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FINANCE, BUDGET AND AUDIT COMMITTEE
MAY 16, 2012

SUBJECT: RETIREE MEDICAL LIABILITIES

ACTION: ADOPT A FUNDING STRATEGY FOR RETIREE MEDICAL LIABILITIES

RECOMMENDATION

Adopt a funding strategy for retiree medical liabilities by amending the Financial Stability Policy, paragraph F15, as indicated in Attachment A.

ISSUE

Our actuaries have recommended that we adopt a funding strategy that they may rely on in performing their bi-annual actuarial assessment of our retiree medical liabilities as required by Government Accounting Standards Board pronouncement number 45 ("GASB 45").

DISCUSSION

GASB 45 is the accounting standard affecting governmental employers who provide retirees other post-employment benefits ("OPEB") such as medical, dental and life insurance. It does not apply to pension benefits. While GASB 45 does not mandate a "funding strategy" to provide the future benefits, a governmental entity that contributes amounts less than actuarially required will be required to report such shortfalls as a liability on their financial statements and this liability could become a bond ratings factor.

GASB 45's basic concept is to recognize the cost of an employee's OPEB during the period of active service. As defined in the standard, a significant expense recognizing the past and future costs of providing OPEB benefits is required to be recorded annually. As in the case of our defined benefit pension plans, this actuarially determined cost is the annual required contribution ("ARC").

We have previously implemented a strategy to minimize future ARCs by setting aside cash in an irrevocable trust. Monies in the trust are then only used for OPEB purposes. The trust assets are legally protected from creditors and the Board has no further discretion over the use of those assets. The Board resolution creating the trust also allows the trust fund assets to be invested in a broader range of securities than is permitted under the MTA Investment Policy that is constrained by State law. Like our pension fund assets, the monies are invested in equity securities and longer term fixed income bonds and, accordingly, are expected to generate greater investment income that can be used to offset OPEB costs.

Funding strategies affect the computation of future ARCs and future amounts of budgetary resources required depending on how much and what types of financing procedures are implemented. The impacts of the funding strategy adopted will be reflected in our audited financial statements and may affect the perception of those, such as investors, who read them.

Our actuaries, Mercer, estimated the Unfunded Accrued Liability ("UAAL") to be $816 million as of January 1, 2011, the latest valuation date. This amount was net of $188 million of investment assets held in the OPEB Trust. The ARC for FY12 and FY13 was $82 million. On the pay-as-you-go basis, the estimated cost of payments to be made on behalf of actual retirees during FY12 was $24 million. The approved FY12 budget deposit included an additional $5 million as a liability reduction contribution.

The determination to actually deposit some or all of the ARCs is addressed in each year's annual budget process.

DETERMINATION OF SAFETY IMPACT

Approval of this action will not impact the safety of Metro's patrons or employees.

FINANCIAL IMPACT

Approval of this action will not have any direct financial impact.

Impact to Budget

Approval of this action provides guidance to staff for making each year's budget proposal for retiree medical liabilities funding. Pursuant to this action, the Board retains discretion to approve or modify staff's budget proposal during the annual budget adoption process.

ALTERNATIVES CONSIDERED

Continue the existing practice of not having a definitive statement of a funding strategy. This alternative is not recommended because without the plan for future funding, the actuaries would use a lower rate to discount the future liabilities, which results in a higher ARC and a greater unfunded liability on our financial statements over time if the ARC is not fully cash funded each year.

ATTACHMENT

A. Financial Stability Policy F15 Marked To Show Changes

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Arthur T. Leahy

Arthur T. Leahy
Chief Executive Officer

F15. Retiree Medical Liabilities – The Government Accounting Standards Board adopted Statement #45 ("GASB 45") that effective for Metro's fiscal year ending June 30, 2008. As defined in the standard, a significant liability recognizing the past and future costs of providing medical and related benefits, other than pensions, to retirees is required to be recorded. he actuarially required contribution ("ARC") is required to be recorded as an expense. The ARC recognizes the cost of the retiree benefits earned by current employees during the period and amortization of the unfunded past liabilities. GASB 45 does not mandate an entity's approach to setting aside cash to provide the future benefits.

It is Metro's policy to fully fund the ARC, i.e., set aside and restrict the cash. However, since this amount is significantly greater than the current amount needed for these expenditures on the "pay as you go" basis , a separate discussion of this issue will be brought to the Board in setting the parameters for each upcoming budget year. A greater accounting liability will result when setting aside less cash than the ARC amount. The ARC will be recognized as an expense in the financial accounting system as required by GASB 45.