



**STATE OF DELAWARE
DEPARTMENT OF FINANCE
OFFICE OF THE SECRETARY**

**RICHARD S. CORDREY
SECRETARY OF FINANCE**

October 14, 2005

Honorable Ruth Ann Minner
Carvel State Office Building
820 N. French Street
Wilmington, DE 19801

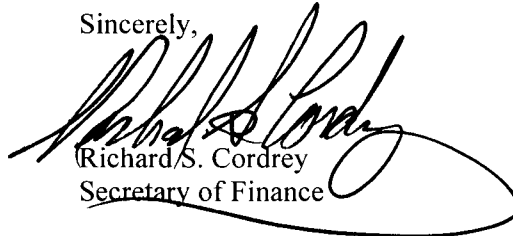
Dear Governor Minner:

I am pleased to provide to you the report required by Executive Order Number 67 Establishing a Retirement Benefit Study Committee. The report outlines the work done by the committee over the summer and summarizes the committee's conclusions.

There is no easy solution for the challenge created by GASB's new accounting standards and Delaware's obligation for retiree health care. It is a very complex issue but one that carries significant importance to both current and future retirees. While trying to protect the state's excellent credit, which we all worked hard to earn, we ultimately must balance the needs of state employees and retirees against the many pressing needs of the state.

The work of the committee may be just a beginning. The process has certainly served as an educational tool for many and the education process should continue – for the General Assembly, for retirees, for employees and for the public. As you and your staff review the report and the work of the committee, I will be glad to answer any questions you may have. I look forward to continuing to work toward a solution.

Sincerely,



Richard S. Cordrey
Secretary of Finance

cc: Members of the General Assembly
Members of the DEFAC

Attachment

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Report to the Governor, Members of the General Assembly and Members of the
Delaware Economic and Financial Advisory Council

from the

Retirement Benefit Study Committee

pursuant to

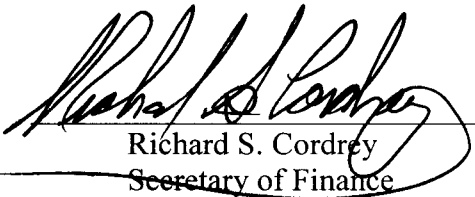
Executive Order No. 67

Acknowledgements

The contents of this report represent the collective efforts of wide array of individuals and organizations. Governor Minner's Executive Order Number 67, which formed the Committee that produced this report, wisely drew upon the diverse talents within the State. The Retirement Benefit Study Committee was well served as it considered the points of view of labor, the private sector, senior State administrators and appointees, and elected officials.

In most endeavors of this sort, the majority of the "heavy lifting" is performed behind the scenes by agency staff. This report certainly followed that model and I am deeply indebted to the hard work and thoughtful consideration provided by staff from the following agencies and offices: the Controller General's Office, the Office of Management and Budget, the State Pension Office and, lastly, to my staff within the Department of Finance.

Special thanks are reserved for Stephanie Scola, my Director of Bond Finance. Stephanie played a pivotal role in every aspect of the process that culminated with this report. For her tireless work in framing the importance of the issue, clearly explaining the very complex trade-offs confronting the State, and managing a process that I believe provides a sound foundation for Delaware to meet the fiscal challenges posed by this issue, I extend my deep appreciation.



Richard S. Cordrey
Secretary of Finance

Retirement Benefits Study Committee Membership

Richard S. Cordrey, Secretary of Finance, Chairman

Jennifer Davis, Director, Office of Management and Budget

Russell T. Larson, Controller General

David Craik, Administrator, State Pension Office

Senator Nancy W. Cook, Co-Chair of the Joint Finance Committee

Representative Joseph G. DiPinto, Co-Chair of the Joint Finance Committee

Representative Deborah Hudson

Representative Bruce C. Ennis

Senator James T. Vaughn

Senator Charles L. Copeland

Donald Cain, former Vice President of Human Resources for Conectiv, State Chamber of Commerce representative

Howard Weinberg, Executive Director, Delaware State Education Association

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Executive Summary

Rising health care costs' effect on state budgets has been a challenge for the better part of the last two decades. The Governmental Accounting Standards Board (GASB), concerned about health care inflation and the degree to which states' financial statements do not capture its long-term implications, issued GASB Statement 45 -- "Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions (OPEB)."

In essence, GASB 45 requires that government financial statements treat OPEB in the same way pensions are presented. In doing so, most state and local governments will be forced to acknowledge large unfunded liabilities on their balances sheets. Delaware's unfunded liability is currently estimated to exceed \$3 billion. Achieving full funding over the 30 year time horizon allowed by GASB 45 requires that the State add hundreds of millions of dollars to its annual outlays and/or reduce retiree health care costs by a comparable amount. The rating agency implications of such a large unfunded liability are consequential to the state's triple-A ratings. The rating agencies have indicated that Delaware's response to GASB 45 will, over time, constitute a significant factor affecting the State's credit worthiness and therefore its' bond ratings.

Recognizing the issue's importance and complexity, Governor Minner issued Executive Order Number 67, which formed the Retirement Benefit Study Committee. The Committee's charge was to study the challenges posed by GASB 45, taking into account its fiscal, workforce, and bond rating implications, and to provide counsel to the Governor and other policymakers.

The Committee considered many options, including direct State appropriations, employee contributions, retiree contributions, and caps on or cuts to the State's level of retiree health care spending. The Committee received actuarial estimates of each option's effectiveness in reducing the State's unfunded liability. Ultimately, the Committee found that no single option or set of options produced a result that permitted it to make a specific funding recommendation. In spite of this, the Committee did produce consensus around the following principles:

1. Pay-as-you-go funding is not a viable long-term solution,
2. The history of Delaware's pension plan, which at one point in time was severely underfunded and is now fully funded, is a model that should be emulated,
3. Partially funding for a number of years is an acceptable approach as long as the time required to "ramp up" to full funding is not excessive,
4. The use of a State appropriation to fund a portion of the annual required contribution should be a part of any funding solution, and

5. A multi-year plan that clearly articulates Delaware's commitment to full funding should be put in place as soon as is practical.
6. The State Employee Benefit Committee should take into consideration the value of the ARC and the long-term impact of changes made to employee and retiree health care.

(A more complete discussion of these principles is found in the report's conclusions on page 10.)

Basis of the Report

This report has been prepared and is presented to Governor Minner, the General Assembly and the Delaware Economic and Financial Advisory Council (DEFAC) in accordance with Executive Order Number 67, which established the Retiree Benefit Study Committee.

The Committee was charged with studying the fiscal issues associated with retirement benefits and making recommendations to the Governor, General Assembly and DEFAC. This report fulfills that requirement.

What is GASB?

GASB is an acronym for the Governmental Accounting Standards Board, an operating arm of the Financial Accounting Foundation and currently the source of generally accepted accounting principles, or GAAP, used by state and local governments within the U.S. The Financial Accounting Foundation also has oversight responsibility for the Financial Accounting Standards Board, or FASB, which establishes standards of financial accounting and reporting for all non-governmental entities. GASB is a private, non-governmental organization funded from sales of its own publications, governments, the public accounting profession and the financial community.

GASB is recognized by the Securities and Exchange Commission as the rule making body for state and local government. GASB's mission is to establish and improve standards of state and local governmental accounting and financial reporting that will result in useful information for users of financial reports and guide and educate the public, including issuers, auditors, and users of those financial reports.¹

GASB 45

GASB Statement 45, "Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions" was adopted to recognize a growing liability that was previously unmeasured and unrecorded. The growth of the liability stems from health care costs that are rising at a rate greater than inflation and the imminent retirement of the baby boomer generation. GASB 45 is the government equivalent of FAS 106, which was adopted in the early 1990s by private entities. GASB 45 levels the playing field for financial statement reporting.

What is it exactly? In addition to a salary, most full-time employees of state and local governments, including Delaware, receive non-cash compensation in exchange for services. Some of these benefits are earned over years of service but will not be received until after employment ends. The most common type of these post-employment benefits is a pension. As the name suggests, *other post-employment benefits* ("OPEB") are post-employment benefits

¹ <http://www.gasb.org/>

other than pension benefits. In Delaware, such benefits primarily include health insurance and prescription drug coverage for retirees, spouses and dependents.

In plain English, GASB 45 requires that the State recognize the full cost of OPEB – retiree health care benefits earned by current employees over their work life - using actuarial methods and assumptions similar to those that are used to measure the pension obligations. Currently, Delaware’s financial statements, like those of other states, do not take into account nor do they reflect the state’s estimated OPEB liability. For Delaware, this new reporting standard will apply -- regardless of whether or to what degree the obligation is financed or funded -- beginning with the fiscal year ending June 30, 2008. GASB 45 does not mandate funding or stipulate any particular funding strategy; it is purely a reporting requirement. It is expected that fiscal year 2008 financial statements would be published sometime in the autumn of 2008.

A Review of Benefits

29 Del. C. § 5202 describes the benefits currently provided to retirees as well as the eligibility criteria. A summary is shown below.

Cost Sharing Arrangements	Length of Service	State Contribution	Retiree Contribution Under Age 65	Retiree Contribution Age 65 +
Hired: PRIOR to July 1, 1991		100% State Contribution	Same Contribution as Active Employees	None
Hired: AFTER July 1, 1991	Over 20 years 15 years 10 years Less than 10 yrs	100% 75% 50% 0%	same as Actives 25%, plus 50%, plus Full Premium	None 25% 50% Full Premium

Eligibility requires vesting in the state’s pension plan, but retirement directly from the state is not required. Dependent coverage continues after a retiree’s death and dependents can be added after a retiree’s death. Of the state’s current retiree population, 75% are Medicare-eligible.

The amount of a particular retiree’s contribution is based on the plan selected and the type of coverage provided. The table shown below summarizes the state’s health care premiums for both active and retired employees. Premium shown are fiscal 2006 rates. The amounts highlighted in yellow represent the state contribution to total premium.

Premium Rates for Active and Retired Employees								
	Monthly Premiums				Employee/Retiree Contribution			
	Employee/Retiree				Employee/Retiree			
	Individual	& Spouse	& Child	Family	Individual	& Spouse	& Child	Family
Blue Cross Blue Shield of Delaware								
Basic Plan	\$ 411	\$ 843	\$ 619	\$ 1,054	\$ -	\$ -	\$ -	\$ -
First State Health Plan	\$ 416	\$ 861	\$ 632	\$ 1,076	\$ 5	\$ 18	\$ 13	\$ 22
PPO Plan	\$ 459	\$ 946	\$ 701	\$ 1,182	\$ 49	\$ 103	\$ 82	\$ 129
BlueCARE	\$ 426	\$ 891	\$ 646	\$ 1,111	\$ 15	\$ 48	\$ 27	\$ 58
Coventry Health Care of Delaware	\$ 431	\$ 889	\$ 657	\$ 1,109	\$ 21	\$ 47	\$ 37	\$ 55
Medicare Supplements								
Special Medicifil	\$ 313				\$ -			
BlueCare Carveout	\$ 286				\$ -			
Coventry Medwrap	\$ 308				\$ -			

Measuring the Liability

Using the most recent information available, an actuarial valuation has determined Delaware's current obligation to be \$3.1 billion. The assumptions used by the actuary in determining the obligation are the same as those used in pension plan valuations and include specifics regarding plan provisions, such as those shown above, participant data provided from payroll records and other assumptions such as termination rates, retirement rates, medical inflation, mortality, etc. A forecast of costs is then discounted to a present value using a discount rate that reflects a conservative investment rate. An 8% discount rate has been used to mirror the assumed investment rate from the pension plan.

To put the \$3.1 billion obligation in perspective, consider that the state pension fund's obligation is about \$5.4 billion. The key difference, however, is whereas the State pension fund has more than \$5.4 billion in assets to cover its estimated liability, the OPEB liability is almost entirely unfunded. Furthermore, the largely unfunded \$3.1 billion liability will grow unless the State actively addresses the OPEB issue.

GASB 45 requires that an actuary determine an annual required contribution, or ARC, which is made up of two components. The first component, normal cost, represents the costs associated with the current year. The second component, past service liability, represents the amount of the liability from past service, the total of which can be amortized over a 30-year period. For example, the benefit determined for a 40-year old employee with 16 years of service in fiscal 2006 will be divided into normal cost – the actuarially determined benefit earned in fiscal 2006 and a past service liability – the actuarially determined benefit earned between 1991 and 2005.

Delaware’s ARC in fiscal 2008, the first year the liability is to be recorded, is expected to be \$286 million. GASB 45 further allows that any cash expenses paid for retiree health care premiums in the current year, commonly known as ‘pay-go expenses’, can offset the ARC. Fiscal 2008 pay-go-expenses are expected to be \$101 million. Thus, the net liability to the state in fiscal 2008 is expected to be \$185 million. Appendix 1 contains the actuarial report as well as a high level summary of assumptions used in the assessment. The estimated ARC and pay-go expenses for the next four years and for years 10 and 20 are shown in the table below.

Baseline Forecast (in millions)	2008	2009	2010	2011	...	2018	2028
ARC	\$285.7	\$298.6	\$312.2	\$326.3		\$446.5	\$705.5
Pay-go expenses	100.8	115.3	128.0	141.8		\$248.9	\$464.2
Annual Incremental Cash Outlay required for 100% funding	\$184.9	\$183.3	\$184.2	\$184.6		\$197.7	\$241.3

Under the State’s current policy, which funds only the pay-go-expenses, a \$185 million unfunded liability will arise in fiscal 2008 and a similar liability will be repeated each year for 30 years. Based on the State’s government-wide net assets of roughly \$2.0 billion, liabilities will grow to exceed assets within 10 years.

It is important to note that while this liability represents all covered employees and retirees, not all employees are paid from the state’s general fund. Therefore, the annual incremental cash outlay required from the general fund to fund 100% of the liability would be about 68%, or \$125 million. The remainder would be expected from special funds.

The actuarial estimates are based on full funding of the ARC and have been discounted using an assumed investment rate of 8%. The higher the discount rate, the lower the obligation. GASB 45 requires that the rate used to discount liabilities be tied to the expected return on assets used to pay these benefits. If each year’s expense is funded to a trust account and investments are actively managed, the assumed rate of 8% is reasonable. If the state continues pay-go cash funding and does not fund the incremental ARC, the discount rate must be based on the return earned on its cash accounts. The likely result in this case will be a discount rate of about 3%, which increases the obligation three-fold. A blended rate can be used in the event a partial funding policy is developed. For example, if the ARC is funded at a level of 70% annually, the blended discount rate might be 6.5% assuming an 8% return on plan assets and a 3% return on ‘employer’ assets.

GASB 45 does not require any employer funding; providing retiree coverage on a pay-go basis is acceptable according to GASB 45. However, the required calculation and the recognition of the cost of retiree health benefits will begin accumulating on an employer’s financial statements if assets have not been set aside to offset the liability. The growing unfunded liability will put pressure on employers to manage the liability by pre-funding, imposing employee contributions or reducing or eliminating the liability by reducing or eliminating benefits. When private employers were faced with FAS 106, a similar change in accounting rules, many simply eliminated the benefit or capped the dollar amount of the benefit available.

Rating Agency Implications

Each agency has issued a report, all of which are attached in Appendix 2. An excerpt from each follows:

S&P: Reporting and Credit Implications of GASB 45 Statement on Other Post-Employment Benefits, December 1, 2004

“...Standard & Poor’s will analyze any OPEB obligations in the same way it currently evaluates pension obligations. As unfunded actuarial assumed liabilities of public pension funds are considered in the rating process as tantamount to bonded debt of the fund’s sponsors, the unfunded OPEB liabilities will be viewed in a similar way. ...As part of the overall OPEB analysis, Standard & Poor’s will include the implications of not only the total unfunded liability, but also how the annual required contribution is managed. For example, an increasing net OPEB obligation would be a negative rating factor just as an increasing net pension obligation. “

Fitch: The Not So Golden Years, June 22, 2005

“Initially, Fitch’s credit focus will be on understanding each issuer’s liability and its plans for addressing it. Fitch also will review an entity’s reasoning in developing its plan. An absence of action taken to fund OPEB liabilities or otherwise manage them will be viewed as a negative rating factor.”

“Fitch will view OPEB liabilities, like pensions, as soft liabilities that fluctuate based on assumptions and actual experience. Reality dictates that an entity may opt to defer OPEB funding in times of budget stress. However, indefinite deferrals are damaging to credit quality. While not debt, pension and OPEB accumulated costs are legal or practical contractual commitments that form a portion of fixed costs. Long-term deferral of such obligations is a sign of fiscal stress that will be reflected in ratings.”

Moody’s: Other Post-Employment Benefits (OPEB), July 2005

“OPEB funding status will become a more visible factor in credit rating process, similar to pension obligations.” Moody’s will exclude OPEB liabilities from calculations of state debt burdens, but will include them as a factor in the overall credit assessment of an issuer.”

The rating agencies will consider both quantitative and qualitative measures in a review of the State’s OPEB liability.

Quantitative

- Funded ratio – When considering the funding ratio of pension plans, ratios of 70% to 80% have been considered adequately funded.
- The reasonableness of actuarial assumptions such as medical cost assumptions, investment rates, and amortization period will be reviewed.
- The ARC and its size relative to the overall budget.

- Net Obligation – a rising net obligation indicates a deferral of payments.
- The policies that have been developed to manage the ARC and subsequent adherence to those policies.
- The difference between the annual required contribution and the actual contribution.

Qualitative

- Flexibility afforded by key labor contracts to reduce or eliminate benefits
- Constitutional or statutory requirements to provide benefits

It is unlikely that the rating agencies will downgrade the rating of state governments, including Delaware, solely because of the new accounting requirement, but, as each of the rating agencies have indicated, the OPEB liability will be factored into its assessment of credit worthiness. Budget decisions that result in increases or decreases of the liability in subsequent years will become a significant factor in state and local government's financial condition.

Specifically, the rating agencies will consider the unfunded OPEB liability when assessing Delaware's financial condition just as unfunded pension liabilities are considered. Delaware's pension liability is fully funded at \$5.4 billion, but the creditworthiness of many states has been adversely affected by significantly unfunded ratios. West Virginia (AA-, Aa3, AA-), Illinois (AA, Aa3, AA) and New Jersey (AA-, Aa3, AA-) have either sought approval to issue bonds or have issued bonds to improve pension funding ratios attempting to take advantage of the interest rate differential between taxable municipal bonds and the assumed investment return on plan assets. West Virginia's employee pension plans currently have a \$5.5 billion unfunded liability and voters recently rejected a proposal that would have authorized taxable bonds to fund the liability with debt. Illinois issued \$10 billion in taxable pension obligation bonds in 2003, gambling that the investments would perform well enough to cover the debt service payments and reduce the contribution requirements. For Illinois, the timing was favorable, but for New Jersey, which issued pension funding bonds in the late 1990's, the investment performance has not offset the new debt service requirements. In July, Gainesville, Florida sold \$35.2 million in taxable general obligation bonds in what is believed to be the first-ever OPEB obligation bond issue.

Rating agency analysts believe that the use of OPEB funding bonds can be a useful tool in asset-liability management, if used moderately and in conjunction with prudent investment. However, bonding these obligations creates real debt, the debt service of which must be paid timely, rather than a 'softer' liability that can be deferred or rescheduled during periods of fiscal stress. State debt limits will also be a consideration in funding this obligation through debt.

Other Employers

FAS 106, adopted in 1993, is the corporate equivalent of GASB 45 and is part of the reason why retiree medical plans are vanishing. According to the Kaiser/HRET Survey of Employer-Sponsored Health Benefits, the number of large employers offering retiree medical

benefits dropped from 66% in 1988 to 36% in 2004² and it is predicted that retiree medical coverage will be disappearing for American workers particularly workers from large, publicly owned companies. Those who still have coverage will be forced to pay more for it. Other reasons cited for the loss of benefits are increased costs, lack of viable and flexible funding vehicles and competition to keep product costs low.

In the public sector, the liability caused by GASB 45 will likely vary from state to state. Moody's Investor Service reports that the states of Iowa (AA+, Aa1, AA) and Mississippi (AA, Aa3, AA) offer little or no coverage. Wisconsin (AA-, Aa3, AA-) and Montana (AA-, Aa3) offer insurance, but require retirees to pay most of the cost. California fully covers many retirees' premiums as well as the majority of premium costs for retirees' dependents. In further examples, the trustees of Ohio's (AA+, Aa1, AA+) \$11 billion healthcare fund, one of the few states that have already accumulated assets for retiree health obligations, determined that medical costs and the growing number of covered retirees would deplete the fund in less than 12 years. Last year, contributions to retiree insurance premiums were scaled back, including dependent coverage, and increased contributions from active employees were mandated. In Utah (AAA, Aaa, AAA), the practice of providing retirees with a month of health insurance for every day of unused sick leave was modified. Effective this year, the equivalent of wages for each day of unused sick leave will be placed in retiree health savings accounts which retirees will then be able to use to purchase their own health coverage.

In the early 2000s, funding of a Post Retirement Health Insurance Premium Fund in Delaware began, but was later suspended. With the fiscal 2006 appropriation of \$10 million, the fund now holds \$22.5 million. If funding continues, 29 Del. C. §5550 provides a mechanism for funds to be invested and managed similar to those invested and managed by the pension plan administrators. Any funds appropriated including earnings thereon, will serve to offset the liability.

Governor's Executive Order

The Governor recognized a need to address the issues surrounding GASB 45 and by Executive Order Number 67, a copy of which can be found in Appendix 3, formed a task force to study the results of available actuarial work and commission additional work. The task force was to identify options available to the State, quantify potential effects and assess the desirability of the options according to predetermined criteria. The options evaluated by the Committee are summarized in the table below. Further detail, including a preliminary assessment of the desirability of the options prepared by Department of Finance staff based on the criteria identified in the Executive Order, can be found in Appendix 4. While the Committee found these criteria to be meaningful, in fact, it addressed the criteria somewhat informally and on an ad hoc basis.

² <http://insight.chicagoconsultingactuaries.com/Insight/Documents/RetireeMedicalArticle.aspx>

Options Considered by the Committee

Option		% Reduction in ARC	Significant Issues Identified
Employee Contributions			
Current Employees	1%	5%	Increased commitment to to continue to provide benefits
	2%	10%	
	3%	14%	
Future Employees	1%	Negligible	3% in 20 years
Retiree Contributions			
Under Age 65 - current and future retirees			large cost increase for retirees
'Implicit Subsidy' the added premium retirees would incur if they were isolated in a single risk pool	44%	10%	
Over age 65 - current and future retirees			About \$30 a month
Percent of Medicare Supplement Premium	10%	8%	
Cap State Contributions			
Current and future retirees			increases pressure on pension plan COLAs legislative pressure may make this option ineffective significant workforce turnover
	125%	66%	
	150%	52%	
Retirees after 7/07	125%	52%	
Decrease State Contribution			
All Retirees	90%	10%	
Retirees and Dependents	90%	13%	

Conclusion

The Committee was surveyed to determine if any consensus could be reached regarding the options presented. A summary of the responses to the survey can be found in Appendix 5. These responses served as an outline, which the Committee used at its September 13, 2005, meeting, to discuss its recommendations.

As the table in Appendix 5 reveals, the Committee's work did not produce consensus around a single option or combination of options. Nor was the Committee split into separate and easily identifiable camps, each with competing and mutually exclusive plans. The

Committee's failure to identify or recommend a specific blueprint for OPEB funding is understandable and perhaps not altogether unexpected. Without exception, the options presented to the Committee included difficult and unavoidable policy trade-offs. There are no straightforward "win-win" solutions. Furthermore, the issue itself is highly complex and, as it is brand new to the public sector, there is no tried and true formula that guarantees financial success at an acceptable cost. Nonetheless, the Committee made progress and reached "broad brush" consensus on six points:

1. The Committee agreed that continuing to fund retiree health benefits entirely on a pay-as-you-go basis is not a viable long-term strategy, especially in light of Delaware's long-standing commitment to judicious fiscal practices;
2. The Committee agreed that, while not ideal, the practices employed in the implementation of the State's pension fund serves as a very valuable model worth emulating or, at a minimum, as a useful yardstick against which progress on OPEB funding can be measured;
3. The Committee agreed that partial funding of the ARC for a number of years is an acceptable and desirable strategy, which recognizes the budgetary and political realities associated with an undertaking of OPEB's size and complexity. It was widely agreed that, so long as the "ramp up" to full funding was not excessively long, this strategy would not be viewed negatively by the rating agencies;
4. The Committee concluded that, when considering the means by which to address the ARC, a direct State appropriation should be part of the funding solution and that some combination of the other approaches presented to the Committee should, when fully implemented, eliminate the ARC's remaining unfunded liability. The Committee did not, however, reach a consensus on how large the State appropriations should be or which of the other approaches should complement it.
5. The Committee recognized the need for and the ability to articulate to the rating agencies a firm, multi-year funding plan as soon as is practical, with particular emphasis and focus on Fiscal Year 2008 – the first year Delaware is required to include its OPEB liability in its financial statements.
6. The Committee further recommended that any changes considered for employee health care coverage should take into consideration changes in the value of the ARC. The Committee would encourage the State Employee Benefit Committee to look for innovative ways to maintain quality health care coverage for employees and retirees while continuing to look for cost efficiencies. Finally, the Committee would encourage consideration of reducing the ARC by means other than direct appropriation.

Ultimately, however, while members of the Committee acknowledged the thoroughness and clarity of the data and analyses presented by staff, they concluded that, for an issue of OPEB's scope and importance, there simply was not enough information available to allow them to identify and recommend a funding solution that is clearly preferable to all other options.



A MILLIMAN GLOBAL FIRM

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September 29, 2005

Ms. Stephanie Scola
Director of Bond Finance
Delaware Department of Finance
820 N. French St, 8th Floor
Wilmington, DE 19801

Re: Projection of GASB 45 costs

Dear Stephanie:

As requested, we have provided a summary of the Annual Required Contribution and Expected Benefit Payments from fiscal year 2008 through fiscal year 2043. We have summarized the results in the enclosed Exhibit 1.

Please let us know if you have any questions or comments about this.

Sincerely,

Milliman, Inc.

John Muehl, FSA, MAAA, EA
Consulting Actuary

Enclosure

cc: David Craik
Amy Shoemaker
Engine Lee

JCM/AS/DEH/01
M:\DSE\2005 studies\OPEBforPdrive\BaselineSummary.doc

**State of Delaware
Projected GASB 45 Costs
Based on Current Plan Including Medicare Part D Savings**

Fiscal Year Ending	Annual Required Contribution (in millions)	Estimated Benefit Payments (in millions)
2008	\$286	\$101
2009	\$299	\$115
2010	\$312	\$128
2011	\$326	\$142
2012	\$341	\$156
2013	\$357	\$171
2018	\$447	\$249
2023	\$560	\$344
2028	\$705	\$464
2033	\$890	\$621
2037	\$1,075	\$784
2038	\$558	\$831
2043	\$747	\$1,112

The purpose of these projections is to assist the State of Delaware to estimate the financial effect of GASB Statement No. 45 for the fiscal years beginning July 1, 2007 and later. It may not be appropriate to use these projections for other purposes.

This analysis is based on the demographic data and benefit plan descriptions as of July 1, 2003, and other information provided by the State, including actuarial assumptions used for the State's pension plan valuations. We used the pension valuation assumptions adopted effective July 1, 2004, including an investment return assumption of 8%. We have made trend and other assumptions that relate specifically to the other post-employment benefit plans. We have used the entry age normal, level percentage of pay, cost method consistent with the pension valuation. The valuation data and methods are described in our preliminary report on retiree health liabilities dated May 12, 2004.

We estimated the annual required contribution using 30-year funding of the past service liability, assuming the State contributes the full amount to a fund each year. To estimate long-term costs, we used approximations consistent with a constant active population.

The implicit subsidy assumption for retirees under age 65 was developed by Palmer & Cay based on eight quarters of conventional premium and claim costs. The Medicare Part D savings assumption of 29% of Medicare-eligible drug cost was developed by the Segal Company based on 2004 drug costs.

The results of our study depend on future experience conforming to those assumptions. It is certain that actual experience will not conform exactly to the assumptions used in this analysis. To the extent future experience deviates from these assumptions, the actual results will vary from the results presented here.

We understand that this is a public document and may be subject to disclosure to third parties. We do not intend to benefit, and assume no liability to, any third party who receives this document.

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Reporting & Credit Implications of GASB 45 Statement on Other Postemployment Benefits

Reporting Changes in GASB 45

Credit Implications

The significance of other (nonpension) postemployment benefit (OPEB) obligations to state and local government credit analysis was again brought to the forefront with the release of GASB Statement 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions," in June.

Postemployment benefits were already a point of much interest in the credit ratings of these entities in terms of pension benefits, due in large part to the recent dramatic declines in funding ratios and concomitant increases in required contributions. Now, GASB 45 changes the way governments report for OPEB obligations. OPEB obligations, which are primarily centered on health care coverage, represent a significant expense for public sector employers. The current level of OPEB promises are primarily the result of employment contracts entered into by governmental entities. The funding of these obligations is of an increasing credit concern, exacerbated by the rapid cost acceleration in many health-related areas. Government jurisdictions have a wide range of OPEB liabilities in terms of absolute size and relationship to budget resources, depending on how generous they have been in awarding benefits. The disparities between employers will now be made more apparent under the new GASB 45 reporting. In some instances, the new reporting may reveal cases in which the actuarial funding of OPEB obligations would seriously strain operations, or, further, may uncover conditions under which employers are unable or unwilling to fulfill these obligations. In such cases, OPEB liabilities may adversely affect the employers' creditworthiness, in that overall liabilities, including debt-like obligations such as OPEB, would be increased and future expenditure flexibility reduced.

Currently, OPEB expenses are included in governmental entities' general fund expenditures and broken out in an audit note, as the cost is expensed in the current year (pay-as-you-go). GASB 45 requires employers to account for OPEB expenses in the same manner as pension benefits are currently handled. Under the new statement, the liabilities attributable to OPEB, and corresponding annual required employer contributions, would be actuarially determined. It is believed that the unfunded actuarial liability related to OPEB, when calculated, will be sizable, and, in many cases, greater than the current unfunded liability for pension benefits, reaching billions of dollars for larger state plans. Initial feedback indicates that, in some cases, the unfunded OPEB liability could total roughly 50% of an employer's corresponding total pension liability.

Reporting Changes in GASB 45

In contrast with the current practice of reporting the cost of retiree health care benefits on a pay-as-you-go basis, GASB believes that there may be a vast difference between this approach and accounting for the cost to the employer of OPEB earned by employees that year. While these benefits are paid out after retirement, GASB has taken the position that OPEB, like pension benefits, are a portion of the compensation currently earned by government employees, and therefore should be part of the current cost of providing public services.

The GASB 45 changes, in part, require determining the full cost of OPEB

using actuarial methods and assumptions in much the same way that pension benefits are measured. This approach would require the employer to measure and disclose an amount for annual OPEB cost that is equal to the employer's annual required contribution, which would finance these benefits after the employees retired, amortizing the liability. Factors in this calculation would include average length of employment, salary increase expectations, demographic trends, projected health care cost growth rates, and investment return assumptions. The normal cost for benefits to be earned in the future, and the portion of the unfunded accrued liability to be amortized that year (for OPEB already earned but not provided for) would, when combined, make up the employer's annual required contribution. On an ongoing basis, the cumulative difference between the annual required contribution and employer's actual contributions would result in the net OPEB obligation, which is to be displayed as a liability (or asset) in governmentwide financial statements.

Actuarial valuations would be required for OPEB every two years for plans with 200 or more members, and every three years for smaller plans. Currently, with pay-as-you-go funding practices, the total future liability is unquantified, and thus, there is no way to determine a fully funded system. GASB 45 sizes the liability, and sets the amortization period for the unfunded OPEB liability so as not to exceed 30 years. These standards are to be implemented on a schedule similar to the recently completed GASB 34 conversion schedule, starting with periods beginning after Dec. 15, 2006 (for "Phase 1" employers with annual revenues of \$100 million or more), and over the next two years for smaller jurisdictions.

Credit Implications

The GASB 45 statement for reporting on OPEB will make more transparent the full liabilities and costs of this current compensation to be received in future years by government employees. In addition, it will provide insight into the potential effect on future benefit agreements before, rather than after, they are entered into. While these benefits, in many cases, represent significant long-term liabilities, it is highly likely that the total costs will not be fully understood. The continued absence of the actuarial funding of OPEB may have given rise to intergenerational inequities in funding benefits. The absence of the nature of the true future costs could have led to reductions in promised benefits, or an additional burden shifted to retirees if, in the future, the employer finds itself unable to deliver the benefits promised. Granted, the vagaries of the components of health care costs make projections very difficult, but the new statement is, at a minimum, an attempt to quantify the issue and plan for its fulfillment on the basis of a tested methodology and, at best, another significant step toward more complete disclosure.

It is expected that mature governmental entities with large percentages of unionized employees, such as states in the Northeast and Midwest, will have considerable obligations identified under this statement. All Standard & Poor's Ratings Services-rated employers will be monitored closely in terms of their reporting under GASB 45. Additionally, the states in which governmental employees do not pay into Social Security will experience a greater effect from these new changes than those states that receive a reduction in costs attributable to retirees receiving the offsetting federal benefits.

Standard & Poor's will analyze any OPEB obligations in the same way it currently evaluates pension obligations. As unfunded actuarial assumed liabilities of public pension funds are considered in the rating process as tantamount to bonded debt of the fund's sponsors, the unfunded OPEB liabilities will be viewed in a similar way. Poorly funded pension plans, historically, have acted to constrain the credit quality of their sponsors. As part of the overall OPEB analysis, Standard & Poor's will include the implications of not only the total unfunded liability, but also how the annual required contribution is managed. For example, an increasing net OPEB obligation would be a negative rating factor, just as an increasing net pension obligation would be.

While health care benefits may be marginally easier to change (reduce) than

pension benefits, they are both difficult to alter, and Standard & Poor's believes that each are commitments made by employers to employees as part of their total compensation, and that they will be honored. We will weigh the effect these obligations have on an employer's ability and willingness to pay debt service on its bonds. While the payments of pension and other postemployment benefits are just two of large number of factors that go into a complete rating analysis, cases may arise in which OPEB obligations, due to their relative magnitude, adversely affect creditworthiness. Upon implementation of these new standards, Standard & Poor's will include the new information as part of its ongoing analytical surveillance of ratings. Close attention will be paid to the newly quantified OPEB unfunded liabilities, given their expected magnitude, and to employers' strategies for managing them.

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Special Report

The Not So Golden Years
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Related Research

- "Reversal of Fortune: The Rising Cost of Public Sector Pensions and Other Post-Employment Benefits," Sept. 18, 2003
- "Local Governments Pressured by Rising Employee Health Care Costs," Dec. 13, 2004

■ Summary

A new public sector accounting standard touches on three hot topics: skyrocketing health care costs, the ongoing national debate over retirement security, and the recent emphasis on greater financial disclosure. Governmental Accounting Standards Board (GASB) Statement No. 45 relates to other post-employment benefits (OPEB) — payments and services provided for retirees other than pensions. OPEB consist mainly of retiree health care benefits. GASB 45 applies the accounting methodology used for pension liabilities (GASB 27) to OPEB and is similar in concept to an accounting standard adopted for the private sector in the mid-1990s.

The new standard, to be implemented beginning in fiscal 2008 for many large governments, is timely given the aging demographics of the governmental work force. It also reflects the consistent efforts of the GASB to improve financial statement transparency and align public accounting more closely with that of the private sector.

GASB 45 does not increase costs of employment, but attempts to more fully reveal them by requiring governmental units to include future OPEB costs in their financial statements. Under current practice, nearly all governments pay only the cost of OPEB due in the current year, with no effort made to accumulate assets to offset future benefit costs. While not mandating funding, GASB 45 does establish a framework for prefunding of future costs.

Amounts required to prefund OPEB on an actuarially sound basis are likely to significantly exceed annual pay-as-you-go outlays for these benefits. Many actuaries believe, bolstered by preliminary studies done on behalf of a few proactive governments, that actuarially determined annual contributions could be five to 10 times higher than current expenses in many cases.

Fitch Ratings views GASB 45 as a positive step toward more fully illuminating governmental obligations to retirees, but acknowledges the inherent tension between allocating scarce resources toward critical government services today and meeting the funding requirements for retirement benefits that might not be due for decades. Fitch anticipates that governments will thoroughly review retiree benefit programs and that responses to OPEB funding challenges will vary considerably. However, Fitch expects many governments will approach GASB 45 in much the same way they responded to the adoption of pension system actuarial and accounting standards, by steadily ramping up annual contributions to actuarially determined levels, altering benefit plans, or taking other actions to ensure long-term plan solvency.

Credit Highlights

- Governmental Accounting Standards Board (GASB) Statement No. 45 will be the accepted accounting practice for governments as of its implementation dates. Failure to comply would prevent auditors from releasing a “clean” audit opinion.
- The switch to actuarial funding from a pay-as-you-go practice may have a sizable fiscal impact. However, Fitch Ratings believes that meeting actuarial funding requirements for other post-employment benefits (OPEB) will be a stabilizing factor and protective of credit over time.
- Fitch expects a wide range of unfunded liability positions to result as GASB 45 is implemented, reflecting the variability of benefits offered around the U.S. Annually required contributions are likely to place disparate burdens on the budgetary resources of state and local governments.
- Initially, Fitch’s credit focus will be on understanding each issuer’s liability and its plans for addressing it. Fitch also will review an entity’s reasoning in developing its plan. An absence of action taken to fund OPEB liabilities or otherwise manage them will be viewed as a negative rating factor.
- For issuers choosing to ramp up annual contributions to reach full funding of actuarially determined levels, Fitch recognizes that a rising net OPEB obligation in the short term may be a by-product. Such an increase, taken in the context of a sound OPEB funding plan, will not by itself affect credit ratings.
- Fitch does not expect OPEB plan funding ratios to reach the generally high levels of pension systems for many years, but steady progress toward reaching the actuarially determined annual contribution level will be critical to sound credit quality.
- Assumptions play a crucial role in calculating plan assets and liabilities. As actuarial standards for OPEB plans become clear, Fitch will review the underlying assumptions and will view negatively any that are overly aggressive. When applicable, assumptions should be consistent with those adopted for the plan sponsor’s pension system.
- Fitch will view OPEB liabilities, like pensions, as soft liabilities that fluctuate based on assumptions and actual experience. Reality dictates that an entity may opt to defer OPEB funding in times of budget stress. However, indefinite deferrals are damaging to credit quality. While not debt, pension and OPEB accumulated costs are legal or practical contractual commitments that form a portion of fixed costs. Long-term deferral of such obligations is a sign of fiscal stress that will be reflected in ratings.

Failure to make actuarially determined OPEB plan contributions will most likely result in rising net OPEB obligations, which like rising net pension obligations are a deferral of financial responsibility. Therefore, over time, a lack of substantive progress in funding and managing OPEB liabilities or a failure to develop a realistic plan to meet annual OPEB contributions could adversely affect an issuer’s credit rating. Conversely, in Fitch’s opinion, the prudent accumulation of assets in a trust account outside the general fund and well in advance of pay-as-you-go cost escalations can avoid or forestall liquidity problems or tax capacity concerns that might lead to credit deterioration.

■ Implementation Schedule

GASB 45 will be phased in, beginning with the largest governments, effective:

- Fiscal periods beginning after Dec. 15, 2006 for governments with annual revenue greater than \$100 million.

- Fiscal periods beginning after Dec. 15, 2007 for governments with annual revenue between \$10 million and \$100 million.
- Fiscal periods beginning after Dec. 15, 2008 for governments with revenue under \$10 million.

■ Exploring GASB 45

GASB 45 furthers the effort to disclose the total cost of compensation earned by public sector employees. Some of this cost, specifically the salaries and related benefits of active workers, is already recognized on the statement of revenues, expenditures, and changes in fund balance (income statement) prepared annually. Similarly, the cost of pension benefits for current and retired workers is recognized through the implementation of GASB 27, which requires income statement recognition of annual employer contributions to pension systems and balance sheet recognition of net pension obligations (most often as a liability, but theoretically an asset). GASB 45 largely adopts the accounting and

actuarial valuation methodologies used for pensions, making minor adjustments to reflect the different nature of OPEB and the reality that very few governments have funded OPEB plans.

OPEB primarily relate to retiree health care, but can also include life insurance and other benefits. OPEB contributions by employers generally take the form of direct indemnity payments or full or partial cost-sharing of annual insurance premiums, but can also take the form of an implicit subsidy. This occurs when retirees pay a health insurance premium that is based on a larger risk pool, thereby benefiting from a lower premium rate than if they had to pay the full age-based premium.

Under GASB 45, governments providing benefits to more than 200 plan members are required to have an actuarial valuation of their OPEB plans done every two years. Most governments accessing the capital markets fall under this requirement. The OPEB plan is defined as whatever constitutes the “substantive plan,” incorporating written and documented plan elements, as well as nondocumented elements that have been communicated and understood between the employer and employees. The actuarial valuation determines the actuarial present value of future liabilities — in essence, the amount that, if invested at the valuation date, would be sufficient to meet all liabilities, assuming embedded assumptions hold true.

From the actuarial valuation, an annually required contribution (ARC) is determined. The ARC is the portion allocated to the current year of the amount needed to pay both the normal costs (current and future benefits earned) and to amortize the unfunded liability (past benefits earned but not previously provided for). GASB 45 requires amortization of unfunded liabilities over a maximum of 30 years.

GASB 45 requires an accounting of a government’s compliance in meeting its ARC. Contributions in an amount less than the ARC result in a net OPEB obligation, which is to be recorded as a liability on the governmentwide financial statements and full accrual-based fund statements. Only the employer’s payments count toward the ARC; employee matching payments do not. The direct payment of benefits counts as a contribution toward the ARC. However, since nearly all plans will have some past service liability to amortize, simply continuing with pay-as-you-go funding is likely to result in rising net OPEB obligations.

Unlike GASB 27, which covers employer accounting for pensions, under GASB 45 there will be no net OPEB obligations reported at transition (unless a government volunteers to record one). Unfunded OPEB plan liabilities will be present as governments begin to implement the standard, but governments will be required to disclose their compliance in meeting the ARC only on a going-forward basis. The footnotes to the financial statements will include information on compliance in meeting ARCs, the cumulative net OPEB obligation, and the actuarial funding ratio of the OPEB plan (assuming a trust account is established).

■ OPEB Trust Funds

A critical element to making OPEB plans affordable and actuarially sound is GASB 45’s requirement that, in order for actuaries to permit the use of a long-term investment return assumption, governments must set aside plan assets in an irrevocable trust. Funds accumulated or earmarked but held outside an irrevocable trust are limited to an investment return assumption consistent with general government investments, which are typically shorter in duration and lower in yield. Partially funded plans are required to use a blended rate, based on the proportion of contributions being used for asset accumulation versus payment of current benefits.

The ramifications for OPEB plan valuation are enormous, as long-term return assumptions are usually at least twice those of short-term investments. The higher the investment return assumption (discount rate), the lower the present value of future liabilities and the corresponding ARC will be.

Governments and actuaries are currently exploring different types of trust mechanisms, with no clear consensus emerging to date. Options include 401(h) accounts, voluntary employee benefit accounts, section 115 governmental trusts, and others. The type of trust account used may vary depending on the design of the OPEB plan. One consideration for governments may be weighing the financial benefits of establishing a trust against the legal and human resources management implications. Many governments reserve the right to unilaterally revoke OPEB. Establishing a trust fund may be seen as conferring a permanency to the benefit plan that might not be intended.

■ Role of Assumptions

As they do for pension systems, economic and demographic assumptions will play a critical role in

determining the magnitude of OPEB plan liabilities (and eventually assets). Beyond the discount rate assumption discussed in the previous section, projections of health care costs and retirement rates and ages will be crucial to OPEB plans.

Health care costs have risen rapidly since the mid-1990s, with double-digit growth rates in some years. The pace of health care cost growth outstrips the salary and general inflation assumptions embedded in pension plan valuations, making OPEB liability growth potentially more volatile. Fitch expects initial variability in medical inflation assumptions, with actuaries making adjustments over time based on experience.

Retirement rate assumptions project how many plan members will leave active service and begin collecting OPEB during the valuation period. Studies have shown that the public sector work force is disproportionately made up of baby boomers, who are nearing retirement age. The pace at which they retire will have a significant effect on liability valuations and could even affect investment performance, as plan managers may have to adjust investment allocations to maintain liquidity sufficient to meet current benefit expenses. Retirement age is also important, given the existence of Medicare. In most cases, OPEB health care costs would be at least partially offset by Medicare. However, retirement age rules vary significantly among and within governments, with some plans having to carry OPEB for 10–15 years until Medicare eligibility is reached, and others facing much shorter exposure.

■ Implementation Issues

GASB 45 potentially creates legal, technical, and policy issues for the public sector.

Defining the “Substantive Plan”: Determining the precise definition of an OPEB plan is the task of the employer, in consultation with the actuary. Written documentation of the benefit plan may or may not accurately reflect the currently understood version of the plan. Employers have a financial interest in more narrowly defining the substantive plan, which may put them at odds with employee groups. Legal challenges or labor grievances can be envisioned.

Legal Status of OPEB: In many states and localities, pension benefits are constitutionally protected, statutorily defined, or otherwise codified. While OPEB may have the same status in some jurisdictions, many governments have greater administrative control over OPEB. If employers seek to modify or eliminate

OPEB for some workers or retirees, legal clarification may be required.

Medicare Part D: The implementation of the new prescription drug benefit under Medicare is under way and scheduled to go into effect Jan. 1, 2006. Integration with government OPEB plans will take time and will be complex. It is not clear at present whether this federal program will provide a financial benefit to or impose additional costs on state and local governments.

Labor Relations: Faced with potentially large costs to prefund OPEB plans, governments may seek concessions from active and retired employees. Conflicts could lead to work stoppages or recruitment and retention problems. Fitch expects such difficulties to appear in the more heavily unionized areas of the country.

■ Potential Funding Solutions

Governments will likely explore switching employees to a defined contribution system for OPEB. Once the government makes its scheduled contribution to employees or beneficiaries, all risk is transferred to the employee. While an attractive option for employers, it is likely achievable only for new hires, as existing beneficiaries have an interest in retaining the current system. Prolonged resistance by employee groups to defined contribution pension funding underscores this difficulty.

Governments facing large unfunded liabilities and steep ARCs may consider OPEB funding bonds. However, state laws are generally not explicit regarding issuing bonds for this purpose, creating a potential impediment to capital financing for OPEB. If legally allowable, OPEB funding bonds may be structured in the same manner as pension obligation bonds, which attempt to take advantage of the interest rate differential between taxable municipal bonds and the assumed investment return on plan assets. Bonds could be issued to fund all or a portion of a sponsor’s unfunded OPEB liability, with the hope that the debt service on the bonds would be less than what the sponsor would otherwise have to pay in annual OPEB ARC costs over the long term.

Fitch believes that OPEB funding bonds, if used moderately and in conjunction with a prudent approach to investing the proceeds and other plan assets, can be a useful tool in asset-liability management. However, a failure to follow balanced and prudent investment practices could expose the plan sponsor to market losses.

Because a sponsor's unfunded OPEB liability will be factored into the rating, bond issuance would simply move the obligation from one part of the governmentwide or full accrual-based fund financial statements to another. However, Fitch notes that OPEB or pension funding bonds create a true debt, one which must be

paid on time and in full, rather than a softer liability that can be deferred or rescheduled from time to time during periods of fiscal stress. Consequently, issuing bonds to fund an OPEB plan could have a significant effect on financial flexibility over time.

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Other Post-Employment Benefits (OPEB)

New Accounting Requirements to Shed Light on Cost of State and Local Retiree Health Benefits; Funding Pressures Expected to Vary Widely

Summary

Just as U.S. local and state governments are emerging from one of the most difficult fiscal periods in recent memory, they face a new hurdle in the form of accrued retiree health-care liabilities. The costs associated with retiree health benefits, though they have been magnified by growth in healthcare spending, are not a new phenomenon. Governments in coming years will have to improve their measurement and disclosure of OPEB costs and liabilities under statements 43 and 45 of the Government Accounting Standards Board (GASB). For many state and local governments rated by Moody's, the rules will apply to fiscal years starting after Dec.15, 2006. A wide range of previously unmeasured liabilities will be reported as a consequence, and the expected drive to address these liabilities will add to the fiscal pressures governments already face from programs such as public education, Medicaid, and employee pension funding.

Moody's does not anticipate that the liability disclosures will cause immediate rating adjustments on a broad scale. In fact, certain positive long-term effects seem likely to stem from the new requirements. This special comment describes the GASB statements and how they may affect the state and local government credit rating process. For municipal issuers, the credit impact of the new statements probably will depend on the following factors:

- The absolute size of unfunded actuarial accrued liability (UAAL) and UAAL size relative to key financial measures such as size of payroll, budget and tax base
- The plan for UAAL amortization as well as ongoing funding of new OPEB costs as incurred, on an accrual basis
- Actuarial assumptions, including discount and medical cost inflation rates, used to determine values of liability and pledged assets
- Retirement benefits promised to current workers and retirees as well as the ability (under contract or statute) to modify benefit offerings
- The impact of full funding on the issuer's financial flexibility and strength, based on measures such as debt or reserve levels
- The current credit assessment of the issuer and other factors affecting financial flexibility



NEW RULES ARE INTENDED TO IMPROVE DISCLOSURE OF PUBLIC PAYROLL COSTS

Statements 43 and 45 will improve disclosure of costs that, along with salaries, pension benefits and pre-retirement health insurance, make up government employees' total compensation package. Like pensions, OPEB are a form of deferred pay, part of an exchange of salaries and benefits for employees' service. Their costs to employers accrue over the period of employment, even though the benefits are not provided until later. GASB's new standards require governments to measure and report OPEB costs as they are incurred, during the employment period. This mandate will force significant changes in government practice. Most governments, by measuring as expense only the outlays associated with current retirees' OPEB, have failed to capture the accrued cost and liabilities of promising retirement benefits to active workers. The actuarial methods used to estimate the cost of OPEB will be similar to those already applied to pensions. Biennial actuarial valuations of OPEB assets and liabilities will be required under the new accounting rules for state and local governments with 200 or more benefit plan participants; smaller plans will have to conduct valuations every three years and in some cases may be able to use an alternative method not requiring use of an actuary.

OBLIGATIONS COVERED BY THE STANDARDS CONSIST PRIMARILY OF HEALTH INSURANCE

OPEB refers to retirement benefits besides pensions and early-retirement incentive (or termination) payments. These include various health-related benefits, as well as disability, life and long-term care insurance provided outside of defined-benefit pension plans. The largest component will be health insurance for which the employer pays some or all of retirees' premiums. The magnitude of this obligation will reflect the increases in prescription drug and other medical costs that have accounted for much of the recent growth in Medicaid, the joint state-federal health program for the poor.

GASB's new standards also require the inclusion in OPEB liability calculations of any implicit rate subsidy provided to retirees whose coverage is derived from a pool serving current employees (*see box*). It is because of this subsidy that even those state and local governments that do not explicitly pay part of their retirees' premium costs will likely have OPEB liabilities.

IMPLICIT RATE SUBSIDIES

A government's retirees in many cases are able to purchase health insurance at the same premium rate as current employees, based on the blending of premium rates that would apply to the two groups independently. The cost per participant of covering both groups together is higher than current-employee coverage would be on its own, and not as high as the cost per participant in a group consisting solely of retirees. Because of this arrangement, retirees with blended-rate health benefits are said to receive implicit rate subsidies. The new standards require measurement and reporting of the rate subsidy of retirees, even in situations where the retirees are required to pay 100% of their stated premiums.

The rules apply to state and local governments and to government-sponsored enterprises, as well as government-owned hospitals, universities, and utilities. Non-profit organizations are covered by standards issued by GASB's sister organization for the private sector, the Financial Accounting Standards Board (FASB). Statement 43 applies to financial reports prepared by health insurance or other OPEB plans, and 45 applies to the governments themselves.

STANDARDS ARE PART OF BROADER EFFORT TO IMPROVE ACCOUNTING FOR PENSIONS AND RELATED COSTS

The new accounting standards are part of a long-running effort in which GASB and FASB have mandated more disclosure of pension and other retirement benefit costs. FASB's Statement No. 81, issued in 1984, outlined disclosure practices for post-retirement health care and life-insurance benefits; Statement No. 87, in 1985, did the same for pension costs. Further clarification of OPEB cost reporting procedure followed when FASB issued Statement No. 106, in 1990. The same year, GASB published Statement No. 12, providing for disclosure of OPEB-related data in notes to governments' financial statements. These disclosures generally were to include the covered year's OPEB expense; the groups receiving (and the eligibility requirements for) the benefits; the respective contribution requirements for beneficiaries and employers; the statutory, contractual or other basis for the benefits, and a description of funding policy (either pay-as-you-go or paying in advance of future costs). Statement No. 12, which was intended as an interim measure, did not require the calculation of an actuarial accrued liability (AAL) or the recognition of current employees' accrued benefits. GASB in 1994 issued Statement No. 25 and Statement No. 27 to clarify how governments should report pension costs. Also at that time, it released Statement No. 26, providing interim guidance on financial reporting practices for post-employment healthcare plans administered by defined-benefit pension plans.

INCREASED BENEFIT PRE-FUNDING, OPEB-BOND ISSUANCE AMONG LIKELY GOVERNMENT RESPONSES

Under the new rules, a government will determine the annual required contribution (ARC) needed to amortize its actuarial liability (in no more than 30 years) and to cover the “normal cost” associated with services rendered by employees during the current year. The UAAL will appear in the notes to financial statements and in a required multi-year schedule of funding progress. But to the extent that a government in a given year fails to make the full ARC, that year's funding deficit will create (or add to) a liability called the net OPEB obligation, which will appear in the statement of net assets. The rules require calculation of an annual OPEB cost that differs from the ARC once this net obligation is recorded. This cost, which must be recognized as an expense in accrual-basis financial statements, will be derived from the ARC plus interest on the net OPEB obligation.

Because failure to pre-fund benefits will result in new balance-sheet liabilities, governments may begin to set aside assets for future OPEB obligations to an increasing extent. Moreover, the rules allow a higher assumed discount rate (and hence a lower present-value actuarial liability) for plans with assets set aside in a trust for OPEB obligations than for those with no (or insufficient) assets set aside. Governments may seek to address large, unfunded liabilities for retiree healthcare through the issuance of taxable bonds similar to pension-obligation bonds. An early example of this practice is the city of Gainesville, Florida, which has issued bonds to address a \$30.6 million liability in its self-insured Retiree Health Care Plan. The credit impact of borrowing to address a retiree health plan funding deficit will depend, as it does with pension-obligation bonds, on the extent to which the debt is part of a realistic plan to address these liabilities, and on its effect on the issuer's overall debt burden.

GOVERNMENTS HAVE BEGUN TO ADDRESS OPEB COST GROWTH

Some state governments, partly in response to the new standards, have already taken steps to reduce growth rates of their OPEB costs. Moody's expects this trend will continue, in part because improved OPEB information will encourage restraint in legislative debates and contract talks where benefits are determined. Alabama (rated Aa3 on watch for a possible upgrade) has enacted legislation increasing the premium payment obligation for various types of employees, including smokers and those who retire after a relatively short period of service. Ohio (Aa1) has modified its retiree health plan so that full coverage is available only to the employees with at least 30 years of service (*see box*).

OHIO'S APPROACH TO POST-EMPLOYMENT BENEFITS

Ohio is one of the few states that already have accumulated assets pledged to retiree health obligations. The Ohio Public Employees Retirement System (OPERS) oversees an \$11 billion healthcare fund. Even so, because of rapid growth in both medical costs and the number of covered retirees, the OPERS trustees determined in 2003 that the health benefits fund would be used up in less than a dozen years. In September 2004, the trustees acted to restrain the fund's cost growth. They cut the portion of insurance premium coverage available to retirees with only 10 years of service to 50% for workers hired in 2002 or earlier, and to 25% for those hired later. For workers who retire with 30 years of service, however, 100% coverage was retained. The overhaul also reduced retiree spouse coverage and mandated increased contributions from active workers and employers. These actions are expected to extend the solvency of the health benefits fund to 18 years. Annual benefits and program adjustments will be reviewed periodically to maintain a balance between responsibilities of the system and its members.

Utah (Aaa) passed legislation this session to change its practice of providing retirees a month of health insurance for every day of unused sick leave. This policy, which was initiated when health insurance costs were substantially lower, will be modified so that the wages for each day of unused sick leave are placed in retiree health savings accounts, which retirees will then be able to use to purchase their own health coverage. The state still will have to address the liability accumulated through its existing policy, which remains in effect through the end of calendar year 2005. Other states that have taken steps to prepare for compliance with the new OPEB accounting rules include Delaware (rated Aaa), which in May of this year formed a committee to oversee an actuarial assessment of retiree health liabilities. In 2003, Delaware performed an actuarial analysis of its retiree health benefits using a preliminary version of the GASB standard. Georgia (rated Aaa), also in May, enacted a law creating the Georgia Retiree Health Benefit Fund to receive annual contributions based on the state's ARC.

Local governments also have begun to scale back retirement health-benefit offerings for new employees. After performing actuarial assessments of liabilities, Orlando, Florida (Aa2), and Arlington, Texas (Aa2), modified the percentages of employees' healthcare premiums that are covered, as well as length-of-service requirements for eligibility.

RETIREMENT HEALTH BENEFITS VARY WIDELY AMONG STATES AND LOCAL GOVERNMENTS

Retiree health benefits offered to public employees vary dramatically among state and local jurisdictions. States such as Iowa (Aa1) and Mississippi (Aa3) offer little or no health-care coverage to retired workers. Some, such as Wisconsin (Aa3) and Montana (Aa3), offer post-employment health insurance but require retirees to pay most of the cost. Still other states, such as California (A3), fully cover many retirees' health-insurance premiums as well as the majority of the premium costs for retirees' dependents. New Jersey covers retiree health insurance costs of local school teachers and college and university professors in addition to those of its regular employees. As a result, its OPEB expenditures for existing retirees already account for more than 3% of its general fund budget. A Kaiser Family Foundation survey of state governments found that in 2002, monthly premiums ranged from as little as \$105 per month for the Indiana (Aa1) Medicare complement plan to as much as \$668 per month in an indemnity-style plan provided by Alaska (Aa2).¹

State and local governments are further distinguished by benefit eligibility requirements, the legal measures that provide for the benefits, and the demographic characteristics of covered employee and retiree groups. As a result, there is likely to be great variation in the relative sizes of OPEB liabilities reported.

OPEB FUNDING STATUS WILL BECOME A MORE VISIBLE FACTOR IN CREDIT RATING PROCESS, SIMILAR TO PENSION OBLIGATIONS

As governments and their retirement benefit plans begin issuing financial reports in compliance with the new rules, OPEB funding status will become more visible among the many attributes Moody's assesses in the municipal credit rating process. While it will most closely resemble pension funding status, there are differences between the two types of obligations. OPEB obligations reflect medical cost trends, while those for pensions are based on salaries, over which a government's management has more control. On the other hand, retiree health benefits may be somewhat easier to modify than pensions, which may have stronger legal or contractual protection. Moody's views both OPEB and pension obligations as less binding than bonded debt, because they tend to allow some flexibility to alter the terms of the benefits (such as eligibility requirements), the assumptions used to derive the actuarial values of plan assets and liabilities, the liability amortization schedule, or other variables.

Moody's therefore will exclude OPEB liabilities from calculations of state or local debt burdens, but include them as a factor in the overall credit assessment of an issuer. This practice is consistent with Moody's approach to municipal pension liabilities. Some governments provide post-retirement health benefits through pooled programs known as cost-sharing, multiple-employer plans. For these governments, the new standards will require reporting of OPEB payments in relation to the amount contractually mandated by their cost-sharing plans. Moody's may have to rely in these cases on the financial reports of the plans, rather than of the governments participating in them, for actuarial information on OPEB funding.

IMPORTANCE OF OPEB TO RATING PROCESS WILL DEPEND ON ISSUER'S OVERALL CREDIT STANDING

The extent to which OPEB funded status becomes an influential or decisive credit factor will depend on an issuer's current rating and how consistent its other attributes are with that rating. State and local governments' liabilities may be large in many cases, given the lack of prefunding in the past. For some issuers, it is possible that efforts to satisfy OPEB funding requirements will exacerbate fiscal pressure. Even so, Moody's does not anticipate that the disclosures required by the new rules will cause immediate and widespread rating adjustments. It is more likely that rating levels will be affected by observations of changes in OPEB funding measurements over time. Statistics such as the UAAL-to-covered payroll will be made available under the new rules, and Moody's expects to use these in the rating process. Plans for UAAL amortization, amortization periods, use of debt, and differences between actual and required contributions will also figure into the analysis, along with actuarial assumptions about medical costs and other variables key to estimating OPEB liabilities. Issuers' flexibility under relevant statutes or contracts to modify their post-employment health benefit offerings will likely be another focal point. Moody's also will monitor financial reserve, liquidity and debt levels that will be affected as issuers begin to set aside funds for OPEB. In general, a state or local government's effectiveness and initiative in OPEB liability management probably will influence our overall assessment of the government's management strength.

1. Hoadley, Jack: "How States are Responding to the Challenge of Financing Health Care for Retirees"; The Henry J. Kaiser Family Foundation, September 2003.

LONGER-TERM IMPACT OF REPORTING REQUIREMENTS WILL BE LARGELY POSITIVE

Even though compliance with the new accounting rules is expected to exert financial stress and to bring to light previously unknown liabilities, Moody's expects the disclosure effects will be largely positive over the long term. As previously mentioned, the rules will require governments to disclose and record the full current cost of benefits provided to employees. Governments will have a strong incentive, though not an obligation, to set aside funds for benefit obligations as they are incurred, which is in keeping not only with accounting principles but also with prudent financial management. Any resulting fiscal strain is likely to be more than offset in most cases by the positive implications of management practice improvements under the accounting rules.

Until the release of audited reports subject to the standards, the lack of actuarially derived OPEB liability information limits Moody's ability to make a more detailed assessment of how these future costs will affect state and local government credit. Expenditures on current retirees' healthcare costs are already incorporated in the rating process. GASB's schedule for compliance with the new OPEB reporting rules is staggered, with smaller-revenue governments afforded additional time (*see Appendix I*). For states, the first financial reporting periods subject to Statement No. 45 will be those ending during calendar year 2008. A comprehensive overview of states' OPEB funding status is therefore not likely until early 2009, when published comprehensive annual financial reports covering fiscal 2008 become available. At that time, Moody's will focus on the OPEB factors listed earlier, including the UAAL size relative to key financial indicators and the plan for UAAL amortization. Before compliant financial statements become available, Moody's may request information from issuers on various aspects of health plans and other retiree benefits that factor into OPEB liabilities (*see Appendix II*).

Appendix I

Effective Dates	
GASB 45	
Government Description	Effective Date
Tier 1 (annual revenues > \$100 mln*)	Yrs Starting After 12/15/2006
Tier 2 (annual revenues > \$10 mln)	Yrs Starting After 12/15/2007
Tier 3 (annual revenues < \$10 mln) Yrs Starting After 12/15/2008	
GASB 43	
Plan Description	Effective Date
Tier 1 (annual revenues > \$100 mln)	Yrs Starting After 12/15/2005
Tier 2 (annual revenues > \$10 mln)	Yrs Starting After 12/15/2006
Tier 3 (annual revenues < \$10 mln) Yrs Starting After 12/15/2007	
* Tiers are based on first fiscal year ending after June 15, 1999, the same basis as applied to Statement No. 34.	

Appendix II

Following are examples of questions Moody's will pose pending disclosure under the new rules:

- 1) Has an actuarial assessment of OPEB liabilities been performed? If so, what were the accrued actuarial liability, actuarial value of plan assets, and funded ratio?
- 2) What health-care and other post-employment benefits subject to the standards are provided? What are the benefits' eligibility requirements?
- 3) Describe the mechanisms (e.g., single-employer or agent multiple-employer defined- benefit plans) through which benefits are provided.
- 4) What legislative or other actions would be required to reduce the benefits' cost?
- 5) What is the total cost of retiree health and related benefits in the budget? How much has this sum changed in recent years, and what has accounted for that?

Related Research

Special Comments:

[GASB 34: What Does It Mean for the Rating Process?, December 2002 \(#76862\)](#)

[Moody's Perspective On Increased Pension Costs For California Local Governments, June 2003 \(#78417\)](#)

Rating Methodology:

[Moody's State Rating Methodology, November 2004 \(#89335\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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Executive Order Number Sixty-Seven Establishing A Retirement Benefit Study Committee

WHEREAS, the Governmental Accounting Standards Board (“GASB”) has issued Statement No. 45, “Accounting and Financial Reporting by Employers for Post-retirement Benefits other than Pensions”; and

WHEREAS, post-retirement benefits other than pensions consist primarily of health care insurance, the cost of which is escalating at a very rapid rate; and

WHEREAS, beginning in fiscal year 2008, GASB No. 45 requires state and local governments to recognize on their financial statements the present and future cost of benefits to pension recipients; and

WHEREAS, to date, the State of Delaware has funded retiree health benefits almost exclusively on a pay-as-you-go basis, and substantial resources will be required to be allocated to avoid a substantial unfunded liability associated with retiree benefits, as reported pursuant to GASB No. 45; and

WHEREAS, in order to meet its obligations to its current and future retirees, preserve sound fiscal practices, and provide necessary public services while maintaining competitive tax rates, the State must examine and quantify the impact of a wide array of important policy options raised by GASB No. 45 and the resulting unfunded liability; and

WHEREAS, the State of Delaware has a long and successful tradition of bipartisan cooperation, credible analyses, and long-term focus in the conduct of its fiscal affairs; and

WHEREAS, a meaningful policy response to GASB No. 45 will require that the State once again draw upon its long and successful tradition of bipartisan fiscal management.

NOW, THEREFORE, I, RUTH ANN MINNER, GOVERNOR OF THE STATE OF DELAWARE, DO HEREBY ORDER AND DECLARE AS FOLLOWS:

1. A Retiree Benefit Study Committee (the “Committee”) is created. The Committee shall consist of twelve (12) members as follows:
 - a. The Secretary of Finance or his designee;
 - b. The State Budget Director or her designee;
 - c. The Controller General or his designee;
 - d. The Director of the State Office of Pensions;
 - e. The Co-Chairs of the Joint Finance Committee;

- f. One member appointed by the Speaker of the House of Representatives;
- g. One member appointed by the Minority Leader of the House of Representatives;
- h. One member appointed by the President Pro Tempore of the Senate;
- i. One member appointed by the Minority Leader of the Senate;
- j. One private sector representative nominated by the Delaware State Chamber of Commerce and appointed by the Secretary of Finance; and
- k. One representative of a public employee union currently recognized as a bargaining entity with the State appointed by the Secretary of Finance.

The Secretary of Finance or his designee shall act as the Committee's Chairperson.

2. The purposes of the Retiree Study Benefit Committee shall be as follows:

- a. Study the results of any available actuarial work (or commission additional actuarial work) that addresses GASB No. 45's impact on the State of Delaware;
- b. Identify the options available to the State, quantify their potential effects, and assess the desirability of such options (or combination of options) according to the following criteria:
 - (1) the extent to which and over what time-horizon the option eliminates or reduces the State's unfunded liability;
 - (2) fairness in the distribution of cost between or among employees and retirees taking into account such considerations as employee and retirees' age, length of State service, starting and ending dates of service, and income levels;
 - (3) the transparency of each option's impact on current and future beneficiaries;
 - (4) ease of administration of the State and use for beneficiaries;
 - (5) the extent to which the option affects the State's position in the labor market including taking into account its competitiveness with other employers, turn-over rates, and incentives or disincentives to retire;

(6) fiscal considerations including an assessment of the opportunity costs of GASB No. 45 compliance or noncompliance in terms of its:

- (a) ratings implications and the cost of capital;
- (b) impact on operating budget growth and programs; and
- (c) tax and revenue policy implications.

3. The Retiree Benefit Study Committee shall be supported by staff from the following State offices:

- a. the Department of Finance;
- b. the State Budget Office;
- c. the State Office of Pensions; and
- d. the Office of the Controller General.

4. The Retiree Benefits Study Committee shall:

- a. meet on a regular basis, with its first meeting occurring not later than June 1, 2005;
- b. rely upon outside experts as needed, including but not limited to actuaries, rating agency staff, the State's Auditor of Accounts, and the State's financial advisor;
- c. present a summary of its preliminary findings to the Delaware Economic and Financial Advisory Council at its September 2005 meeting; and
- d. issue a written report of its findings and recommendations to the Governor, General Assembly and the Delaware Economic and Financial Advisory Council by October 15, 2005.

Approved: May 2, 2005

OPEB OPTIONS MATRIX

Option	Unfunded Liability: How well and fast is it reduced? All changes go into effect 7/1/07 All numbers based on funded discount rate (8%)			Change from Baseline		
BASELINE - Current Costs with Medicare Part D	<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>			
	PAYGO cost	101	249	464		
	State Cost (ARC)	286	447	705		
	Liability	3,132	6,200	11,704		
	Assets	26	2,661	8,641		
Unfunded	3,106	3,538	3,063			
1	Require Employees to Contribute 1% of Pay Starting 7/1/07					
1.a. All employees	<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>	<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	101	249	464	-	-
	State Cost (ARC)	271	426	676	(14)	(21)
	Liability	3,132	6,200	11,704	-	-
	Assets	26	2,661	8,641	-	-
Unfunded	3,106	3,538	3,063	-	-	
1.b. Employees hired after 7/1/07	<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>	<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	101	249	464	-	-
	State Cost (ARC)	286	437	683	(0)	(9)
	Liability	3,132	6,200	11,704	-	-
	Assets	26	2,661	8,641	-	-
Unfunded	3,106	3,538	3,063	-	-	

OPEB OPTIONS MATRIX

Option	Unfunded Liability: How well and fast is it reduced? All changes go into effect 7/1/07 All numbers based on funded discount rate (8%)			Change from Baseline				
2 Increase Retiree Contributions								
2.a. Require all current and future retirees under age 65 to pay the implicit subsidy estimated at 44% of the premium in addition to the current retiree contribution		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	88	215	417	PAYGO cost	(13)	(34)	(47)
	State Cost (ARC)	258	402	635	State Cost (ARC)	(28)	(44)	(71)
	Liability	2,861	5,744	10,936	Liability	(271)	(455)	(768)
	Assets	26	2,514	8,140	Assets	-	(147)	(501)
	Unfunded	2,835	3,230	2,796	Unfunded	(271)	(308)	(267)
2.b. Require retirees who retire after 7/1/07 under age 65 to pay the implicit subsidy estimated at 44% of the premium in addition to the current retiree contribution		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	101	221	418	PAYGO cost	-	(28)	(46)
	State Cost (ARC)	263	410	646	State Cost (ARC)	(22)	(36)	(60)
	Liability	2,950	5,769	10,934	Liability	(182)	(430)	(770)
	Assets	26	2,439	8,051	Assets	-	(223)	(590)
	Unfunded	2,923	3,331	2,883	Unfunded	(182)	(208)	(180)
2.c. Require all current and future retirees and spouses age 65 and over to pay 10% of the premium		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	95	232	428	PAYGO cost	(6)	(17)	(36)
	State Cost (ARC)	263	411	649	State Cost (ARC)	(23)	(36)	(57)
	Liability	2,890	5,672	10,656	Liability	(242)	(528)	(1,048)
	Assets	26	2,409	7,831	Assets	-	(252)	(810)
	Unfunded	2,864	3,263	2,825	Unfunded	(242)	(275)	(238)
2.d. Require retirees who retire after 7/1/07 and their spouses to pay 10% of the premium when they are age 65 and over		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	101	243	442	PAYGO cost	-	(6)	(22)
	State Cost (ARC)	270	421	664	State Cost (ARC)	(16)	(26)	(42)
	Liability	3,007	5,798	10,752	Liability	(125)	(402)	(952)
	Assets	26	2,402	7,813	Assets	-	(259)	(828)
	Unfunded	2,981	3,396	2,939	Unfunded	(125)	(143)	(123)

OPEB OPTIONS MATRIX

Option	Unfunded Liability: How well and fast is it reduced? All changes go into effect 7/1/07 All numbers based on funded discount rate (8%)			Change from Baseline				
	<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>	
2.e. Require retirees who retire after 7/1/07 from terminated vested status to pay contributions based on the 7/1/91 new hire schedule	PAYGO cost			PAYGO cost				
	State Cost (ARC)			State Cost (ARC)				
	Liability			Liability				
	Assets			Assets				
	Unfunded			Unfunded	-	-	-	
2.f. Eliminate coverage for <u>future</u> terminated vested employees	PAYGO cost	101	247	457	PAYGO cost	-	(1)	(8)
	State Cost (ARC)	275	428	674	State Cost (ARC)	(11)	(18)	(31)
	Liability	3,075	5,943	10,960	Liability	(57)	(257)	(744)
	Assets	26	2,469	7,953	Assets	-	(192)	(688)
	Unfunded	3,049	3,473	3,007	Unfunded	(57)	(65)	(56)
2.g. Require all spouses and dependents to pay an additional 10% of the premium (20% after the death of the retiree)	PAYGO cost	99	244	454	PAYGO cost	(2)	(5)	(11)
	State Cost (ARC)	279	436	688	State Cost (ARC)	(7)	(11)	(17)
	Liability	3,064	6,049	11,398	Liability	(68)	(151)	(305)
	Assets	26	2,588	8,402	Assets	-	(74)	(239)
	Unfunded	3,038	3,461	2,996	Unfunded	(68)	(77)	(67)
3 Reduce Future Increases in State Contribution								
3.a. Cap contribution at current (7/1/07) level for all current and future retirees	PAYGO cost	101	118	122	PAYGO cost	-	(131)	(342)
	State Cost (ARC)	97	131	180	State Cost (ARC)	(189)	(316)	(525)
	Liability	1,290	1,432	1,567	Liability	(1,842)	(4,768)	(10,137)
	Assets	26	-	321	Assets	-	(2,661)	(8,320)
	Unfunded	1,264	1,432	1,247	Unfunded	(1,842)	(2,106)	(1,816)

OPEB OPTIONS MATRIX

Option	Unfunded Liability: How well and fast is it reduced? All changes go into effect 7/1/07 All numbers based on funded discount rate (8%)			Change from Baseline				
3.b. Cap contribution at 125% of 7/1/07 level for all current and future retirees		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	101	147	153	PAYGO cost	-	(102)	(311)
	State Cost (ARC)	119	160	220	State Cost (ARC)	(167)	(286)	(485)
	Liability	1,570	1,788	1,955	Liability	(1,562)	(4,412)	(9,749)
	Assets	26	29	432	Assets	-	(2,632)	(8,209)
	Unfunded	1,544	1,759	1,522	Unfunded	(1,562)	(1,780)	(1,541)
3.c. Increase contribution from 7/1/07 level 3.75% per year for all current and future retirees		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	101	170	256	PAYGO cost	-	(79)	(209)
	State Cost (ARC)	164	237	343	State Cost (ARC)	(122)	(209)	(363)
	Liability	1,968	3,113	4,803	Liability	(1,164)	(3,087)	(6,901)
	Assets	26	901	2,888	Assets	-	(1,760)	(5,753)
	Unfunded	1,942	2,212	1,915	Unfunded	(1,164)	(1,326)	(1,148)
3.d. Cap contribution at current (7/1/07) level for retirees who retire after 7/1/07		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	101	187	214	PAYGO cost	-	(62)	(250)
	State Cost (ARC)	137	189	265	State Cost (ARC)	(148)	(257)	(440)
	Liability	1,960	2,393	2,415	Liability	(1,172)	(3,807)	(9,288)
	Assets	26	190	508	Assets	-	(2,472)	(8,133)
	Unfunded	1,934	2,203	1,907	Unfunded	(1,172)	(1,335)	(1,156)
3.e. Cap contribution at 125% of 7/1/07 level for retirees who retire after 7/1/07		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	101	201	237	PAYGO cost	-	(48)	(227)
	State Cost (ARC)	149	205	285	State Cost (ARC)	(136)	(242)	(420)
	Liability	2,079	2,635	2,748	Liability	(1,053)	(3,564)	(8,956)
	Assets	26	297	724	Assets	-	(2,365)	(7,917)
	Unfunded	2,053	2,339	2,024	Unfunded	(1,053)	(1,200)	(1,038)

OPEB OPTIONS MATRIX

Option	Unfunded Liability: How well and fast is it reduced? All changes go into effect 7/1/07 All numbers based on funded discount rate (8%)			Change from Baseline				
3.f. Increase contribution from 7/1/07 level 3.75% per year for retirees who retire after 7/1/07		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	101	212	316	PAYGO cost	-	(37)	(148)
	State Cost (ARC)	189	273	395	State Cost (ARC)	(97)	(173)	(310)
	Liability	2,381	3,704	5,340	Liability	(751)	(2,496)	(6,364)
	Assets	26	1,021	3,017	Assets	-	(1,640)	(5,624)
	Unfunded	2,355	2,683	2,322	Unfunded	(751)	(856)	(741)
3.g. Cap contribution at current (7/1/07) level for employees hired after 7/1/07		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost				PAYGO cost			
	State Cost (ARC)				State Cost (ARC)			
	Liability				Liability			
	Assets				Assets			
	Unfunded				Unfunded			
3.h. Same as 3.a., except reduce subsidy 2.4% per year for early retirement		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost	101	117	121	PAYGO cost	-	(132)	(343)
	State Cost (ARC)	96	130	179	State Cost (ARC)	(190)	(317)	(526)
	Liability	1,285	1,421	1,552	Liability	(1,847)	(4,779)	(10,152)
	Assets	26	-	311	Assets	-	(2,661)	(8,330)
	Unfunded	1,259	1,421	1,242	Unfunded	(1,847)	(2,117)	(1,821)
4 Health Savings Accounts Specifics not yet defined		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>		<u>FY 2008</u>	<u>FY 2018</u>	<u>FY 2028</u>
	PAYGO cost				PAYGO cost			
	State Cost (ARC)				State Cost (ARC)			
	Liability				Liability			
	Assets				Assets			
	Unfunded				Unfunded			

OPEB OPTIONS MATRIX

Option	Fairness between & among retirees & employees	Transparency: Is the impact of the option clear to those affected?	Ease of Administration for State and use for beneficiaries	Labor Market: Will the option allow the state to retain a quality workforce?	Fiscal Considerations a) ratings & cost of capital b) operating budget & programs c) tax & revenue policy
BASELINE - Current Costs with Medicare Part D	Employees / Retirees = MOOT: Unfunded liability is met by annual appropriation and not by a specific employee or retiree contribution. (Broader notion of fairness may need to be considered: What are the opportunity costs of this option in terms of State programs and/or revenue policy?)	FUNDING OPTION -- LOW: Affected workers & retirees see no clear and immediate impact via lower take home pay, reduced benefits. (Someone else "pays" via lower state services or higher taxes.) FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Essentially the same as current system.	UNCERTAIN: Depends upon who bears the costs. If, over time, State wages stagnate to pay for this option and other employers adopt more efficient health care plans, then this option harms the State's position in the labor market. If costs are passed along in the form lower service levels or higher taxes, the State's position in the labor market is enhanced. (There would be other	a) RATINGS: Full funding clearly a huge plus for rating agencies; b) BUDGET: \$176 million in FY 2008, 2009, 2010.....; c) TAXES: \$176 million in FY 2008 2009, 2010....
1 Require Employees to Contribute 1% of Pay Starting 7/1/07					
1.a. All employees	Employees / Retirees = POOR: Current retirees don't contribute to solution; 100% employee funded; Among Employees = MIXED: All employees contribute. Proportional contribution relative to income. Those close to retirement pay far less. (Expectation of State match?)	FUNDING OPTION -- HIGH: Affected workers clearly see impact via lower take home pay, but will employees understand/accept nexus between pay cut & retirement health coverage? (Does contribution institutionalize expectation of no benefit cut?) FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Should be relatively straightforward (Pension as model.)	MINOR IMPACT: Lower take home pay, but not likely to fundamentally change market for new hires / retention for most employees. (May hasten some retirements around time of implementation.)	
1.b. Employees hired after 7/1/07	Employees / Retirees = POOR: Retirees for the foreseeable future don't contribute to solution; 100% employee funded; Among Employees = POOR: Even though they're responsible in large part for the unfunded liability, current employees don't contribute	FUNDING OPTION -- HIGH: Affected workers hired after 7-1-07 clearly see impact via lower take home pay. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Should be relatively straightforward (Pension as model.)	MINOR IMPACT: Lower take home pay for those hired after 7-1-07, but not likely to fundamentally change market for new hires / retention for most employees.	

OPEB OPTIONS MATRIX

Option	Fairness between & among retirees & employees	Transparency: Is the impact of the option clear to those affected?	Ease of Administration for State and use for beneficiaries	Labor Market: Will the option allow the state to retain a quality workforce?	Fiscal Considerations a) ratings & cost of capital b) operating budget & programs c) tax & revenue policy
2 Increase Retiree Contributions					
2.a. Require all current and future retirees under age 65 to pay the implicit subsidy estimated at 44% of the premium in addition to the current retiree contribution	Employees / Retirees = POOR: Employees don't contribute to solution; 100% retiree funded; high cost employees still get subsidy Among Retirees = MIXED/ POOR: closer match between benefits and costs; 44% is a huge increase; effectively a cut in income; if already retired, little or no chance to plan for change, biggest pct impact on lowest-income retirees; No contribution from 65+	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Assuming higher contribution can be netted out of Pension payments.	SIGNIFICANT IMPACT: Paying full subsidy out-of-pocket will prevent or delay retirement until age 65 meaning the State workforce will "age."	BUDGET: Need to consider impact on salary cost of older employees deferring retirement.
2.b. Require retirees who retire after 7/1/07 under age 65 to pay the implicit subsidy estimated at 44% of the premium in addition to the current retiree contribution	Employees / Retirees = POOR: Employees don't contribute to solution; 100% retiree funded; high cost employees still get subsidy; Among Retirees = POOR: closer match between benefits and costs, but only for those retiring in FY08 or later (arbitrary?); 44% is a huge increase; effectively a cut in income, biggest pct impact on lowest-income retirees; No contribution from 65+	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	MIXED: Date certain means Administrators could be overwhelmed as employees retire prior to deadline. Long-run, assuming higher contribution can be netted out of Pension payments, administration should be straightforward.	EXTRAORDINARY IMPACT: Date certain (7/1/07) for implementation provides an "all or nothing" incentive. Huge exodus in months prior to July, 2007. Big disruption in State's workforce. Difficulty replacing most experienced employees simultaneously. AFTER 7-1-07, big incentive to work until age 65.	
2.c. Require all current and future retirees and spouses age 65 and over to pay 10% of the premium	Employees / Retirees = POOR: Employees don't contribute to solution; 100% retiree funded; Among Retirees = POOR: closer match between benefits and costs, 10% is a more manageable increase; effectively a cut in income, little or no chance to plan, biggest pct impact on lowest-income retirees; No contribution from under 65	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Assuming higher contribution can be netted out of Pension payments.	MINOR IMPACT: Lower take home income for retirees 65+, but not likely to fundamentally change market for new hires / retention for most employees.	
2.d. Require retirees who retire after 7/1/07 and their spouses to pay 10% of the premium when they are age 65 and over	Employees / Retirees = POOR: Employees don't contribute to solution; 100% retiree funded; Among Retirees = MIXED/POOR: closer match between benefits and costs, 10% is a more manageable increase; allows some time to plan; effectively a cut in income, biggest pct impact on lowest-income retirees; No contribution from under 65.	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	MIXED: Date certain means Administrators could be overwhelmed as employees retire prior to deadline. Long-run, assuming higher contribution can be netted out of Pension payments, administration should be straightforward.	SIGNIFICANT IMPACT: Date certain (7/1/07) for implementation provides an "all or nothing" incentive. Exodus in months prior to July, 2007. Disruption in State's workforce. Difficulty replacing most experienced employees simultaneously. Because out of pocket contribution is deferred and significantly less than OPTION 2b., disruptions, while significant, should be smaller.	

OPEB OPTIONS MATRIX

Option	Fairness between & among retirees & employees	Transparency: Is the impact of the option clear to those affected?	Ease of Administration for State and use for beneficiaries	Labor Market: Will the option allow the state to retain a quality workforce?	Fiscal Considerations a) ratings & cost of capital b) operating budget & programs c) tax & revenue policy
2.e. Require retirees who retire after 7/1/07 from terminated vested status to pay contributions based on the 7/1/91 new hire schedule	Employees / Retirees = POOR: Employees don't contribute to solution; 100% retiree funded; Among Retirees = MIXED: Affects small segment (pre 7-1-91 hires) of retirees; Effectively confers larger benefits to "lifers;" closer match between benefits and costs; effectively a cut in income, biggest pct impact on lowest-income retirees; Cuts a benefit that some might consider "overly-generous."	FUNDING OPTION -- UNCERTAIN: Affected individuals present a communication challenge in that they are not as easy to contact/educate regarding impact of proposal. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	MIXED: Short-run -- Communication / education challenge; Long-run -- assuming higher contribution can be netted out of Pension payments, administration should be straightforward.	MINOR IMPACT: Should not have a fundamental impact on market for new hires, but will factor into retention decision for employees hired prior to 7-1-1991. (No impact on employees hired after 7-1-1991.)	
2.f. Eliminate coverage for <u>future</u> terminated vested employees	Employees / Retirees = POOR: Employees don't contribute to solution; 100% benefit cut for selected retirees; Among Retirees = MIXED: Affects small segment future of retirees; Effectively confers benefits only to "lifers;" effectively a huge cut in income, biggest pct impact on lowest-income retirees. Cuts a benefit that some might consider "overly-generous."	FUNDING OPTION -- MIXED: Affected individuals present a communication challenge in that they must understand the consequences of a decision to leave State employment. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	MIXED / GOOD: Implementation should be straightforward, but continual challenge and responsibility to inform employees of consequences of terminating state employment.	SIGNIFICANT IMPACT (FUTURE): Hotel California Effect -- incentive to remain employed with State. Less likely to have a significant impact on market for new hires.	
2.g. Require all spouses and dependents to pay an additional 10% of the premium (20% after the death of the retiree)	Employees / Retirees = POOR: Employees don't contribute to solution; Among Retirees = MIXED/GOOD: Affects segment of retirees -- but one receiving what some consider to be an "overly generous" benefit; " effectively a cut in income, biggest pct impact on lowest-income retirees.	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Short-run -- Communication / education challenge; Long-run -- assuming higher contribution can be netted out of Pension payments, administration should be straightforward.	VERY MINOR: Should not affect market for new hires; limited impact on retention / timing of retirement decisions.	
3 Reduce Future Increases in State Contribution					
3.a. Cap contribution at current (7/1/07) level for all current and future retirees	Employees / Retirees = POOR: Employees don't contribute to solution; Among Retirees = MIXED: Alignment of costs / benefits; Affects all retirees; effectively a phased-in cut in retirement income; in inflation adjusted terms, current retirees get much better deal; biggest pct impact on lowest-income retirees.	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Assuming higher contribution can be netted out of Pension payments.	SIGNIFICANT IMPACT: Creates a large incentive to postpone retirement until age 65 when Medicare eligible. Should not have a large affect on new hires.	

OPEB OPTIONS MATRIX

Option	Fairness between & among retirees & employees	Transparency: Is the impact of the option clear to those affected?	Ease of Administration for State and use for beneficiaries	Labor Market: Will the option allow the state to retain a quality workforce?	Fiscal Considerations a) ratings & cost of capital b) operating budget & programs c) tax & revenue policy
3.b. Cap contribution at 125% of 7/1/07 level for all current and future retirees	Employees / Retirees = POOR: Employees don't contribute to solution; Among Retirees = MIXED: Affects all retirees; Alignment of costs / benefits; effectively a phased-in cut in retirement income; in inflation adjusted terms, current retirees get much better deal; biggest pct impact on lowest-income retirees.	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Assuming higher contribution can be netted out of Pension payments.	SIGNIFICANT IMPACT: Creates a large incentive to postpone retirement until age 65. Should not have a large affect on new hires.	
3.c. Increase contribution from 7/1/07 level 3.75% per year for all current and future retirees	Employees / Retirees = POOR: Employees don't contribute to solution; Among Retirees = MIXED/GOOD: Affects all retirees; Alignment of costs / benefits; effectively a phased-in cut in retirement income; in inflation adjusted terms, current retirees get better deal; some allowance for future inflation, though; biggest pct impact on lowest-income retirees.	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Assuming higher contribution can be netted out of Pension payments.	SIGNIFICANT IMPACT: Creates an incentive to postpone retirement until age 65. Should not have a large affect on new hires.	
3.d. Cap contribution at current (7/1/07) level for retirees who retire after 7/1/07	Employees / Retirees = POOR: Employees don't contribute to solution; Among Retirees = MIXED/POOR: Affects only future retirees; Alignment of costs / benefits; phased-in cut in retirement income for future retirees; in inflation adjusted terms, current retirees get a much, much better deal; biggest pct impact on lowest-income retirees.	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	MIXED: Date certain means Administrators could be overwhelmed as employees retire prior to deadline. Long-run, assuming higher contribution can be netted out of Pension payments, administration should be straightforward.	EXTRAORDINARY IMPACT: Date certain (7/1/07) for implementation provides an "all or nothing" incentive. Huge exodus in months prior to July, 2007. Big disruption in State's workforce. Difficulty replacing most experienced employees simultaneously. AFTER 7-1-07, big incentive to work until age 65.	
3.e. Cap contribution at 125% of 7/1/07 level for retirees who retire after 7/1/07	Employees / Retirees = POOR: Employees don't contribute to solution; Among Retirees = MIXED/POOR: Affects only future retirees; Alignment of costs / benefits; phased-in cut in retirement income for future retirees; in inflation adjusted terms, current retirees get a much, much better deal; biggest pct impact on lowest-income retirees.	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	MIXED: Date certain means Administrators could be overwhelmed as employees retire prior to deadline. Long-run, assuming higher contribution can be netted out of Pension payments, administration should be straightforward.	EXTRAORDINARY IMPACT: Date certain (7/1/07) for implementation provides an "all or nothing" incentive. Huge exodus in months prior to July, 2007. Big disruption in State's workforce. Difficulty replacing most experienced employees simultaneously. AFTER 7-1-07, big incentive to work until age 65.	

OPEB OPTIONS MATRIX

Option	Fairness between & among retirees & employees	Transparency: Is the impact of the option clear to those affected?	Ease of Administration for State and use for beneficiaries	Labor Market: Will the option allow the state to retain a quality workforce?	Fiscal Considerations a) ratings & cost of capital b) operating budget & programs c) tax & revenue policy
3.f. Increase contribution from 7/1/07 level 3.75% per year for retirees who retire after 7/1/07	Employees / Retirees = POOR: Employees don't contribute to solution; Among Retirees = MIXED/GOOD: Affects all future retirees; Alignment of costs / benefits; effectively a phased-in cut in retirement income for future retirees; in inflation adjusted terms, current retirees get better deal; some allowance for future inflation, though; biggest pct impact on lowest-income retirees.	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Assuming higher contribution can be netted out of Pension payments.	SIGNIFICANT IMPACT: "Date Certain Effect" -- rapid turnover, etc; Creates an incentive to postpone retirement until age 65. Should not have a large affect on new hires.	
3.g. Cap contribution at current (7/1/07) level for employees hired after 7/1/07	Effectively places entire burden on future employees. Current employees and retirees, all of whom helped "create" the unfunded liability, contribute nothing to solution. By the time most affected individuals are eligible for retirement, the State's share will cover only a tiny fraction of total cost.	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. Impact is deferred. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Assuming higher contribution can be netted out of Pension payments. Impact is deferred.	MIXED IMPACT: None on current retirees and employees. May have an impact on State's desirability as a employer in the future, though.	
3.h. Same as 3.a., except reduce subsidy 2.4% per year for early retirement	Employees / Retirees = POOR: Employees don't contribute to solution; Among Retirees = MIXED: Alignment of costs / benefits; Affects all retirees; effectively a phased-in cut in retirement income; in inflation adjusted terms, current retirees get much better deal; biggest pct impact on lowest-income retirees.	FUNDING OPTION -- HIGH: Affected retirees clearly see impact -- overall retirement package is cut. FUNDAMENTALS: No improvement in Price/Value/Quality equation.	GOOD: Assuming higher contribution can be netted out of Pension payments.	SIGNIFICANT IMPACT: Creates a large incentive to postpone retirement until age 65. Should not have a large affect on new hires.	
4 Health Savings Accounts Specifics not yet defined	POTENTIAL SIGNIFICANT IMPROVEMENT: Group rating means that genetically-based illness or accident victims get affordable coverage AND Consumer driven aspect means that unhealthy lifestyles & over consumption subsidized to a lesser degree.	POTENTIAL SIGNIFICANT IMPROVEMENT: With identical coverage, high deductible insurance + savings account mean that the actual cost of each procedure, doctor visit or prescription is more clear. Employees likely to consume essential services. Early evidence suggests that: 1) Quality of care and preventative care not shortchanged and 2) Health care market and pricing frustrating some early adaptors.	MIXED: Short-run -- Fundamental change in the delivery of health care coverage dictates a large and extended educational commitment on the part of the State. Expect resistance to change. Some dissatisfaction in process of markets changing to embrace demands of consumers. Long-run -- once implemented, beneficiaries would need to take price / quality into account.	MIXED: Short-run -- change to consumer driven approach could be seen as a negative. Long-run -- lower cost may allow State to maintain same coverage levels; personal control and portability likely to be seen as pluses.	

RETIREMENT BENEFIT STUDY COMMITTEE

10/12/2005

Fax completed survey to the Office of the Secretary of Finance at 302-577-8982 or e-mail to stephanie.scola@state.de.us

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NAME:

		Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
	Annual Required Contribution (ARC) – Obligation, Levels & Timing					
1.	The <u>only</u> rationale for fully funding the ARC is maintenance of Delaware's AAA rating.		2	1	5	
2.	Because Delaware is ahead of most states, we have time to evaluate what other states are doing, gauge the rating agencies' reactions, and move forward incrementally as opposed to committing to a comprehensive strategy in the next year or so.	1	2	1	4	
3.	The most important consideration is fully funding the ARC as soon as possible to maintain AAA rating and a sound fiscal foundation.		2	2	2	2
4.	When evaluating this issue, fully funding the ARC is not the most important consideration.	1	2	2	3	
5.	Partial funding of the ARC for a number of years is acceptable.	2	5	1		
	Allocating the Cost of Addressing the Unfunded Liability					
6.	Because current retirees are part of the unfunded liability, they should be required to contribute to the funding solution.	1	3	3		1
7.	Because current retirees have more claims, they should be required to contribute to the funding solution.		2	4		1
8.	Because current employees are part of the unfunded liability, they should be required to contribute to the funding solution.	1	3	2	1	1
9.	Any funding solution should require both current retirees and employees to make contributions.		3	3	1	1
10.	It is more important to consider the individual's ability to afford a contribution (i.e., income level) than it is to consider their actual cost of consuming health care when determining how much they should contribute.	2	2		4	
11.	It is more important to consider the actual cost of health care than it is to consider the individual's ability to afford a contribution (i.e., income level) when determining how much they should contribute.		3	1	3	1
12.	The State should pay the entire amount; no explicit contributions should be required from employees or retirees.			4	3	1
13.	It is okay to treat future employees or retirees less generously than current employees or retirees. (E.g., employees hired after 7-1-2007, must pay X% of their salary to reduce the ARC.)		4	1	3	

RETIREMENT BENEFIT STUDY COMMITTEE

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		Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
14.	Capping the State's contribution to retirees' premiums at flat amount of is preferable to reducing the State's relative share of the premiums. (Once reached, the flat cap never grows; the relative share, say 90%, would rise with cost of the premium.)		2	3	2	1
	Other Issues					
15.	The State should use its pension plan as <u>the</u> model when determining how to fund this liability.	2	5	1		
16.	The State should reduce the ARC by simply scaling back the scope of health care coverage offered to its retirees.			2	3	3
17.	The unfunded liability for retiree health care is a symptom of a larger issue. The current method of delivering health care coverage using third-party providers has serious shortcomings, which should be addressed via Consumer Driven Health Plans (CDHP). Before a comprehensive funding strategy is adopted that might require employees and/or retirees to shoulder higher costs or reduced benefits, the State should implement a CDHP for employees and retirees and use some or all of the saving to address the ARC.			5	1	2