



Best Practices for Funding Retirement & Benefits



Lincoln Institute
December 2, 2016

About New Bedford



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- ▶ 95,000 population (6th largest in Massachusetts)
- ▶ Incorporated in 1847, located 56 miles from Boston.
- ▶ Largest fishing port in the U.S. by catch value.
- ▶ Hit hard by the Great Recession – average annual unemployment reached as high as 13.7% and assessed valuation fell by 25% (\$1.8 billion).
- ▶ City has experienced an gradual economic recovery – current unemployment is at 5.8%, and FY 2017 valuation has grown by \$313 million from its recession low.



About New Bedford



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- ▶ City identified the need for a Chief Financial Officer (CFO) to manage New Bedford's finances.
- ▶ Position oversees back office operations, conducts long-range planning and manages citywide performance improvement programs.
- ▶ Development of financial policies and introduction of best practices is a central part of this effort.



Background Items

- ▶ **Government Accounting Standards Board (GASB) – Establishes Generally Accepted Accounting Principles (GAAP) for State and local governments.**
- ▶ **Other Post Employment Benefits (OPEB) – Accounting concept created by GASB to address moral obligation expenses, such as pensions and retiree health insurance.**
- ▶ **The organization's obligation is presented in the form of an actuarial liability, i.e. the cost of providing future benefits to existing employees & retirees,**



OPEB Liabilities

- ▶ Post-retirement benefits costs are driven by the size of the workforce and the level of benefits provided.
- ▶ States and localities have been inconsistent in addressing the issue.
- ▶ The Commonwealth conducted a statewide study of OPEB liabilities in 2012. The final report found the following:
 - ▶ The unfunded OPEB liability for state and local government totaled \$46 billion.
 - ▶ Budgetary spending for retiree health benefits exceeded \$1 billion per year.
 - ▶ In contrast to pension obligations, the Commonwealth and local governments had not set aside significant resources to prefund their OPEB liabilities.
- ▶ The dynamic continues: as of 2015, the Commonwealth had set aside funding equivalent only to 3.7% of its \$15.9 billion OPEB liability.



Pension Liabilities

- ▶ The Commonwealth and localities have been more aggressive in their approach toward pension costs, largely due to State reform efforts and pressure from the rating agencies.
- ▶ As of 2015, the unfunded liability for state and local governments totaled \$51.9 billion, with a 58.1% funding ratio.
- ▶ The Actuarial Standards Board reported in 2016 that unfunded liabilities total \$5 trillion nationwide and funding ratios average just 39%.



Management Strategies

- ▶ The City has engaged in a strategy to achieve long-term sustainability for post-retirement benefits.
 - ▶ Funding for the regional retirement system.
 - ▶ Management of health insurance benefits, identification of additional cost savings, prefunding of OPEB trust.
- ▶ Circumstances have required a variety of approaches due to legislative restrictions and collective bargaining requirements.

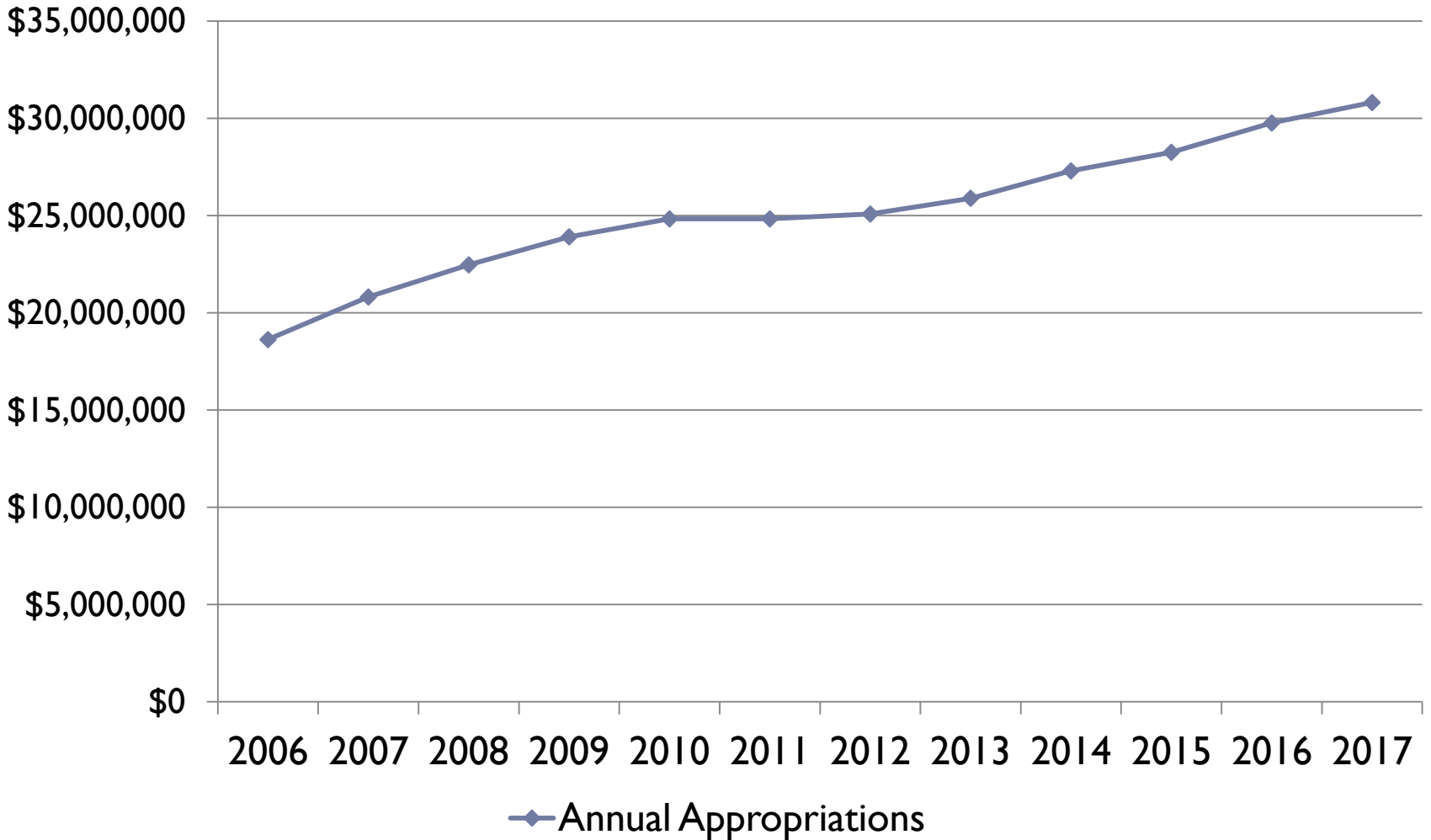


New Bedford Retirement System

- ▶ Government entities typically conduct actuarial studies every two years to determine ongoing funding requirements.
- ▶ The City of New Bedford participates in a regional pension plan that includes several related entities, of which the City is the largest, while maintaining its own health benefits program.
- ▶ The retirement system and the City conducted their most recent actuarial studies in 2016.



New Bedford Retirement System

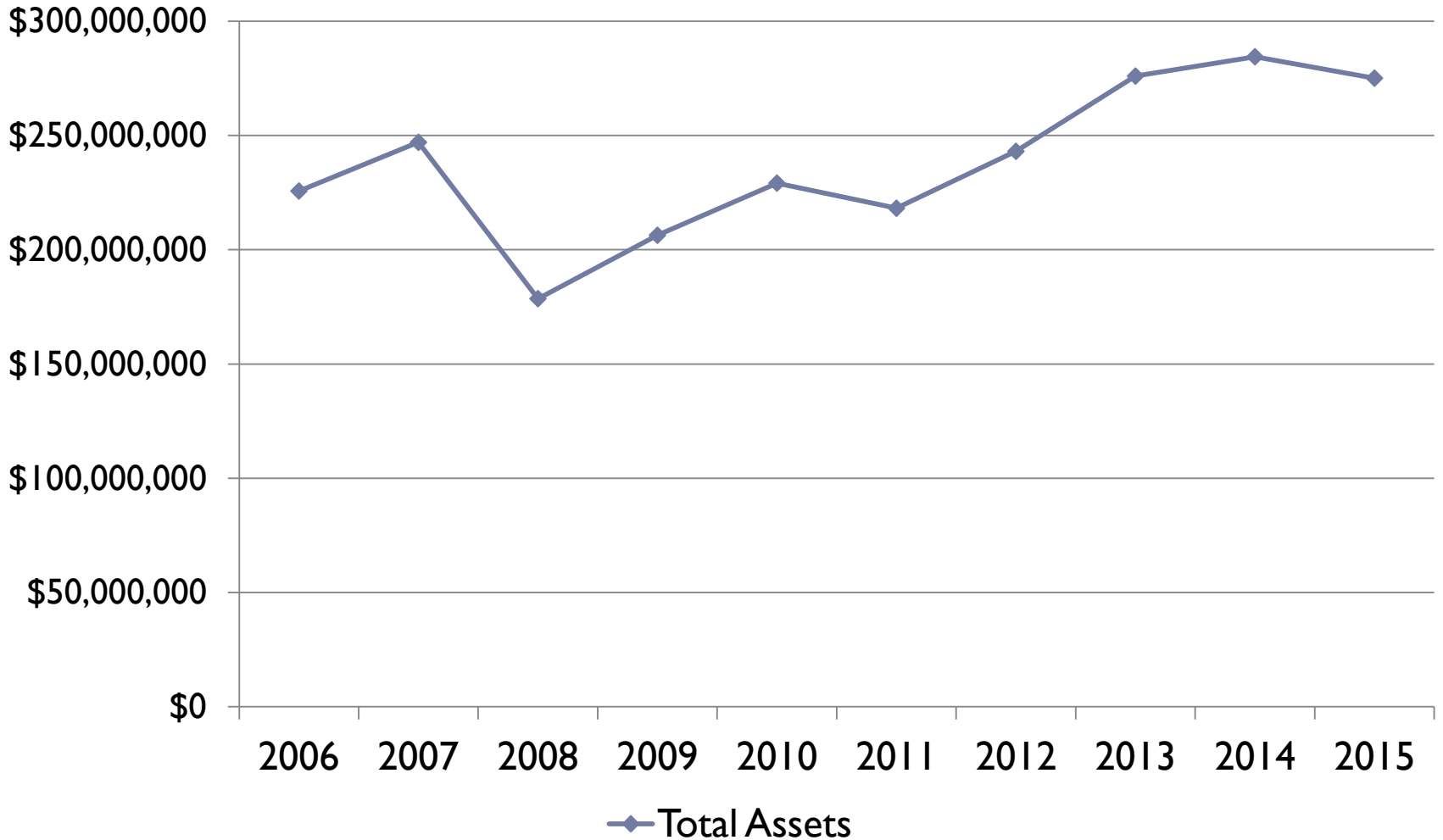


New Bedford Retirement System

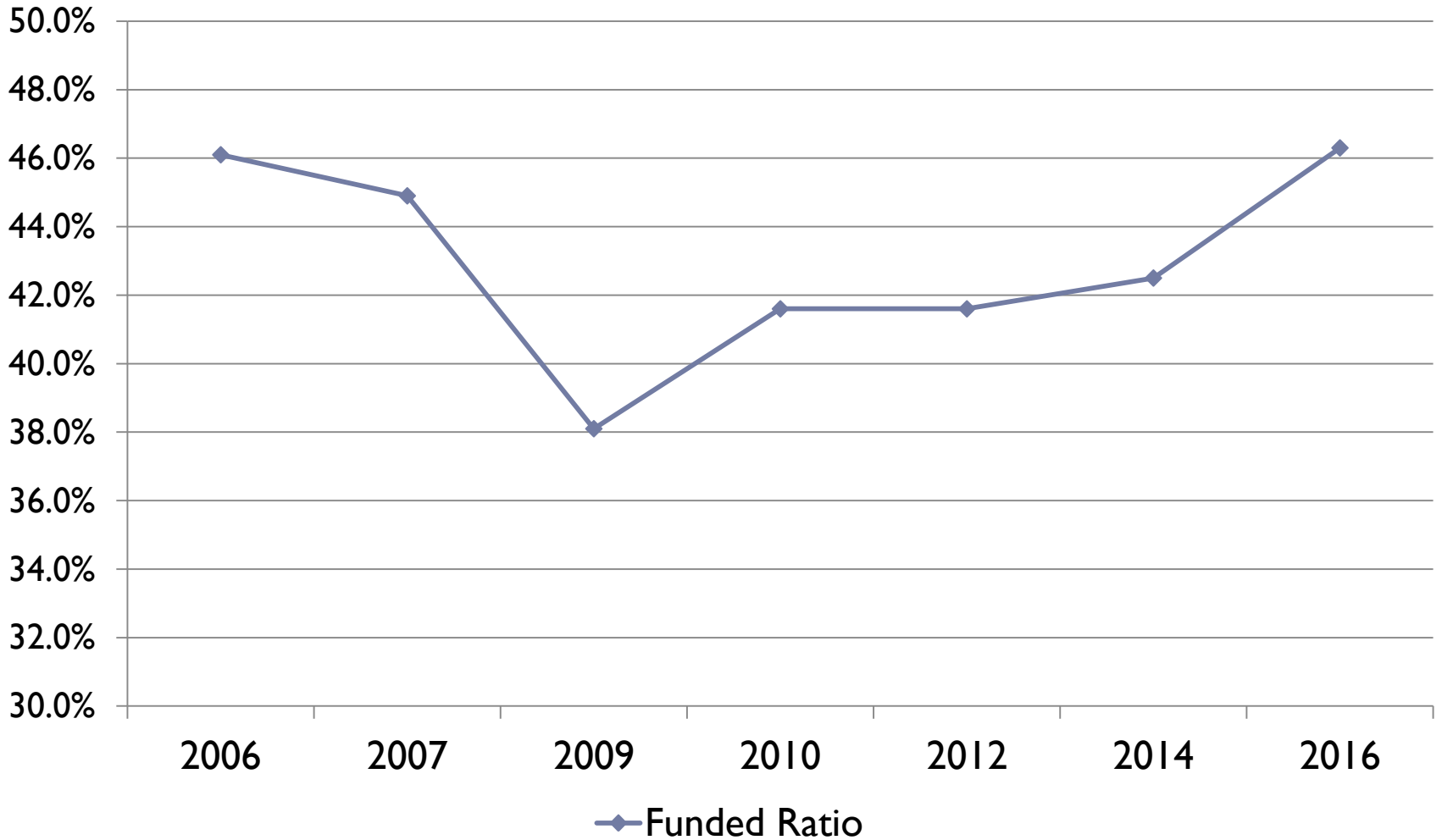
- ▶ New Bedford's retirement program benefits from eligibility and funding changes instituted by the State and by steadily increasing annual appropriations.
- ▶ The retirement program suffered from declines in value connected with the Great Recession.
- ▶ While only 46.3% funded, the retirement program is on track to achieve full funding by 2034.
- ▶ Annual appropriations increased from \$18.6 million in 2006 to \$29.8 million in 2016.



New Bedford Retirement System



New Bedford Retirement System



Retiree Medical Benefits

- ▶ Prefunding for retiree medical benefits is a relatively new dynamic, introduced by GASB during the mid-2000s.
- ▶ The Commonwealth and localities have only begun to identify funding strategies.
- ▶ In many cases, employee representatives have been reluctant to participate in significant benefits reform.
- ▶ Failure to address OPEB costs would endanger the reliability of retiree benefits in the future and undermine financial stability.



Retiree Medical Benefits

- ▶ GASB has begun to require inclusion of OPEB and retirement liabilities in annual financial statements.
- ▶ The City conducted studies of its OPEB costs using information from 2012 and 2014.
- ▶ The 2012 study estimated that New Bedford's OPEB costs total about \$563.1 million, and could be funded by paying \$21.5 million per year.
- ▶ Thus, in order to fully fund future retiree health insurance costs, the City would need to put aside \$21.5 million per year to meet projected future costs.

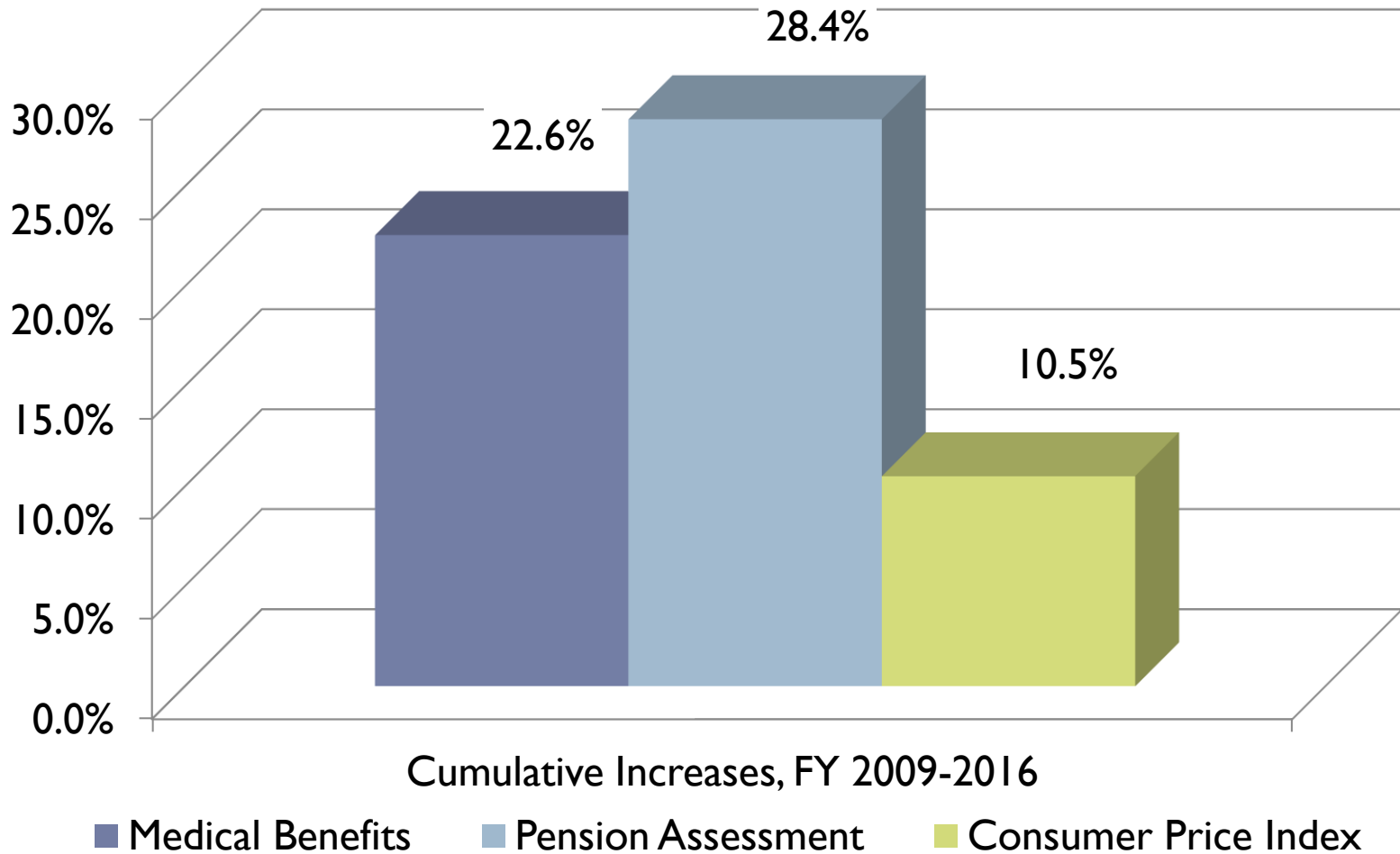


Retiree Medical Benefits

- ▶ Following the 2012 study, New Bedford implemented a series of reforms aimed at reducing OPEB costs. These measures included:
 - ▶ Changing the plan administrator through a competitive bidding process.
 - ▶ Increasing deductibles and copays for active employees and retirees.
 - ▶ Reducing direct costs by changing the approach used to fund Medicare drug benefits. The change meant that the Medicare program picks up a greater percentage of total costs, so that both the City and retirees pay less.
 - ▶ Establishing an OPEB Trust, funded initially by savings to the City from a one-week health insurance holiday.
- ▶ The plan reforms resulted in a 25% reduction to the 2012 estimate, bringing OPEB costs to about \$424.8 million, which could be funded by a \$19.8 million annual payment.
- ▶ The OPEB liability resumed its upward climb in 2015-16, increasing to \$486.3 million with the most recent actuarial study.
- ▶ Benefits costs have increased faster than inflation despite the reforms.



Benefits costs are increasing faster than inflation:



Best Practice Resources

“Commercial or professional procedures that are accepted or prescribed as being correct or most effective.”

The Government Finance Association’s (GFOA) best practices program identifies specific policies and procedures as contributing to improved government management.



Best Practice Resources

- ▶ GFOA best practices address many aspects of governmental business processes: accounting, budgeting, economic development, debt management, technology, treasury operations, as well as **pension and benefits administration**.

www.gfoa.org/best-practices

- ▶ Effective policies allow for the implementation of best practices at the organizational level.



Effective Policies

- ▶ The key to addressing the OPEB problem lies in a consistent and disciplined approach. Effective policies:
 - ▶ Institutionalize good management practice.
 - ▶ Clarify & crystallize the organization's strategic intentions.
 - ▶ Enhance predictability by defining the parameters within which the organization operates.
 - ▶ Promote long-term & strategic thinking.
 - ▶ Manage risks to the organization's financial condition.
 - ▶ Enhance the organization's standing with outside rating agencies.
 - ▶ Balance current service needs against long-term sustainability in a realistic manner.
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Making a Policy Relevant

- ▶ Pay attention to the policy and ensure compliance.
- ▶ Use the policy to guide important decisions.
- ▶ Conduct reviews and implement revisions on a regular basis.
- ▶ Orient new governing board members/elected officials.
- ▶ Show stakeholders how a policy solves problems and/or creates benefits.



Building Policy-Based Management

- ▶ New Bedford has developed financial policies for several purposes.
- ▶ Internal policies (travel/reimbursement, purchasing) are implemented administratively.
- ▶ Policies regarding appropriations and fund structure (fund balance, debt management, investments, OPEB) are approved by the City Council.



New Bedford OPEB Policy (Draft)

- ▶ The City's draft OPEB Trust Fund policy describes a forward path for addressing New Bedford's OPEB liability.
- ▶ The OPEB Trust Fund was established in 2015; City invests in the State Retiree Benefits Trust Fund.
- ▶ Limited funding requires City to take a conservative approach in setting the minimum funding levels (at least 10% of annual Free Cash).
- ▶ City works closely with union representative and health care providers to restrain expenses.
- ▶ Withdrawals from the Trust are prohibited until the Fund accumulates a two-year reserve.



New Bedford OPEB Policy (Draft)

- ▶ The City will implement future strategies and policies to limit future liabilities.
- ▶ New Bedford's OPEB policy is currently under consideration by the City Council.
- ▶ Adoption will provide a framework for addressing OPEB issues going forward.
- ▶ Key point: a financial policy is a living document. Plan to update and revise as circumstances require.



Questions / Comments?

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