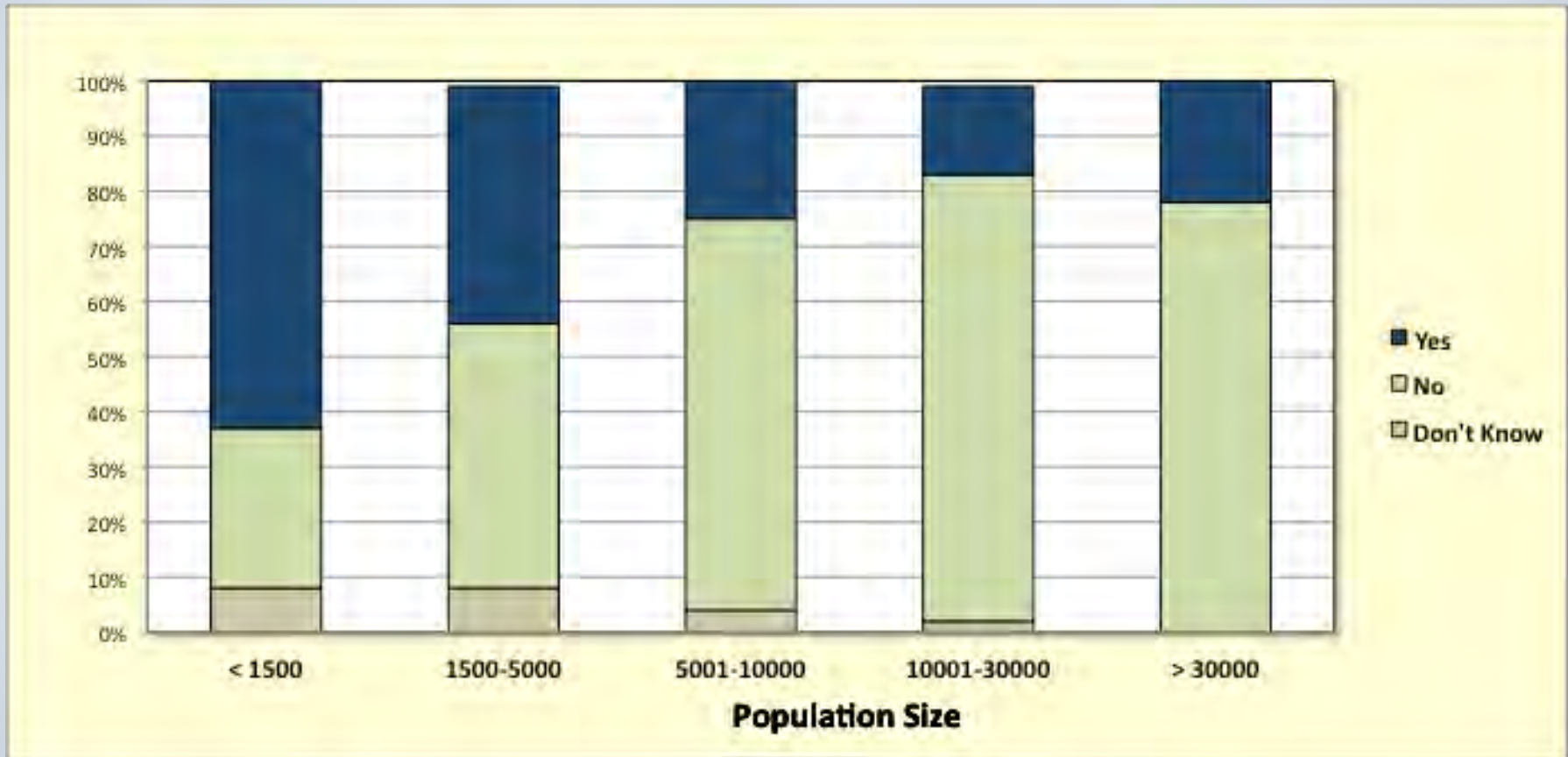
Overall, how effective would you say your jurisdiction's efforts, if any, have been at controlling costs related to its retirement income benefits?



(Among those with defined benefit/hybrid pensions)

Whose pension obligations are fully funded?

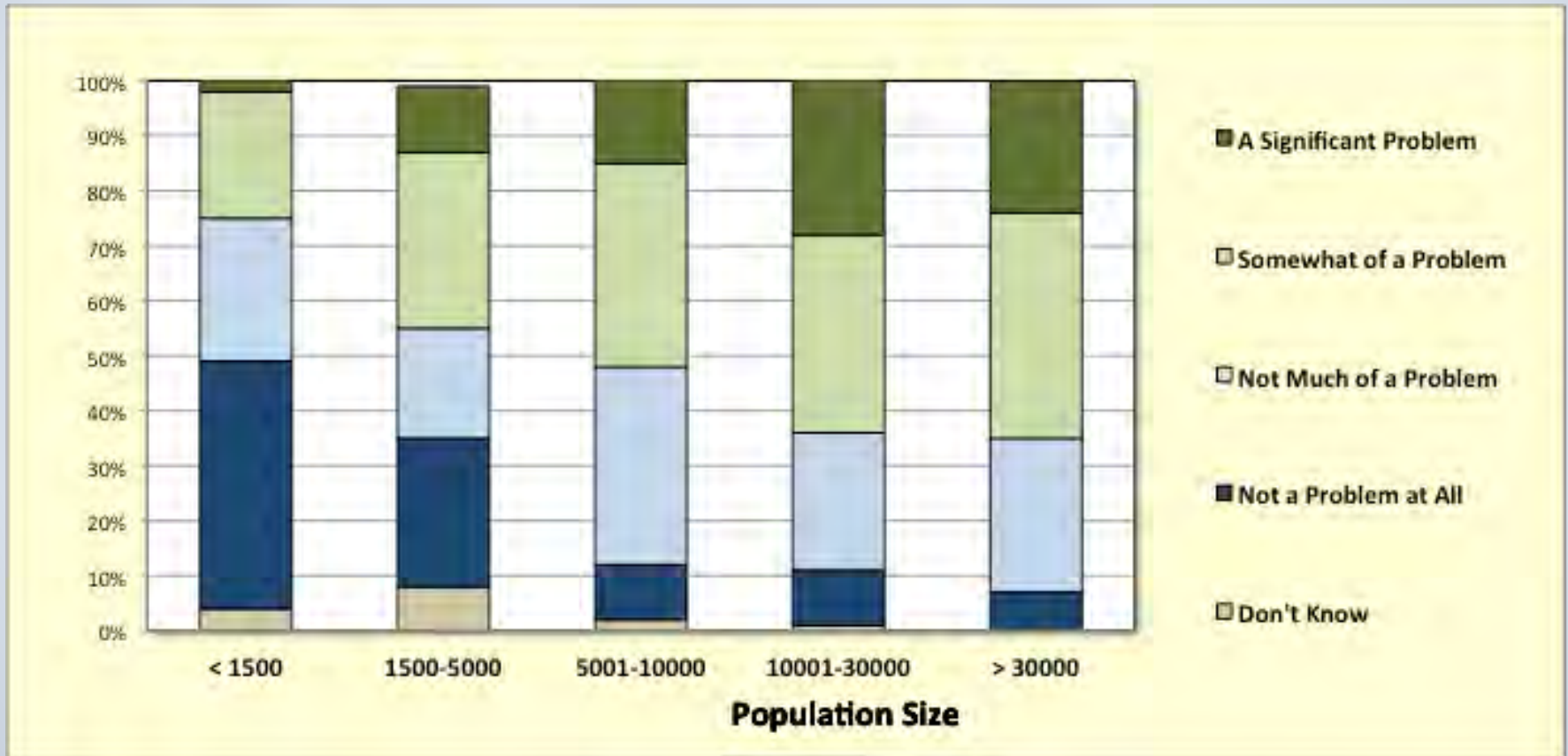
To the best of your knowledge, are your jurisdiction's pension obligations currently fully funded?



(Among those with defined benefit/hybrid pensions)

Whose obligations are a problem for fiscal health?

Regardless of whether or not your jurisdiction's defined benefit and/or hybrid plan pension obligations are currently fully funded, in your opinion, are these obligations a...
problem for your jurisdiction's fiscal health?

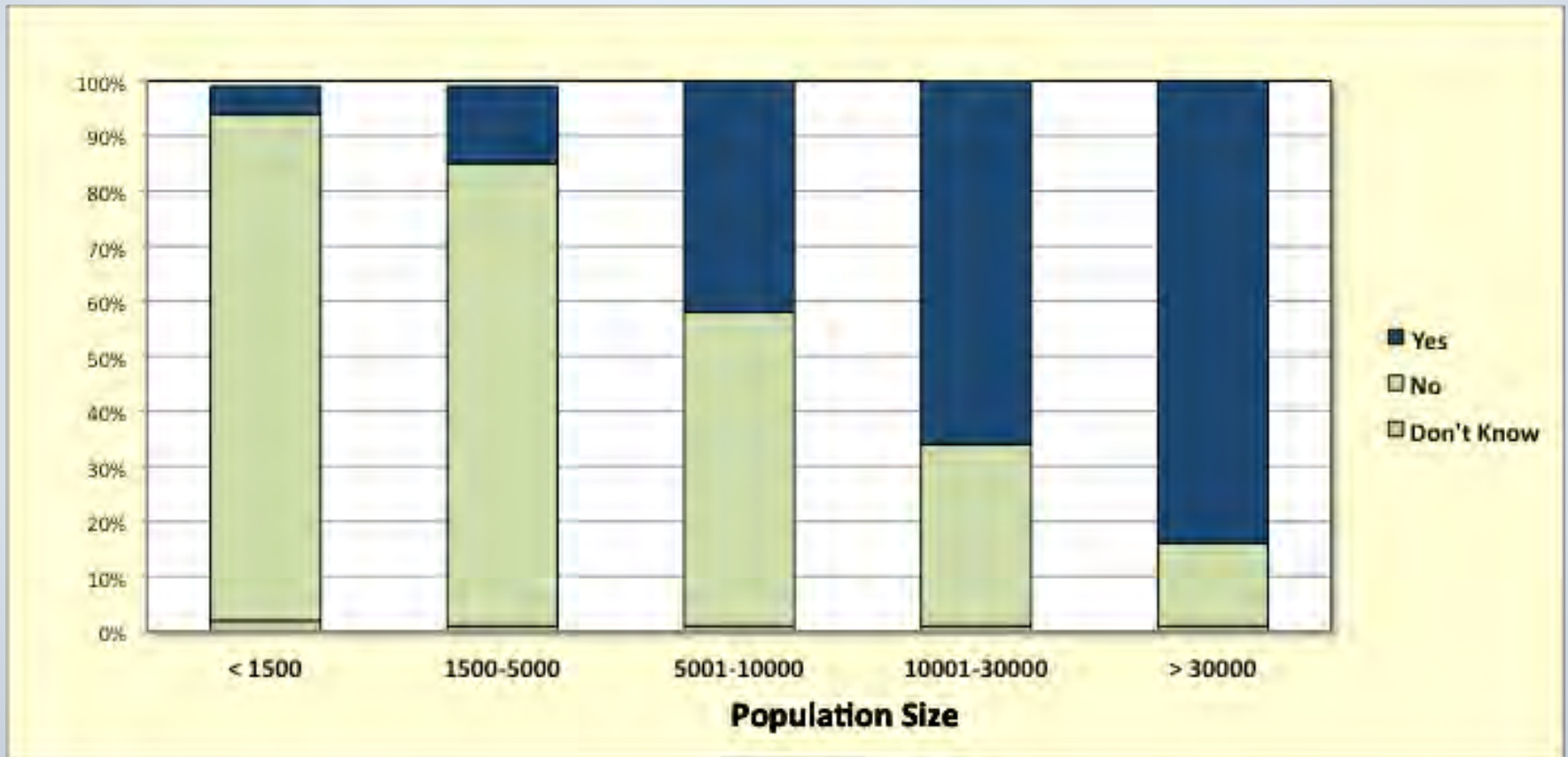


(Among those with defined benefit/hybrid pensions)

Michigan local governments' Retiree Health Care Benefits (OPEB)

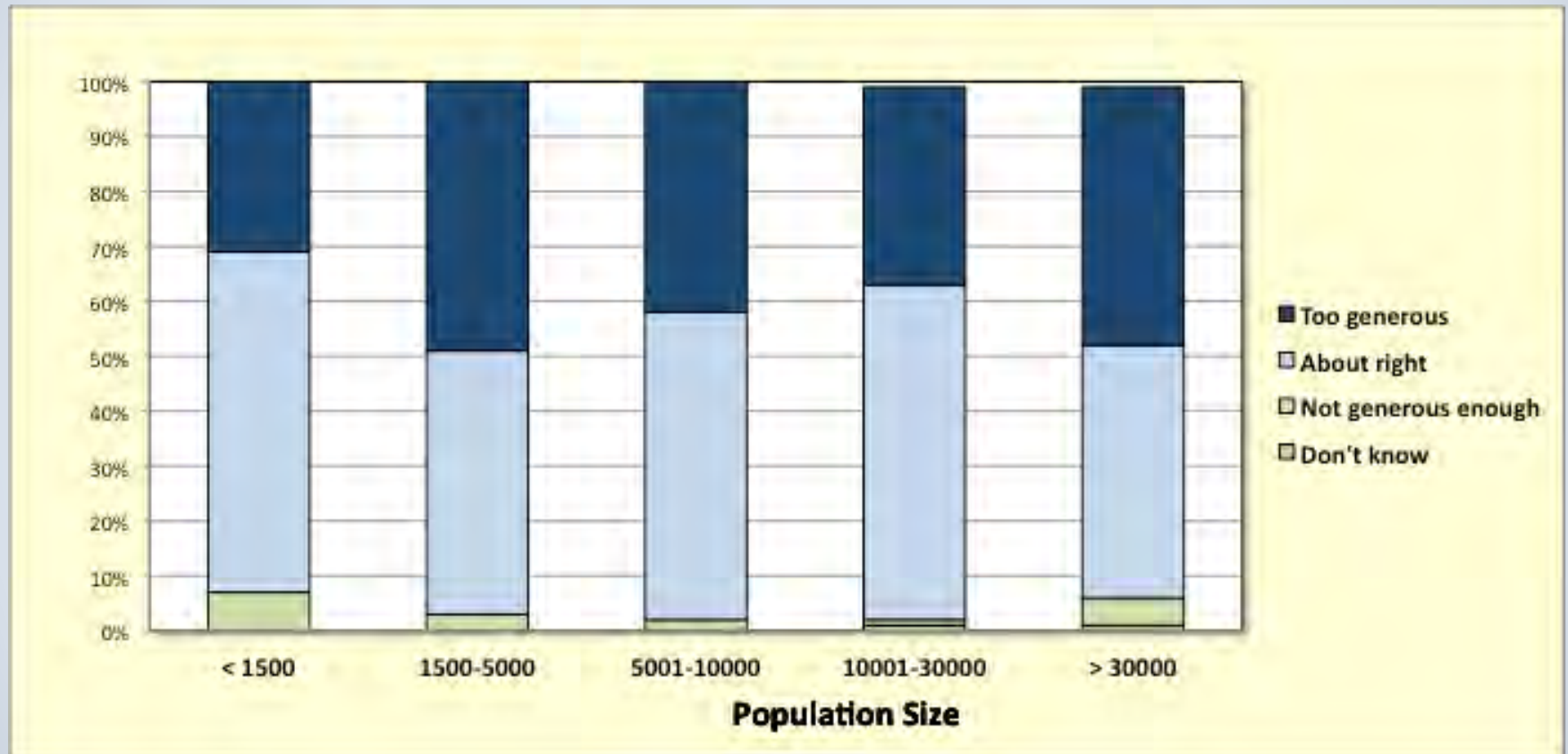
Who offers OPEB?

Does your jurisdiction provide any kind of retiree health care benefits to any current or former employees and/or elected officials?



Who thinks their OPEB are too generous?

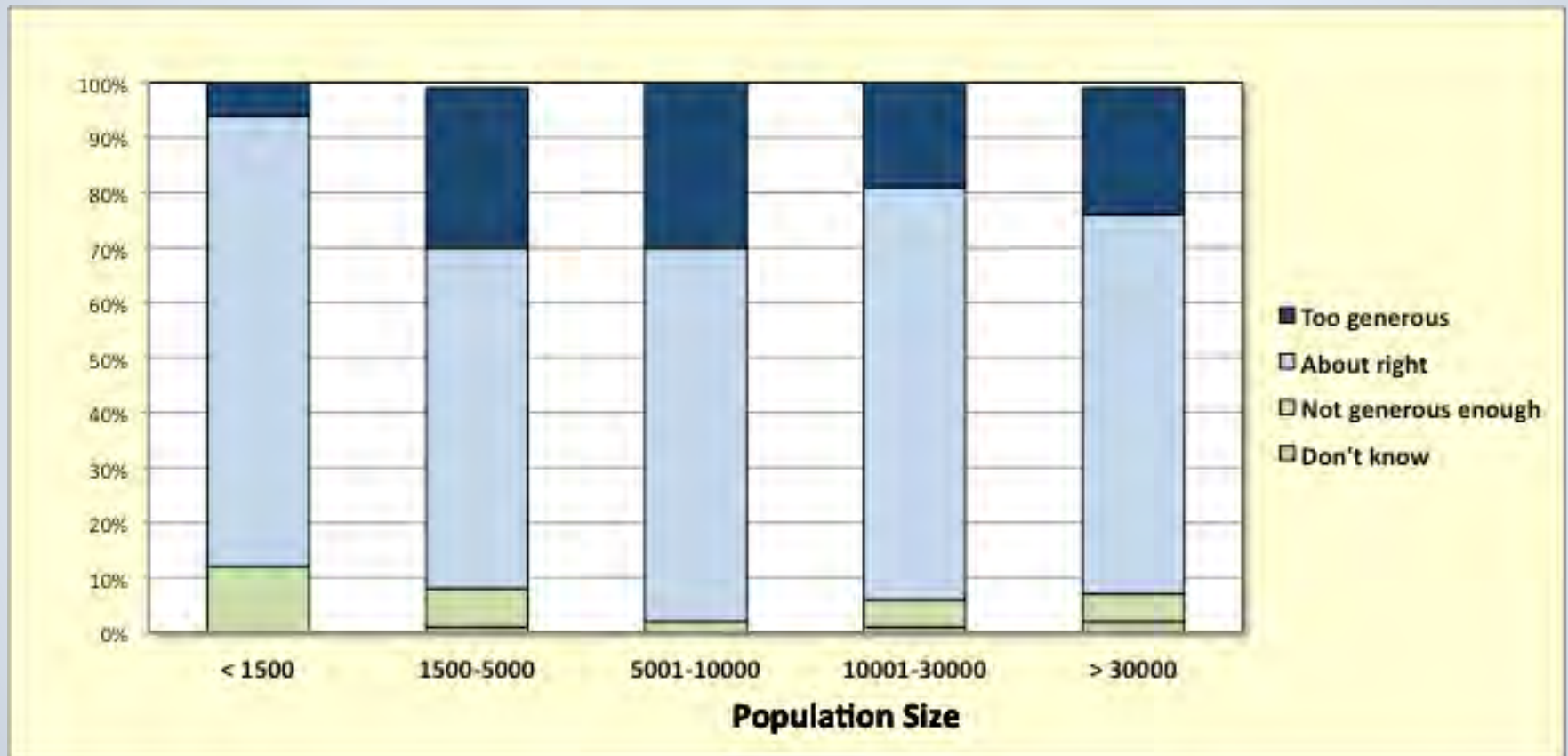
Overall, do you consider your jurisdiction's retiree health care benefits- or lack thereof - for **current retirees** to be too generous, about right, not generous enough?



(Among those who offer OPEB)

Who thinks their OPEB are too generous?

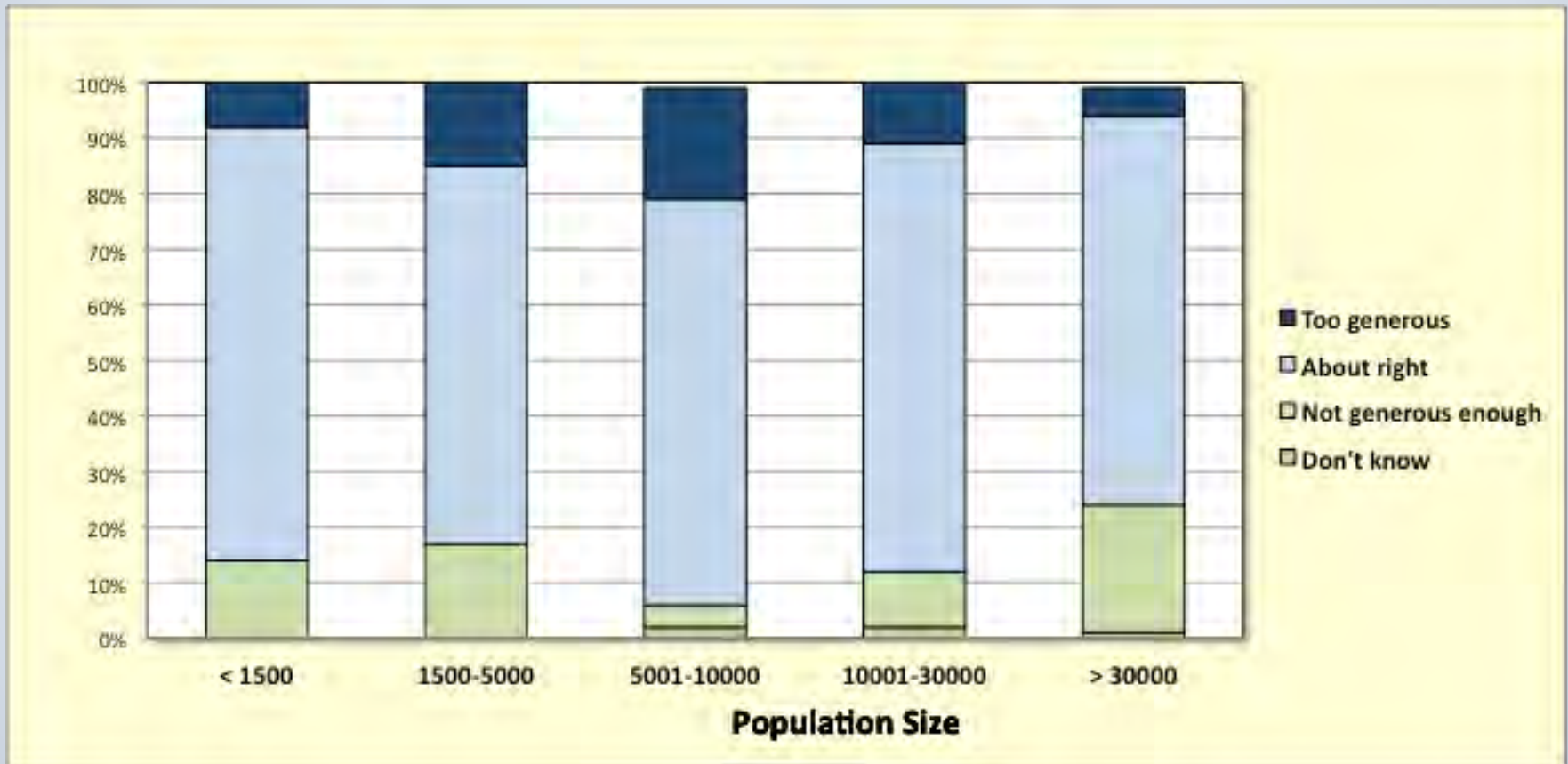
Overall, do you consider your jurisdiction's retiree health care benefits- or lack thereof - for **current employees** to be too generous, about right, not generous enough?



(Among those who offer OPEB)

Who thinks their OPEB are too generous?

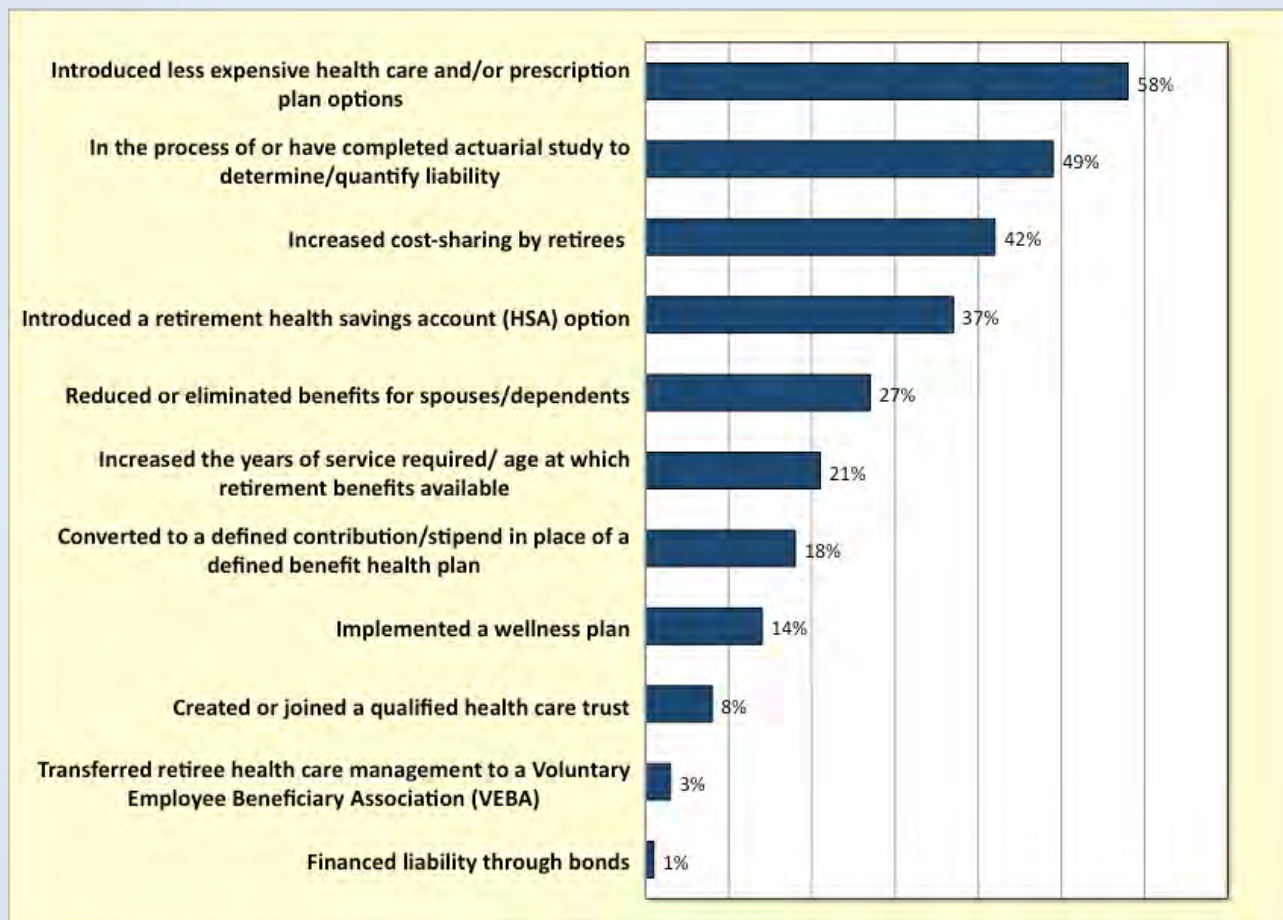
Overall, do you consider your jurisdiction's retiree health care benefits - or lack thereof - for **new hires** to be too generous, about right, or not generous enough?



(Among those who offer OPEB)

Who has taken action to control OPEB costs?

Which of the following actions, if any, has your jurisdiction taken so far regarding its retiree health care benefits for any current or future retirees?



(Among those taking action on OPEB)

Who has taken action to control OPEB costs?

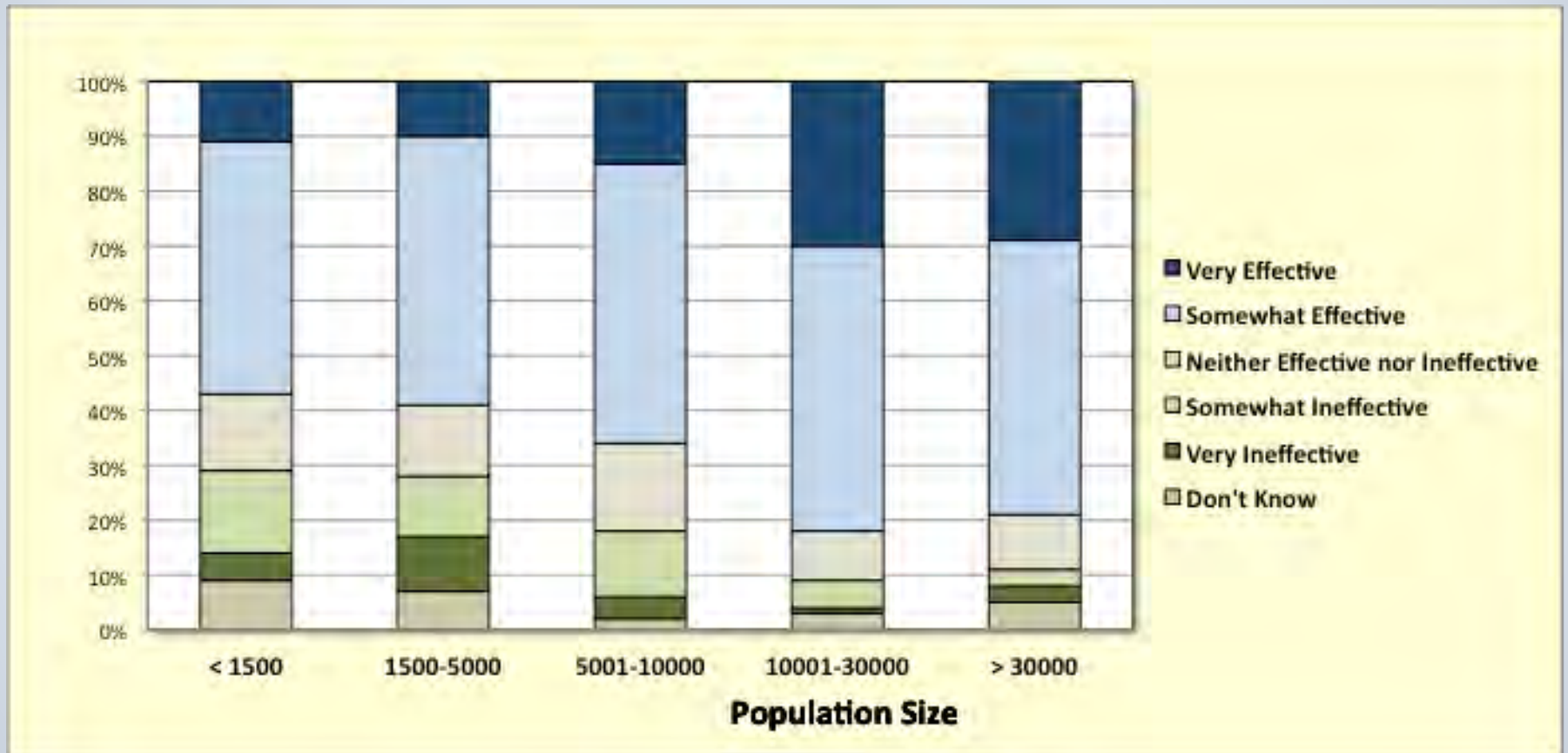
Which of the following actions, if any, has your jurisdiction taken so far regarding its retiree health care benefits for any current or future retirees?

| | Population <1500 | Population 1500-5000 | Population 5001-10000 | Population 10001-30000 | Population >30000 |
|--|---------------------|-------------------------|--------------------------|---------------------------|----------------------|
| Introduced less expensive health care and/or prescription plan options | 31% | 52% | 50% | 63% | 71% |
| In the process of or have completed actuarial study to determine/quantify liability | 26% | 37% | 40% | 53% | 72% |
| Increased cost-sharing by retirees | 25% | 29% | 40% | 54% | 48% |

(Among those taking action on OPEB)

Who thinks their OPEB cost controls are effective?

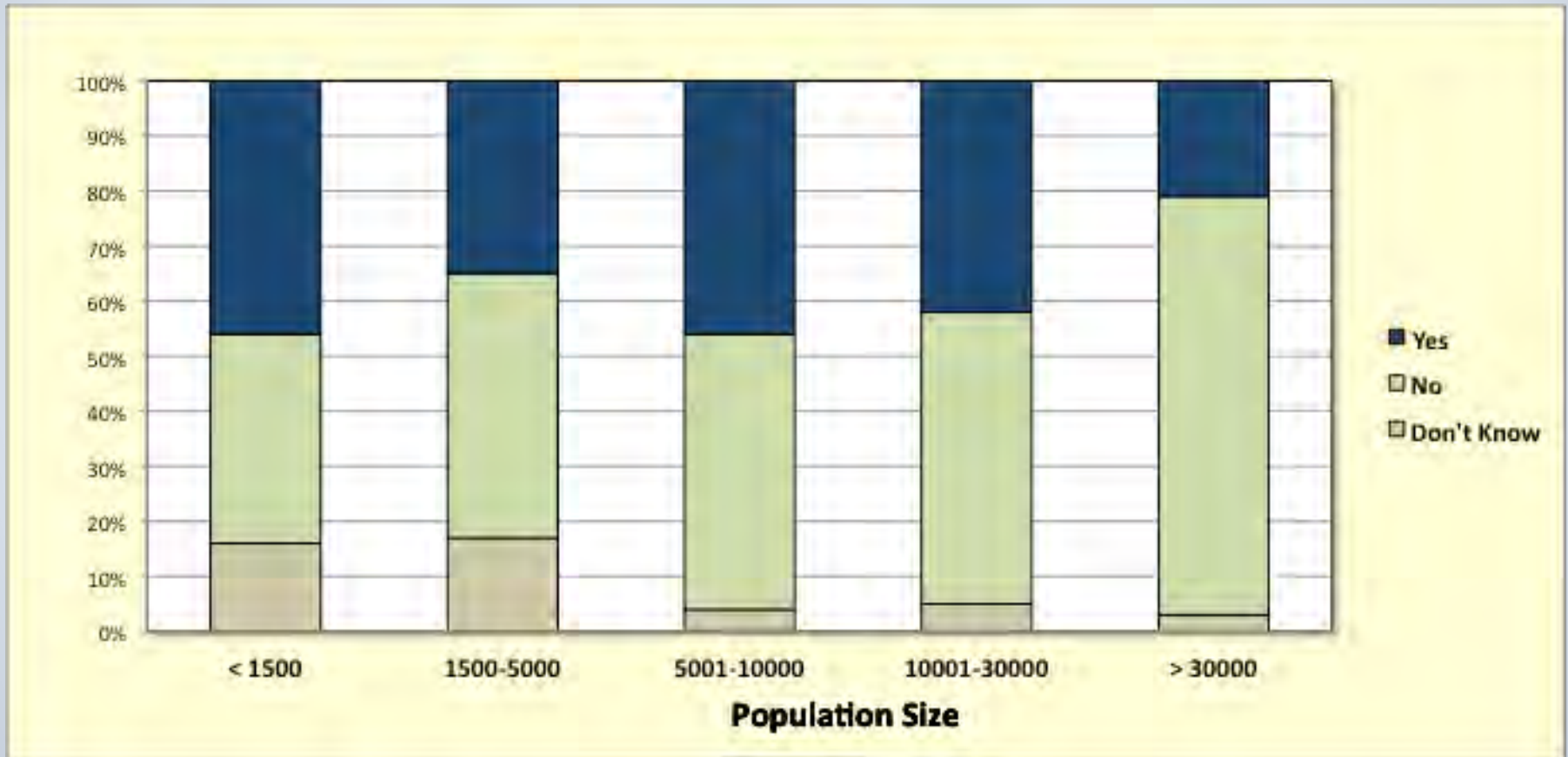
Overall, how effective would you say your jurisdiction's efforts, if any, have been at controlling costs related to its retiree health care benefits?



(Among those who offer OPEB)

Whose OPEB obligations are fully funded?

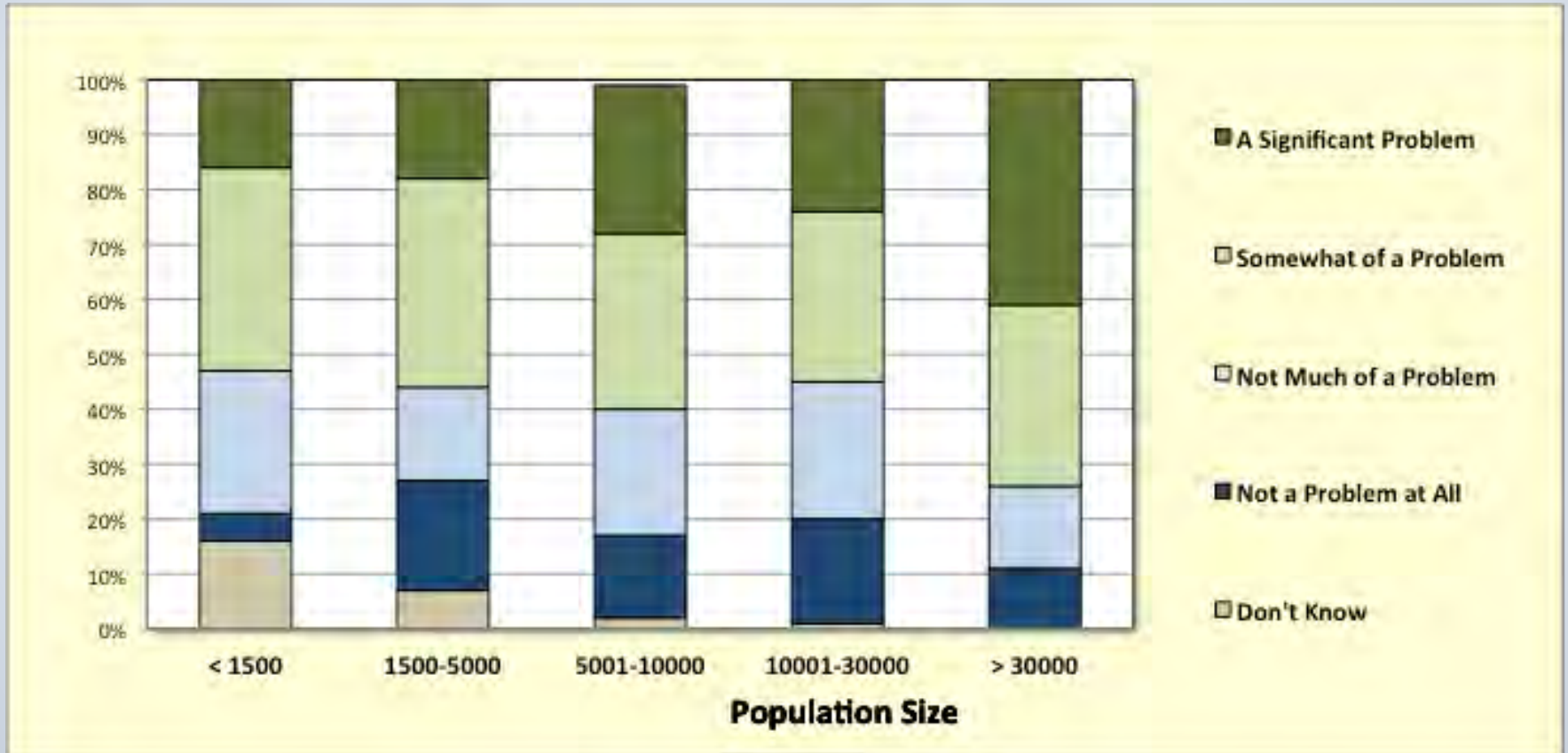
To the best of your knowledge, are jurisdiction's retiree health care obligations currently fully funded?



(Among those who offer OPEB)

Whose obligations are a problem for fiscal health?

Regardless of whether or not your jurisdiction's retiree health care obligations are currently fully funded, in your opinion, are these obligations a... problem for your jurisdiction's fiscal health?



(Among those who offer OPEB)

The Michigan Public Policy Survey (MPPS)

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Navigating the Changing Seas of Retiree Finance: League Database

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Research Intern, Michigan Municipal League

Jessica Reed

Program Coordinator, Michigan Municipal League





Project Overview

- Part of the League Municipal Finance Initiative
- Response to legislative pressure and regulatory changes





Preliminary Research

- Reviewed reports from across the state and from various states across the country
- Looked at how other reports and databases collected their data
- Met with multiple experts on municipal finance





Scope

- Selected League member communities based on number of employees
 - Employee size from 6-1,600
 - Comprises over 90% of the League's member workforce
 - 335 communities total





Methodology

- Collected data from the most recent available Comprehensive Annual Financial Report using the State of Michigan's Treasury website
- Then used member demographic data already collected by the League
- Compiled data into central database



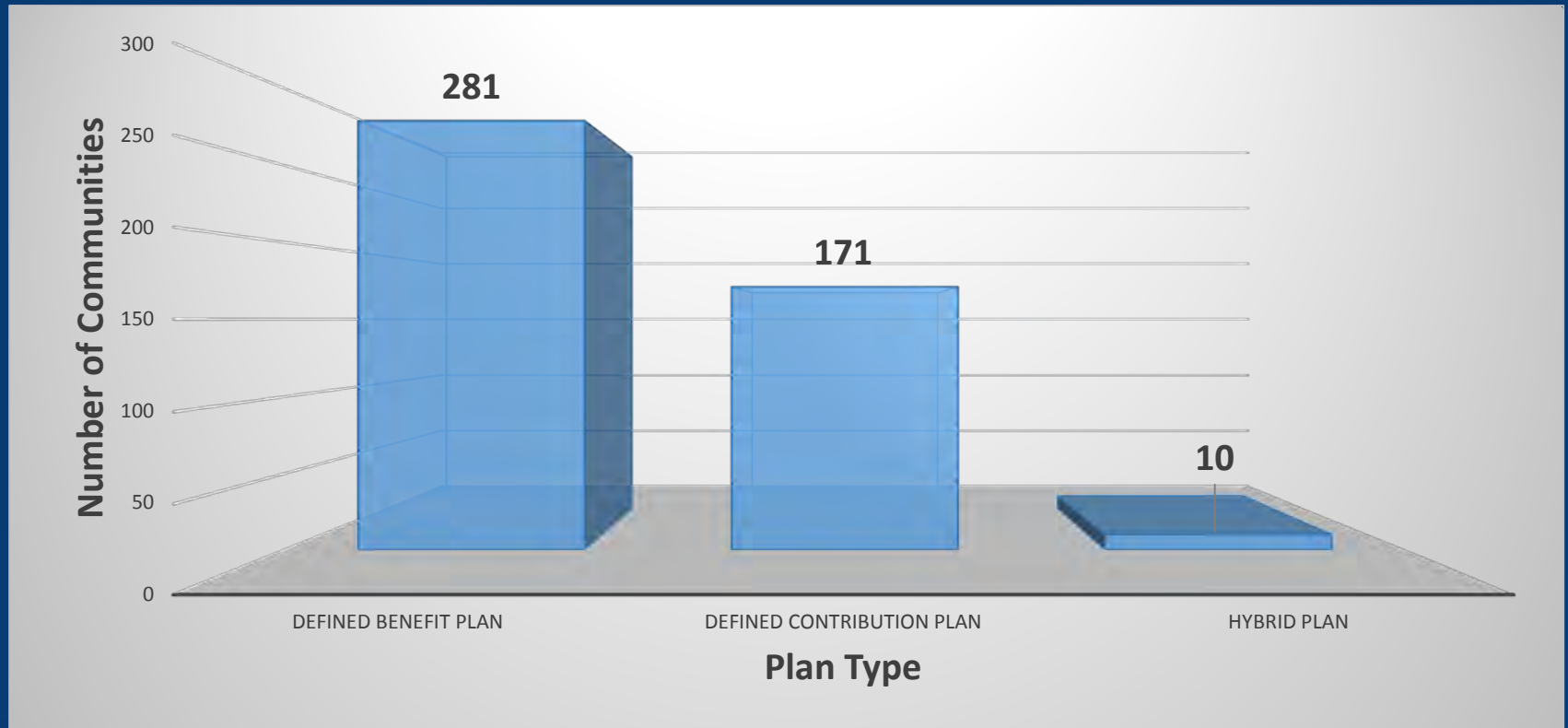


Notes

- The City of Detroit was left out of the upcoming figures
- Figures represent defined benefit style pension and other post-employment benefits plans

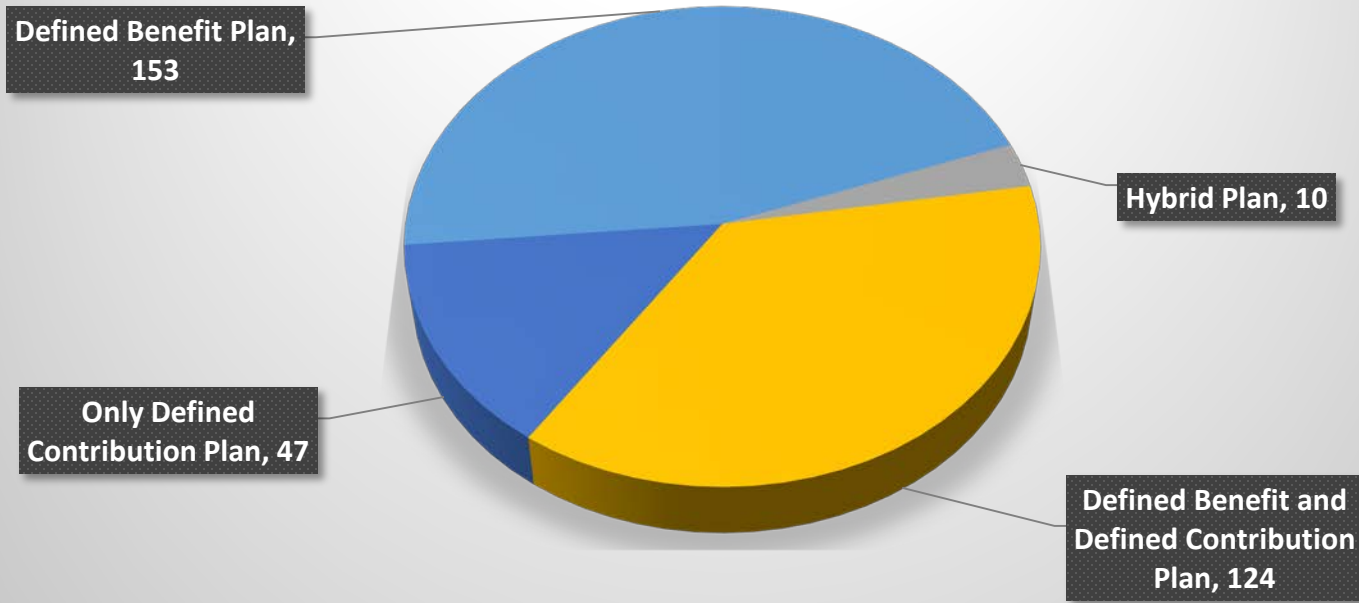


Types of League Member Pension Plans



We love where you live.

Types of League Member Pension Plans



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Pension Findings

Total Annual Pension Cost (APC)

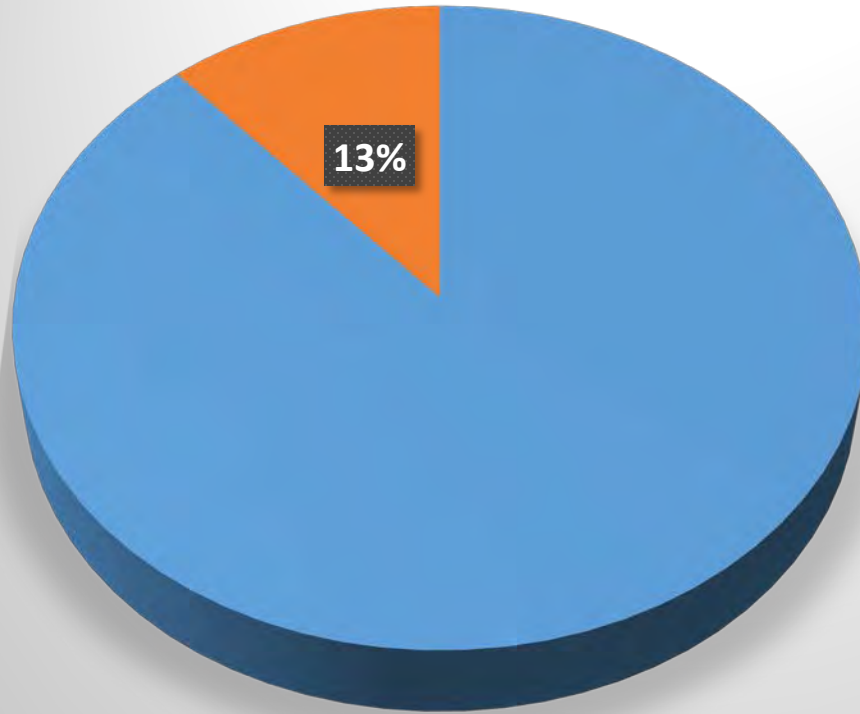
\$366 million

Total Annual Required Contribution (ARC)

\$369 million



ARC as a percentage of General Fund



■ Total Annual Required Contribution

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Pension Findings

Total Actuarial Value of Assets (AVA)

\$10.6 billion

Total Actuarial Accrued Liability (AAL)

\$14 billion

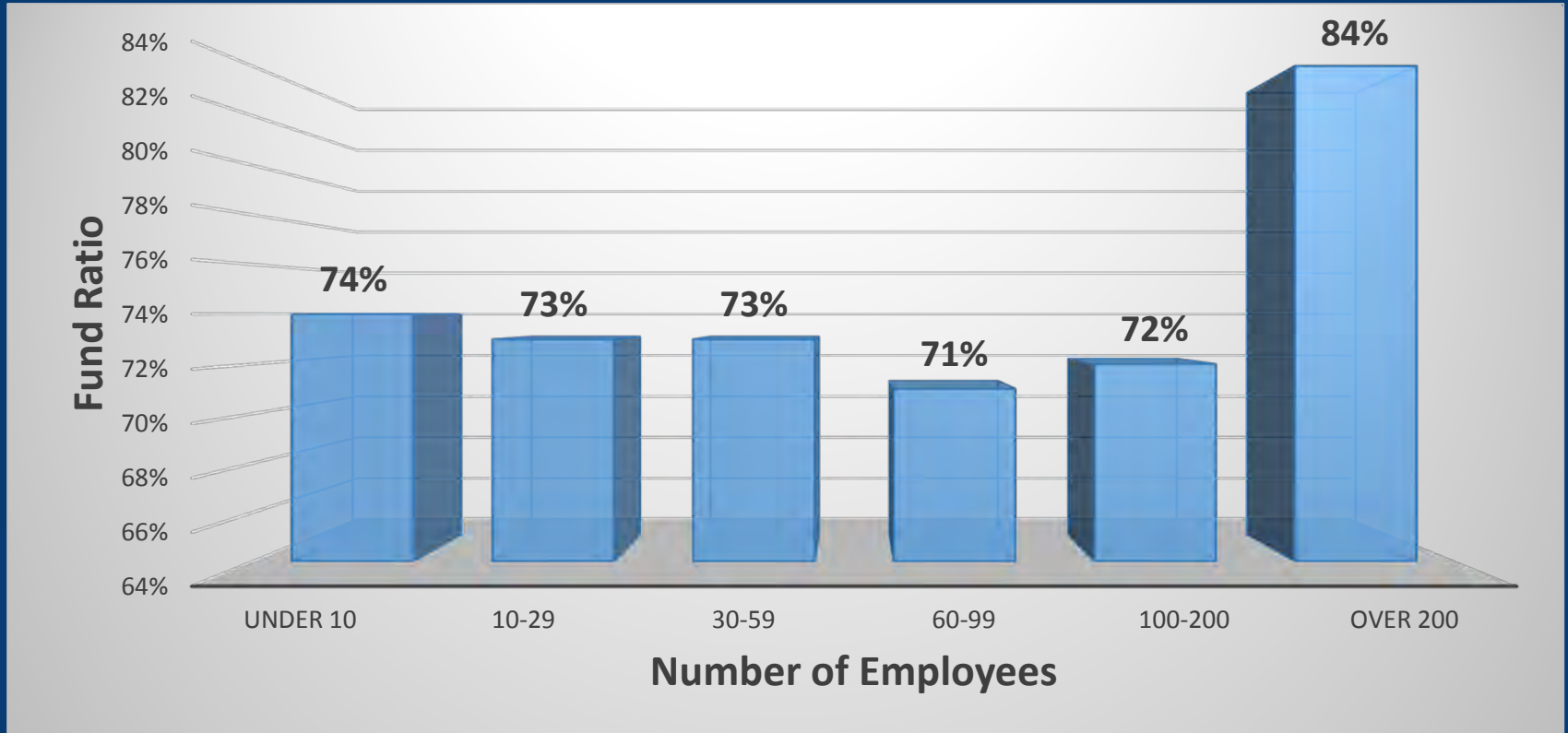
Average Fund Ratio

74% funded

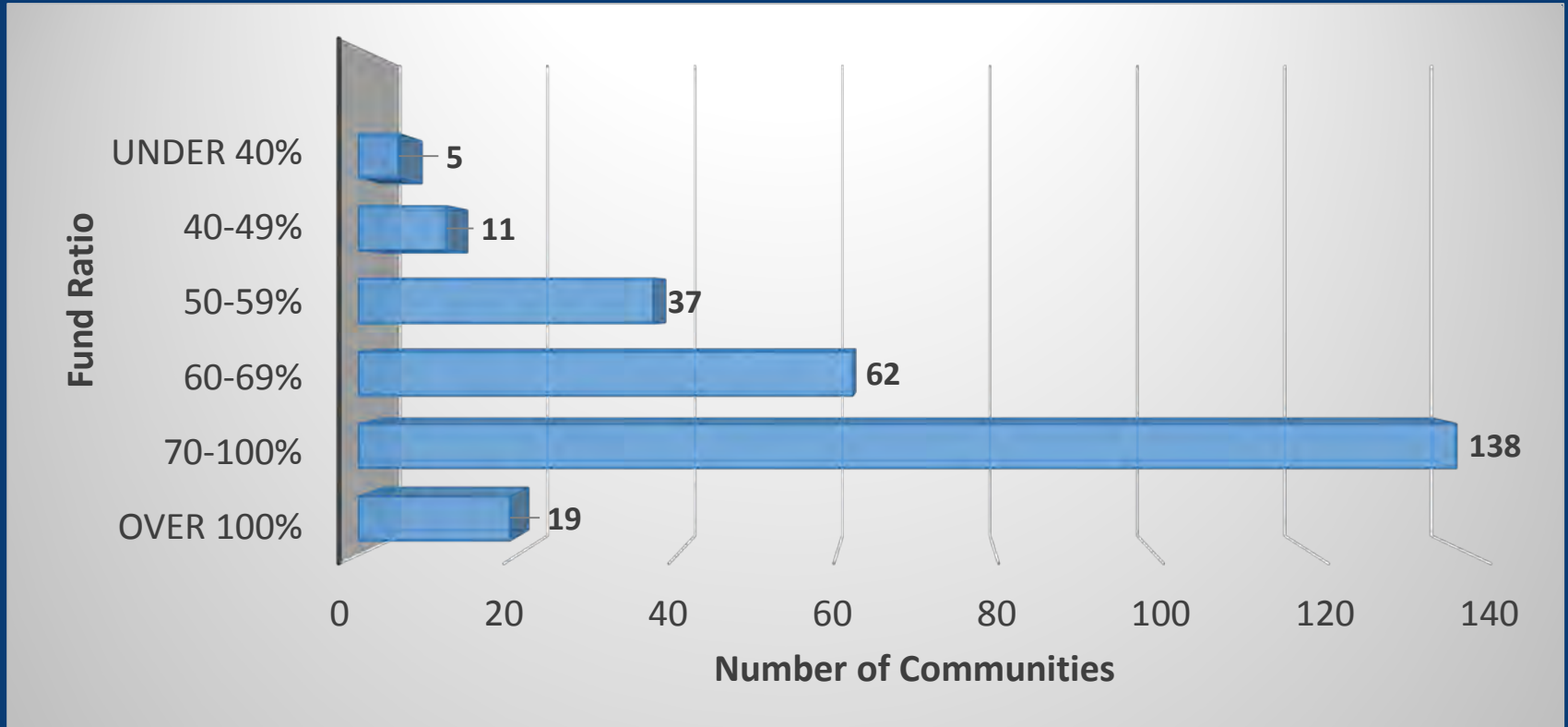




Fund Ratio by Employer Size



Funding Status of Pension Plans:

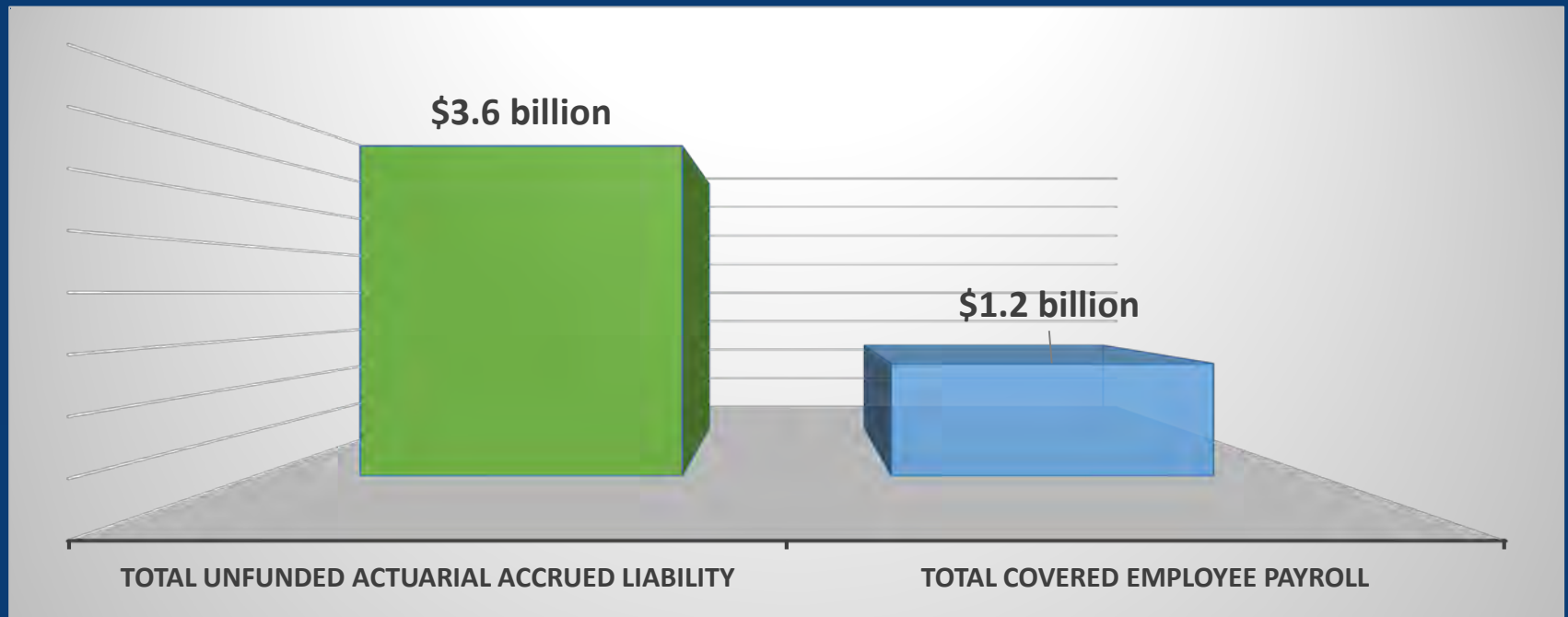


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UAAL Compared to Covered Payroll



Average Percent of Covered Employee Payroll - 296%





Other Post-employment Benefits(OPEB) Findings

Total Annual OPEB Cost (AOC)

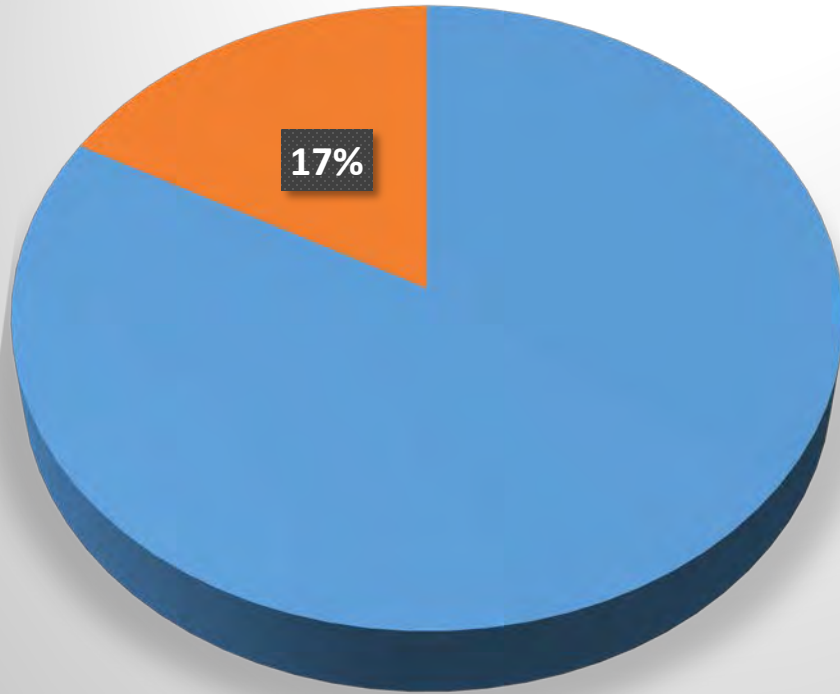
\$486 million

Total Annual Required Contribution (ARC)

\$489 million



ARC as a percentage of General Fund



■ Total Annual Required Contribution

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OPEB Findings

Total Actuarial Value of Assets (AVA)

\$980 million

Total Actuarial Accrued Liability (AAL)

\$71 billion

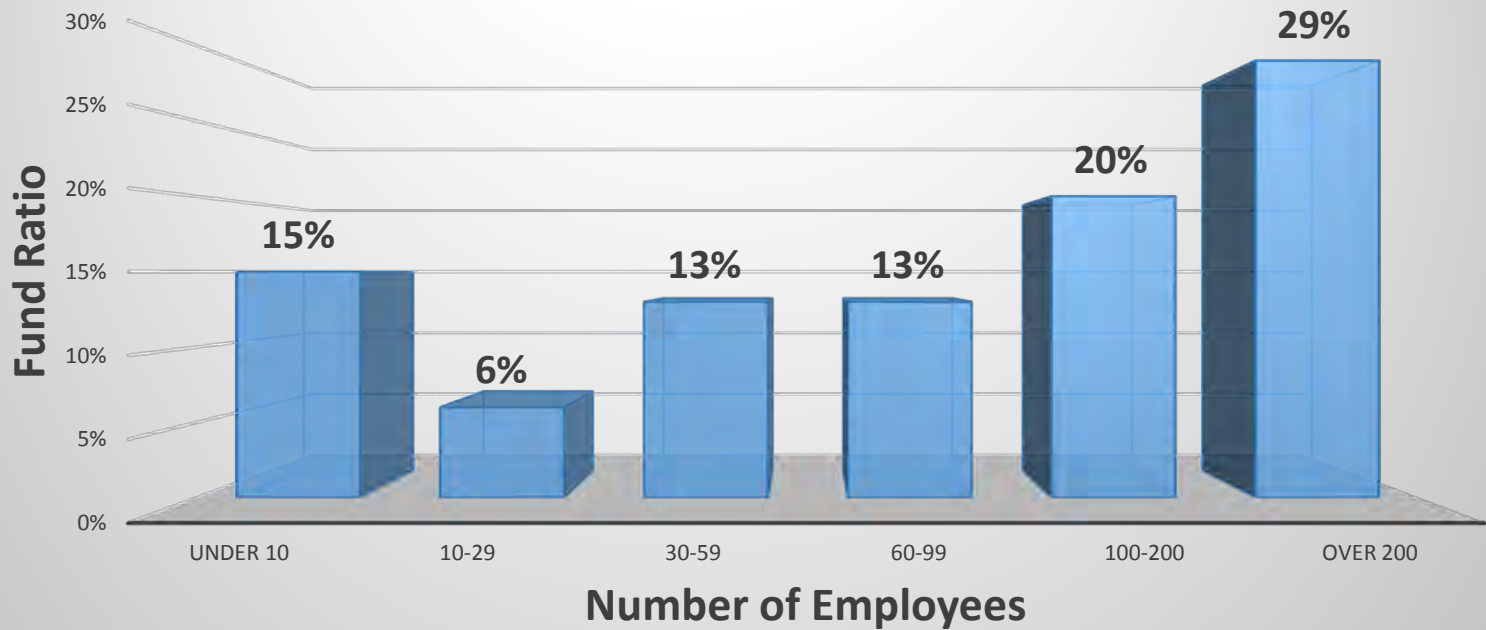
Average Fund Ratio

15% funded



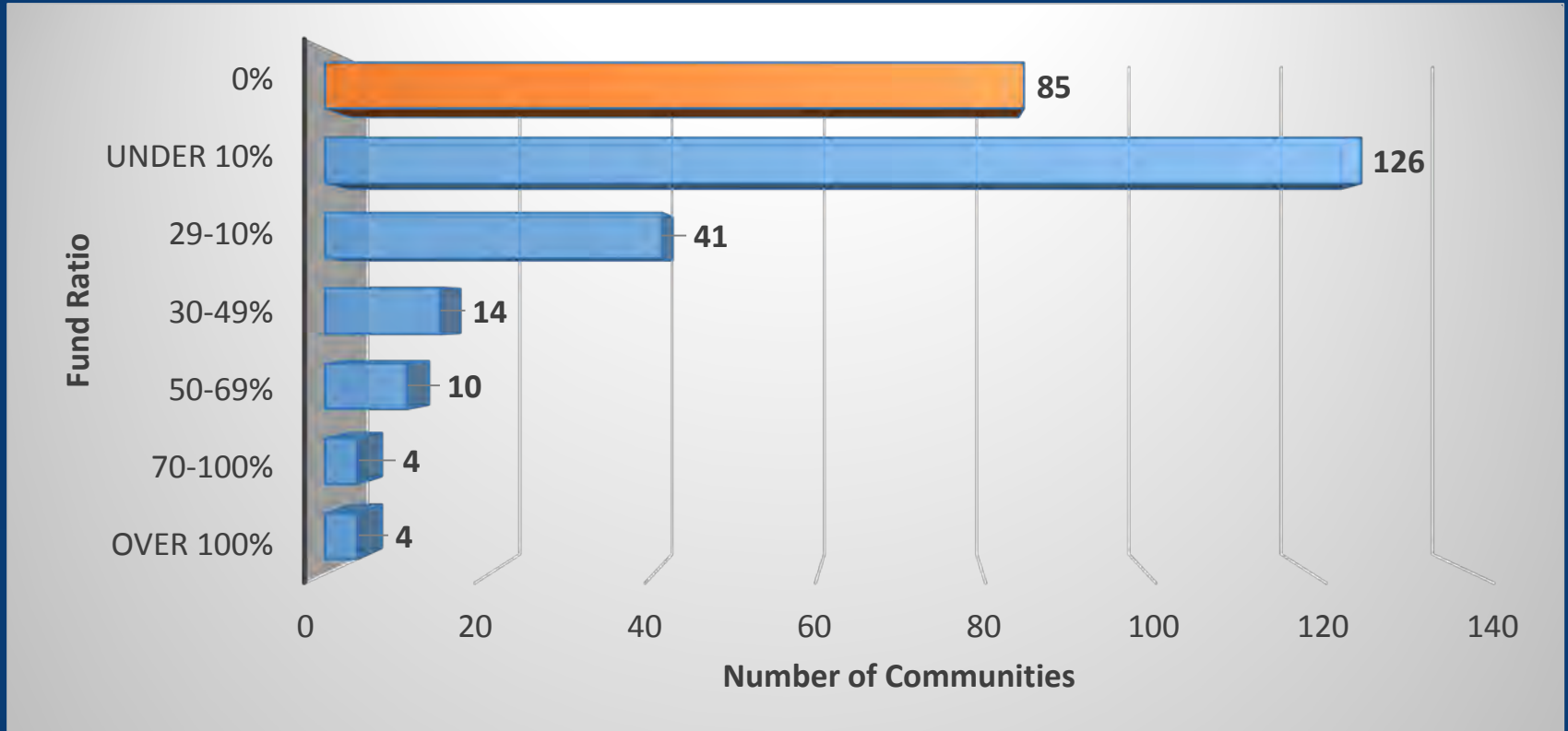


Fund Ratio by Employer Size



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Funding Status of OPEB Plans:

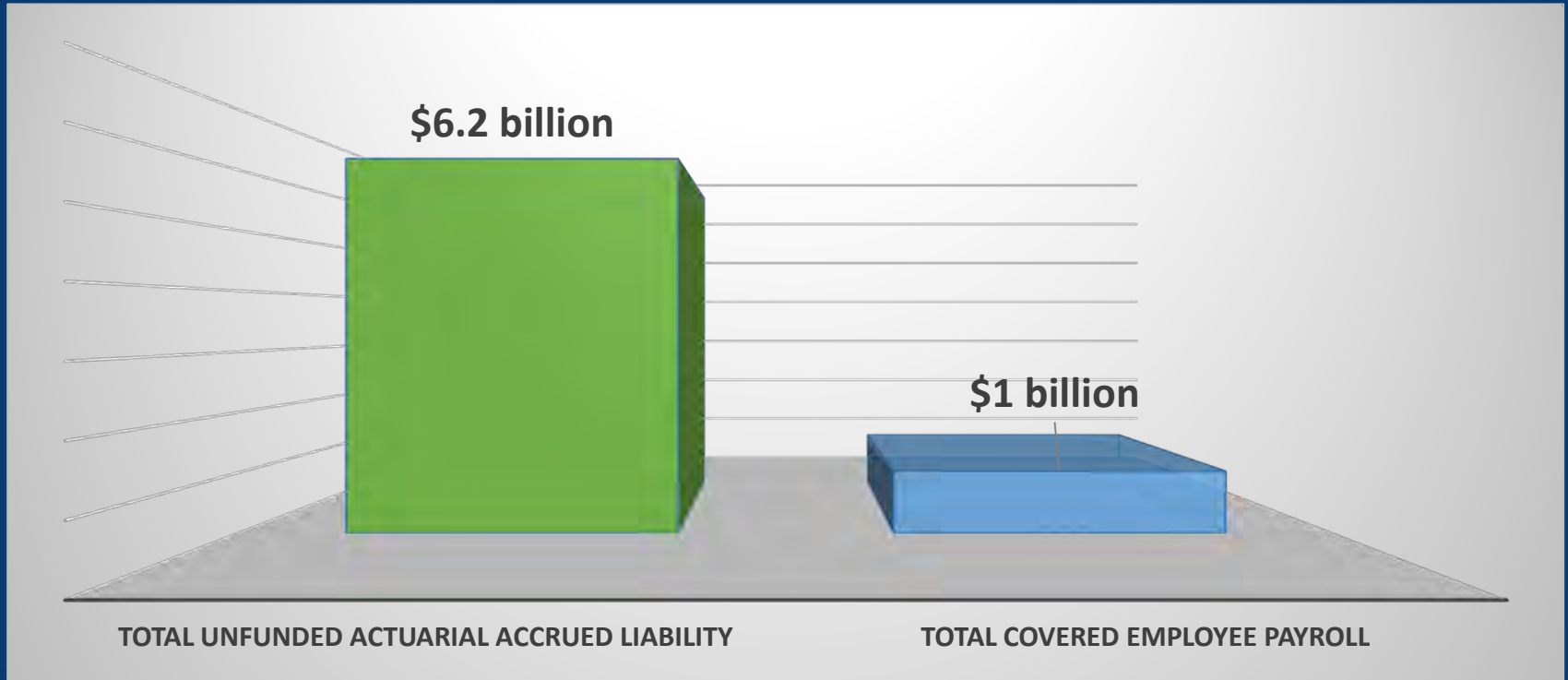


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UAAL Compared to Covered Payroll



Average Percent of Covered Employee Payroll - 621%



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Key Findings

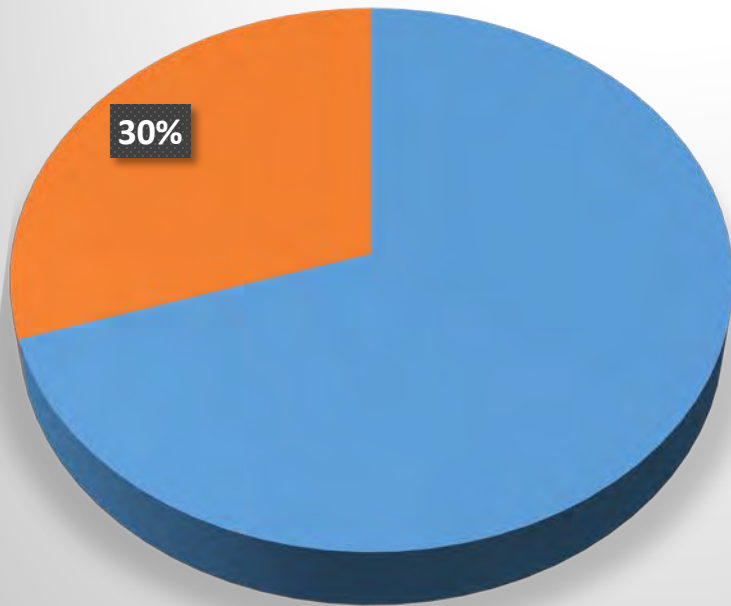
- Average Pension Fund Ratio of 74%
- Average OPEB Fund Ratio of 15%

- Pension UAAL \$3.6 billion
- OPEB UAAL \$6.2 billion



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Pension and OPEB ARC Expenditure Compared General Fund Revenues



■ Combined Pension and OPEB
Annual Required
Contribution

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Next Steps

- Delve deeper into the data
- Expand scope to include charter townships
- Create report in partnership with a third-party expert
- Develop online database for member access
- Set plan to update database yearly



Feel free to contact the League!



Jessica Reed
Program Coordinator

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