

Executive Summary

Issue

7/10/2018

- The Village's unfunded liability for the required provision of health benefits is \$12.3 million.
- The unfunded liability will appear in Village financial statements beginning with the FY18 audit and may affect future bond ratings, increasing the cost of issuing bonds for capital projects.

Plan to Address OPEB Unfunded Liability

- Create an OPEB Trust Fund with a Trust Document, Funding Policy and Investment Policy by December 2019.
- Reduce OPEB Unfunded Liability by:
 - Making annual contributions in predetermined amounts for the first 3 to 5 years starting with \$300,000 in 2018 and 2019. Then make the actuarially determined contribution, currently estimated to be about \$800,000.
 - Using the investment returns from the OPEB Trust Fund assets to reduce the Village's annual contribution.
 - Make plan design changes to existing health benefit plan to include the creation of a Health Reimbursement Account to provide financial incentives to retirees to participate in another health benefit plan instead of participating in the Village's plan.

Rating Agencies View of OPEB Trust Funds

Establishing an OPEB trust and consistently funding the benefits while employees are working shows the rating agencies that (1) long-term obligations are being funded, (2) the Village's ability to pay debt service is not threatened over the long term, and (3) management is aware of and responsive to the OPEB issue.

Issue

All municipalities in Illinois are required to provide retired employees access to the employee health benefit program. The required provision of health benefits is known as Other Post Employment Benefits (OPEB).

While retirees pay health benefit premiums to help cover the cost of the benefits, the cost to the Village of providing the health benefits to retirees exceeds the amount paid to the Village in premiums. This difference creates a liability for the Village. The unfunded liability for OPEB is the actuarially calculated difference between the amount paid to the Village by retirees and the amount the Village will have to pay to provide their health benefits.

The Government Accounting Standards Board (GASB) requires municipalities to calculate financial liability of OPEB. The unfunded liability will appear in the Village's financial statements beginning in 2018.

Failure to create a plan to fund the OPEB liability will likely negatively impact the Village's bond rating, which would increase the cost of issuing bonds for capital improvement projects.

The Village's OPEB unfunded liability is \$12.3 million. The annual actuarially determined contribution to address the unfunded liability is estimated to be approximately \$800,000.

Recent Actions

The Village has been aware of the OPEB unfunded liability issue for several years and has been taking actions to reduce the liability. In 2012, the Village reduced the OPEB unfunded liability by \$7.2 million by using a fully insured Medicare Supplement plan to provide health benefits to retirees 65 years of age and older. As part of the FY18 Budget, the Village created an OPEB Fund and placed \$300,000 in the fund.

The 2017-2019 Long Range Plan identified OPEB Unfunded Liability as a key issue. The LRP recommends a strategy of establishing an OPEB trust to fund current and future liabilities similar to a pension fund. The LRP includes *Develop a Plan to Address OPEB Unfunded Liability* as a Priority Action Item.

Plan to Address OPEB Unfunded Liability

The plan to address the OPEB unfunded liability consists of three key components:

Benefits Design - The Village should design and maintain a retiree health benefit program which reduces the Village's cost of providing the benefits.

Funding - The Village should provide annual funding to reduce the unfunded liability over time.

Asset Management - The Village should invest the money in the OPEB fund to maximize the long term return on these assets, reducing the Village's annual contributions.

Actions and Schedule

The plan to address the OPEB Unfunded Liability includes the following three actions to be completed by the end of 2019. The actions support the key components explained above.

Action	Schedule	Key Component
Establish a Health Reimbursement Account	December 2018	Benefits Design
Create an OPEB Trust Fund	December 2019	Funding
Draft and Approve a Trust Document, Funding Policy and Investment Policy	December 2019	Asset Management

Establish a Health Reimbursement Account by December, 2018

This action supports the Benefits Design key component. By creating a Health Reimbursement Account, the Village would provide financial incentives to retirees to participate in another health benefit plan instead of participating in the Village's plan. An HRA would allow the Village and retirees under the age of 65 to put money into savings account to be used to pay premiums on a non-VoDG health benefit plan. The Village contribution amount would be less than the projected cost of providing health benefits. Retirees choosing this option could reduce their cost of purchasing health benefits.

Assistance from an OPEB Financial Management Firm

Staff plans on securing the services of a financial management firm to establish the OPEB Trust and administer the trust on an on-going basis. Staff plans issuing a Request for Proposals for these services in late 2018 or early 2019. The firm selected will provide a template trust document to be used by staff to create the Village's OPEB Trust document, funding policy and investment policy.

Create an OPEB Trust Fund by December, 2019

Like most local governments, the Village currently pays an amount each year equal to the benefits distributed to retirees in that year. These payments are made from the Health Fund. This approach is commonly referred to as a "pay-as-you-go" basis.

With the creation of an OPEB Trust Fund, the Village would fund the OPEB benefits each year while the participant is working. Much like the operation of the public safety pension funds, the Village would use annual Village contributions to not only pay for annual benefit expenses but also invest money to pay for the future expenses of current workers. The accumulated investment returns compounded over the participant's career, are designed to fully pay for the

OPEB benefits that the participant is expected to enjoy during his or her retirement. The compounded interest generates a significant amount of investment return over a participant's career, resulting in a significant reduction in the Village's contributions that are needed to fund the OPEB benefits versus the amount needed under the pay-as-you-go approach.

Under the GASB accounting standards, the actuarial valuation of the OPEB benefits must reflect an investment return assumption that is consistent with the expected long-term rate of return on the assets used to pay those benefits. If the Village continues the pay-as-you-go approach, the rate of return is limited by the investments allowed. With an OPEB trust with additional asset classes, the rate of return increases which reduces the liability and the required contribution.

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Draft and Approve a Trust Document, Funding Policy and Investment Policy by December 2019

To operate the OPEB Trust according to GASB standards, the Village should draft and approve these three documents. They should be approved prior to the creation of the OPEB Trust Fund.

Trust Document

The OPEB Trust is the mechanism through which assets are accumulated and retiree benefits are funded. It ensures that:

- the employer contributions to the trust are irrevocable
- trust assets are dedicated to providing benefits to Village retirees in accordance with the terms of the trust
- trust assets are legally protected from creditors

In addition, the Trust has broader investment powers which will enable the trust to attain a higher investment returns.

Funding Policy

The purpose of the policy is to state the funding goals and actuarial assumptions to be used for the OPEB Trust. Similar to the pension funding policy, this policy should state the amount to be contributed each year to the OPEB Trust. The current approach recommended by staff is to use a phase-in strategy with a fixed amount invested for the first few years, with funding the Actuarially Determined Contribution as the long term goal. The initial contribution would be about \$300,000.

Investment Policy

The purpose of the investment policy is to provide a clear understanding of the objectives, goals, risk tolerance, and investment guidelines established for the OPEB Trust. The Investment policy will cover permitted investments, targets and ranges for asset allocation.