VILLAGE OF DOWNERS GROVE
Report for the Village
10/1/2019

SUBJECT:	SUBMITTED BY:
Other Post-Employment Benefits (OPEB) Trust	Judy Buttny Finance Director

SYNOPSIS

Resolutions have been prepared to authorize the creation of an OPEB Trust and to adopt an OPEB Investment Policy and an OPEB Funding Policy.

STRATEGIC PLAN ALIGNMENT

The goals for 2017-2019 include *Steward of Financial, Environmental and Neighborhood Sustainability.*

FISCAL IMPACT

The FY19 Budget provides $20,000 in the Health Fund related to creation of the OPEB Trust. Actual expenses were $5,025. The FY20 will budget $5,000 for annual trustee fees for U.S. Bank.

UPDATE & RECOMMENDATION

This item was discussed at the September 17, 2019 Village Council meeting. Staff recommends approval on the October 1, 2019 consent agenda.

BACKGROUND

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 appeared 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 $10.5 million.

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. Specific actions for this Priority Action Item are to draft and approve a Trust Document, Funding Policy and Investment Policy.

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 return.

Staff is proposing that the Village establish an irrevocable trust with a Section 115 Trust Agreement with U.S. Bank serving as trustee for the OPEB assets. Annual fees for this service will be $5,000. U.S. Bank will have custody of the OPEB assets, and execute investments upon direction from Village staff.

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. Staff worked with the Village's actuary, Lauterbach & Amen, to prepare the policy. 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 contributions will be $300,000 per year.

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 covers permitted investments, targets and ranges for asset allocation. The Village worked with PFM Asset Management LLC to develop an investment strategy and policy. The investment policy proposes an asset allocation of 60/40 Equity/Fixed Income and also defines an asset allocation range with a 20% corridor on each side of the target to account for market shifts. When the allocations breach the specified ranges, the portfolio will be rebalanced. Staff will report investment performance on a quarterly basis to Village Council.

ATTACHMENTS

Resolutions
Section 115 Trust Agreement
OPEB Funding Policy
OPEB Investment Policy

Village of Downers Grove
Official Village Policy Approved by Village Council

Description:	**Other Post-Employment Benefits ("OPEB") Funding Policy**
Res. or Ord. #:	**2019-** Effective Date: **10/01/19**
Category:	**Financial Services**
	X New Council Policy
	____ Amends Previous Policy Dated: ____________
	Description of Previous Policy (if different from above): ____________

1.0 INTRODUCTION AND PURPOSE

1.1 Introduction

The Village of Downers Grove has established the Village of Downers Grove Other Post-Employment Benefits Trust (the "Trust"). This Trust is intended to provide funding of non-pension other post-employment benefits ("OPEB") for those employees who meet the age and service requirements outlined in the plan document.

1.2 Purpose

The purpose of this policy is to set forth the procedures that the Village will utilize to make funding contributions to the Village of Downers Grove Other Post-Employment Benefits Trust to fund the long-term cost of benefits to the plan participants. In order to assure that the Trust is financially sustainable, it should accumulate adequate resources in a systematic and disciplined manner over the active service life of benefitting employees.

2.0 GOALS AND OBJECTIVES

The key goals and objectives of the funding policy are the following:

1. To ensure that benefits are secure for fund participants now and in the long-term.
2. To develop recommendations that are more cost-effective in the long-term.
3. To provide year-to-year contribution stability/budgeting for the Village.
4. To address any transition items needed at the policy implementation.

3.0 FUNDING POLICY

3.1 Actuarially Determined Contribution

It is necessary for the Village to determine an Actuarially Determined Contribution (ADC) on an annual basis. The ADC will provide a plan to achieve 100% funding and will be determined using the below principles:

1. Selection of Actuarial Cost Method
2. Amortization Policy for Handling Unfunded Accrued Liability
3. Selection of Asset Smoothing Method

3.1.1 Actuarial Cost Method

3.1.1.1 Purpose

The intent of any Actuarial Cost Method (ACM) is to set aside the appropriate amount of money during an employee's working career so that the Trust has the funding necessary to make payments after retirement. The ACM provides two key measures for reporting:

1. Normal Cost – The amount of money to contribute for each active employee for the upcoming year of service.
2. Accrued Liability – The amount of money that is expected to be in the Trust already, based on all past service worked by members of the Plan.

3.1.1.2 Recommended Selection

The Entry Age Normal (EAN) Cost Method (Level Dollar) is the current recommended method to measure the Normal Cost and Accrued Liability for the Plan. The EAN Method is a cost-based actuarial method which focuses on budgeting annual costs during the working career of an employee. The Normal Cost level is set with the expectation that it will not increase during an employee's working career and it will use the following assumptions:

1. The investment rate of return assumption will be 7.0% per year.
2. The salary increase assumption will be 3.5% per year.
3. Non-economic assumptions, such as rate of separation, disability, retirement, mortality, etc. shall be determined by the Village in consultation with the actuary to reflect current experience.

3.1.2 Unfunded Accrued Liability

3.1.2.1 Purpose

The ACM will provide a method for setting the expected level of assets needed to be on budget for past services rendered by employees. When the Trust's actuarial assets do not match the expected assets under the budget, an unfunded/overfunded liability exists.

3.1.2.2 Unfunded Liability

The Unfunded Actuarial Accrued Liability may either be amortized over a period of level dollar amounts or as a level percentage of projected payroll.

The unfunded actuarial accrued liabilities established as of December 31, 2018 unrelated to Assumption Changes will be amortized by level dollar contributions to a 100% funding target over 15 future years as of the December 31, 2018 fiscal year.

The unfunded actuarial accrued liabilities established as of December 31, 2018 related to Assumption Changes will be amortized by level dollar contributions to a 100% funding target over 5 future years as of the December 31, 2018 fiscal year. The change in liability is due to a re-measurement at change in the reporting standards.

3.1.2.3 New Unfunded Liability

Volatility in contribution determination can occur when new unfunded liability arises once the amortization period is within 15-20 years of the funding target.

The Village will amortize any new unfunded liability over a 15-year period established as of the date the new unfunded liability emerges using level dollar contributions to a 100% funding target.

3.1.3 Actuarial Value of Plan Assets

3.1.3.1 Purpose

The Actuarial Value of Plan Assets is the figure used annually to determine the level of underfunding in the OPEB Plan. The Actuarial Value of Plan Assets does not necessarily equal the Fair Market Value of Assets. While the Actuarial Value of Plan Assets does not represent dollars that are available on that day to make benefit payments, use of an Actuarial Value of Plan Assets recognizes that assets will not all be distributed at a single point in time.

The objective of using an Actuarial Value of Plan Assets that differs from the Fair Market Value of Assets is to redistribute contributions over the life of the OPEB Plan in a manner that is less volatile. The overall level of contributions over the life of the Plan is not expected to change. To achieve this, gains and losses on the Fair Market Value of Assets are recognized in the Actuarial Value of Plan Assets over a period of time. In order to be successful as part of long-term funding, the Actuarial Value of Plan Assets should be equally likely to fall above or below the Fair Market Value of Assets.

3.1.3.2 Key parameters

1. Years – the number of years to smooth market value gains and losses.

2. Corridor – A limitation placed on the Actuarial Value of Plan Assets. This parameter will limit the Actuarial Value of Plan Assets in relation to the Fair Market Value of Assets.

3.1.3.3 Recommendation

The current recommendation is that the Actuarial Value of Plan Assets will be equal to the Fair Market Value of Assets, with unexpected gains and losses on the Fair Market Value of Assets smoothed over a 5-year period.

It is anticipated that the Actuarial Value of Plan Assets will not stray too far from the Fair Market Value of Assets with the 5-year smoothing parameter. The Village has selected a corridor of 80% to 120% to ensure that the Actuarial Value of Plan Assets does not deviate too far from the Fair Market Value of Assets.

3.2 Funding

Although the Village will determine the ADC on an annual basis, it has the option to not dedicate the entire annual ADC each year. Instead, the Village will initially dedicate $300,000 to fund the Trust annually. The Village will review a benchmark contribution on an annual basis that is done on an actuarial basis to provide direction to transition to full funding of the ADC. The Village will annually review the metrics to determine when to pay benefits with trust assets. Benefit payments will be made from Village resources.

4.0 <u>OPERATIONAL PROCEDURES</u>

4.1 Funding Recommendations

The Village's Finance Director or his/her designee will use the policies and procedures set forth herein to recommend a contribution amount to be made by the Village to the Trust each year.

4.2 Actuarial Assumptions

The Village will review the actuarial assumptions used for determining the Plan's funding levels at least every 3-5 years. The Village will use assumptions that are the best estimate of the future anticipated experience under the Plan. By getting the best estimate on actuarial assumptions, short-term changes in unfunded liability are expected to be offset over a long-term period of time. Review of the assumptions every 3-5 years will help to minimize the impact of assumption changes that have deviated from actual experience over a long period of time.

If any events occur that could impact assumptions immediately (for example, a change in the Investment Policy or strategy), the Village will assess the associated assumption on a more immediate basis and will not be limited by the 3-5 year cycle.

4.3 Review of Funding Policy

The Village will review this Policy on an annual basis. When doing so, the Village should consider:

1. A review of the progress being made on the unfunded liability that exists at implementation.
2. An analysis of cash flow to monitor the continuous ability of the plan to pay benefits.
3. An analysis of the causes of any changes in unfunded liability over recent preceding years.
4. An analysis of the actuarial expectations versus actual experience over recent preceding years.

1\mw\policy\cou-pol\FS OPEB Funding Policy-final-10-01-19