June, 2008

Article for Minnesota Cities

New OPEB Law – A Primer for Cities

By Rebecca Otto, State Auditor

Under new accounting rules issued by the Government Accounting Standards Board (GASB), cities must disclose their accrued actuarial liability for post-employment benefits (other than pension) in their financial reports. These benefits consist mainly of health care-related benefits that had been promised to retirees before they retired. These benefits are referred to as “OPEB” benefits—Other Post-Employment Benefits.

Because public entities in Minnesota have never been required to account for this liability, many are now in the process of determining the extent of their liability and its effect on their financial statements. Once a city determines the extent of its liability, the city has one choice if it wants to minimize its accrued actuarial liability. The GASB rules only allow a city to show that it has put money aside to pay this liability to the extent the city has put money into an “irrevocable” OPEB trust.

This year the legislature enacted a new law, Minn. Stat. § 471.6175, intended to help cities address their OPEB liability in at least four important ways.

First, it allows cities to create both irrevocable and revocable OPEB trusts. Cities with OPEB liability will now be able to create an irrevocable OPEB trust and, to the extent money is put into the trust, cities will be able to reduce the net OPEB liability presented in their financial statements. The law also provides for the creation of “revocable” trusts. This part of the new law was requested by public entities that believe the federal government will become involved in the health care field sometime in the next thirty years. (OPEB actuarial liabilities are calculated on a 30 year maximum time period.)

These public entities are concerned that, if national health care is adopted in some form, their OPEB liability to their retirees will be reduced or eliminated. If that happens, large amounts of money could be “trapped” in an irrevocable OPEB trust. Even though public entities cannot improve their financial statements with a “revocable” trust, many feel that being able to get some of the money returned if some form of national health care is adopted is worth whatever discomfort will be associated with having a large net OPEB liability on their annual financial statements.
According to the new law, even if a city creates a revocable OPEB trust, funds in the trust are dedicated to paying OPEB benefits unless certain events occur. One of the events is a change in federal or state law that would change a public entity’s OPEB liability. A federal law creating a national health care system is one example of a change in law that would affect a public entity’s OPEB liability. If such an event occurs, funds not needed to make OPEB payments can be withdrawn from a revocable trust.

If a city does not intend to take advantage of the law to set up an irrevocable trust to deal with OPEB liabilities, why would it set up an OPEB trust at all? The answer to this question involves the second major advantage created by Minnesota law. It authorizes the use of a different list of permissible investments for both irrevocable and revocable OPEB trusts. Instead of using the limited list of investments available to cities and other public entities, OPEB trusts can use the long list of investments currently available to public pension plans. This list includes stocks, international securities and various mutual funds and index funds. With prudent investments, this list should yield a greater return over the likely thirty-year life of an OPEB trust than the limited list of investments available to public funds would earn.

Third, a number of cities may have created OPEB trusts prior to 2008. These trusts are grandfathered in under the new law. The new law validates these trusts and provides that they have until January 1, 2009 to bring trust documents and procedures into compliance with the provisions of the new law.

Fourth, the new law also permits cities to invest OPEB trust assets with the State Board of Investment (SBI), bank trust departments and certain insurance companies. Investing with the SBI is desirable because of its traditionally high rate of return. The SBI has had very low administrative costs which accounts for, in part, its annual rate of return of about ten percent for the last twenty years (Combined Fund through 6/30/07).

Whether a city uses SBI or a bank trust department or an insurance company to administer its OPEB trust investments, the cities should proceed cautiously. Cities have not had experience investing in the various types of investments on the long list, investments that have been historically permitted for public pension plans but not for cities. In addition, cities have had little experience with the various fees, front-end and annual, charged by fund managers. If expectations are not met, a city can always change trust administrators. Once a trust is set up and investments are made, however, making such a change can be problematic. A little extra work at the beginning of the process will result in greater returns over the life of the OPEB trust.

If you have any questions regarding the new OPEB rules or the trust statute, please feel free to contact Dave Kenney at the Office of the State Auditor at 651-297-3671.