City of Oakland
Other Post-Employment Benefits (OPEB) Funding Policy

Prepared by
Finance Department
Adopted by the City Council
February XX, 2019

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1.0 POLICY

This policy details the City of Oakland's funding approach for Other Post-Employment Benefits (OPEB) as provided to retirees in addition to pensions. The purpose of this funding policy is to set forth the City's overall OPEB funding and benefit goals, the benchmarks that will be used to measure progress, and the methods and assumptions that will be used to develop and maintain these benchmarks.

2.0 OPEB PROGRAM OBJECTIVES

The primary objectives of the City's overall OPEB program goals are to provide benefits that are:

- **Affordable** in the near-term, without crowding out the City's capacity to deliver quality services to the public or to provide reasonable salary increases to active employees;

- **Sustainable** over the long-term, ensuring that benefits will be secure and reliable for career employees throughout retirement, with substantial intergenerational equity for taxpayers in regard to the funding of benefit costs; and,

- **Competitive**, to support effective recruitment and retention of a strong municipal workforce.

The specific elements of this funding policy are intended to provide a balanced approach for addressing these goals within the parameters of the City's resources.

3.0 OPEB FUNDING GOALS

3.1 The City of Oakland funds OPEB in two primary ways.

- Explicit Subsidy

First, the City provides a benefit payment to eligible City retirees that is used to offset some or all of the cost of participation in health coverage. Prior to attaining Medicare eligibility, City retirees participate in the same health plans offered to active employees, and parallel plans integrated with Medicare are provided for retirees who have reached the age of Medicare eligibility. The City's benefit payment toward coverage in these plans is referred to in accounting terms as an explicit subsidy, because it is structured as a contribution toward the stated premium costs for these plans.

- Implicit Subsidy

Second, the City also provides an implicit subsidy toward retiree medical coverage. This cost to the City results from the pooled approach to the health plans in which the City participates administered by the California Public Employees' Retirement System (CalPERS) pursuant to the Public Employees' Medical & Hospital Care Act (PEMHCA). Under these PEMHCA plans, the same rates are charged for active and retired employee participants on a blended basis. In turn, because the underlying cost for retirees, on average, will be higher than the underlying costs for active employees, this blended CalPERS rate effectively leads to a subsidy of the true costs for retirees in the aggregate. This implicit subsidy takes the form of the higher payments by the City for active employee premiums than would otherwise be required if retirees were not covered under the same PEMHCA pool with blended rates. As of the initial adoption of this OPEB Funding Policy, PEMHCA does not offer the option of using separate rates for active employees and retirees, such that this implicit subsidy is unavoidable under the PEMHCA program.

3.2 Explicit Subsidy Funding Goals

To fund the explicit subsidy, the City participates in an irrevocable Section 115 Trust (hereinafter "OPEB Trust"). The objective in providing employer contributions to this OPEB Trust is to accumulate sufficient assets during a member's period of active employment to fully finance the benefits the member receives throughout retirement.

Toward this objective, the City establishes the following OPEB Trust funding and related goals:

- Maintain a stable or increasing ratio of trust assets to accrued liabilities, with the goal of reaching a 100% funded ratio (full funding) for all explicit subsidy benefits. For this purpose, the funded ratio is defined as the actuarial value of trust assets divided by the trust's actuarial accrued liability for explicit subsidy benefits.

- Develop a pattern of stable and regular contribution rates when expressed as a percentage of member payroll as measured by valuations prepared in accordance with the principles of practice prescribed by the Actuarial Standards Board, ultimately reaching a minimum employer contribution level at least equal to the Actuarially Determined Contribution (ADC) associated with explicit subsidy benefits.

- Manage the cost of benefits through labor-management partnership and collective bargaining to reach and maintain an affordable and sustainable level of coverage.

3.3. Implicit Subsidy Funding Goals

For any implicit subsidy, the City's objective will be to ensure that combined employer and employee/retiree contributions are made in full for annual premiums, such that this funding requirement will consistently be met on a yearly basis.

4.0 BENEFIT PROGRAM

The City's goal is to provide an affordable, sustainable, and competitive level of retiree healthcare benefits for career employees.

4.1 Labor-Management Partnership

Specific benefit structures are subject to collective bargaining for represented employees, and the City respects the negotiation process and values its labor-management partnerships.

In parallel with each biennial OPEB actuarial valuation, and in advance of any rounds of collective bargaining, the City should seek to review its retiree healthcare benefits relative to offerings among other Bay Area governments and large California cities.

As retiree healthcare benefits are periodically reviewed and renegotiated, the following principles will serve as guidelines for pursuit of any adjustments:

- Until the City's OPEB Trust is fully funded, the affordability and sustainability of the City's retiree medical benefits offerings will be evaluated on the basis of whether the City's ADC for explicit subsidy benefits can be fully funded with a combination of full Pay-Go Funding ("pay-go") plus a supplemental employer contribution of no higher than 2.5% of payroll.

- Periodic adjustments to benefits will be pursued as required to ensure full funding and plan sustainability under the terms of this policy. ~~If the ADC for explicit subsidy benefits exceeds pay-go costs plus a supplemental City payment of 2.5% of payroll, then the City will seek to negotiate approaches to modify benefits to close this sustainability gap. Among the potential approaches for closing this gap, the City may pursue retiree benefit modifications and/or contributions toward future OPEB coverage from active employees.~~

- ~~The City will also seek to negotiate reopeners for retiree health care benefits in any year during which the trigger outlined in Section 5.3 below is met for waiving or deferring supplemental City OPEB contributions beyond pay-go.~~

- Any proposed OPEB changes shall be accompanied by an actuarial valuation projecting the impact on the ADC, funded ratio, and overall OPEB actuarial liability.

4.2 CalPERS Policies and Practices

The City will also partner with its employee groups' representatives to explore and potentially advocate for appropriate policy changes by CalPERS, to the extent the City continues to provide retiree healthcare benefits through the CalPERS system. Such policy changes may include, but are not limited to the development of plan design changes that do not incur penalty costs under the Affordable Care Act, and the separation of rates for active and retiree healthcare plans to eliminate the implicit subsidy.

5.0 FUNDING POLICY FOR SUSTAINABLE BENEFITS

5.1 Pay-Go Funding

At a minimum, the City will fully fund its pay-go commitments to eligible retirees and beneficiaries for the benefits they receive each year, inclusive of any implicit subsidy resulting from the blending of active and retiree healthcare rates.

5.2 OPEB Trust Funding

The City will continue to make contributions to its OPEB Trust. Once full funding has been achieved on an actuarially sound basis, and as full funding is sustained thereafter, all explicit subsidy payments on behalf of retirees and beneficiaries shall be made from the Trust, with the City also contributing the full ADC associated with explicit subsidy payments each year to ensure the continued health and sustainability of the Trust. Once full funding of the explicit subsidy is achieved, the annual City contribution will represent the actuarial normal cost for the explicit subsidy benefits, reflecting the dollars required to be set aside on a current basis so that active members' benefits will be fully funded upon retirement.

Until the Trust is 100% funded for explicit subsidy benefits, the City will make contributions in excess of the annual pay-go cost for current retirees and beneficiaries toward achieving full funding, under the policy outlined below.

- Beginning in FY2020, the City will contribute an additional 2.5% of payroll above pay-go into the OPEB Trust on an annual basis until the liability associated with the explicit subsidy is fully funded.

- ~~Consistent with Section 4.1 of this policy, if the sum of annual pay-go costs plus the supplemental contribution as outlined above is less than the ADC for explicit subsidy payments in that same year, then the City will seek to negotiate benefit and/or employee contributions sufficient to close this sustainability gap.~~

For the purposes of the above calculations, the ADC will be calculated with regard to retiree benefits exclusive of future implicit subsidy payments, as the City is committed to funding the implicit subsidy component of the OPEB liability on an ongoing basis through its general employee healthcare rates.

5.3 OPEB Trust Funding Adjustments

In addition to the above annual contributions, the City will continue to make further one-time contributions to the OPEB Trust when Excess Real Estate Transfer Tax (RETT) thresholds are met as provided in the City of Oakland Consolidated Fiscal Policy. This approach will help to build OPEB funding more rapidly, thereby improving plan stability and reducing future contribution requirements.

In the event of a severe economic downturn the City will seek to continue the above payment structure in full, but, if authorized via Council Resolution, may temporarily reduce or defer its supplemental payments above pay-go until the City's revenues have recovered.

For the purpose of this provision: a severe downturn shall be defined as a fiscal year in which aggregate General Purpose revenues are projected to be negative and/or less than 50% of forecast growth in the Consumer Price Index for the ensuring fiscal year; and recovery shall be defined as the next fiscal year following a fiscal year when General Purpose revenues are estimated to have again been positive and exceeded 50% of forecast growth in the Consumer Price Index.

In no event shall the City draw down from its OPEB Trust to meet pay-go costs if the ADC is not made in full for that same fiscal year.

6.0 ACTUARIAL APPROACH

6.1 Biennial Valuations

An OPEB actuarial valuation will be performed at least biennially.

6.2 Actuarial Method and Assumptions

The actuarial funding method used to develop the benchmarks will be the entry age normal actuarial cost method. Any unfunded liability will be amortized over a closed 30-year period.

Other actuarial assumptions used will be those adopted by the City Finance Department based on the advice and recommendation of the OPEB actuary. The actuary shall conduct an investigation into each system's experience at least every five (5) years, and use the results of the investigation to form the basis for those recommendations, consistent with Actuarial Standards of Practice (ASOP) and Government Finance Officers Association (GFOA) guidance.

7.0 TRANSPARENCY AND REPORTING

Funding of the City's OPEB program should be transparent to all stakeholders, including City employees, retirees, employee organizations, elected officials, and Oakland residents and taxpayers. In support of this transparency, the following information shall be available:

7.1 Report to City Council

When each actuarial valuation for the City's OPEB plan is completed, typically on a biennial basis, a copy shall be transmitted to City Council along with a Finance Department report regarding progress toward full funding of the plan and ADC, and overall advancement of this policy's OPEB plan goals of affordability, sustainability, and competitiveness.

7.2 Website Publication

These OPEB actuarial valuations and the City's Comprehensive Annual Financial Report (CAFR) shall be published on the City's website. The CAFR includes information regarding the City's OPEB plan, contributions to the OPEB Trust, and the funded status of the plan.

7.3 Budget Transparency

The City's annual operating budget shall include clear and specific appropriations for contributions to the OPEB Trust and pay-go costs.

8.0 REVIEW OF FUNDING POLICY

Sustainable OPEB funding requires a long-term commitment. To ensure that adequate resources are being accumulated to meet the City's OPEB goals, the City will review this policy biennially in conjunction with completion of its OPEB actuarial valuations.

9.0 GLOSSARY

Definitions of key OPEB-related terms are listed in Exhibit A.

EXHIBIT A

GLOSSARY

ACTUARIAL ASSUMPTIONS: Assumptions as to the occurrence of future events affecting costs, such as: mortality, withdrawal, disablement and retirement; changes in compensation and Government provided benefits; rates of investment earnings and asset appreciation or depreciation; and other relevant items.

ACTUARIAL COST METHOD: A procedure for determining the Actuarial Present Value of Plan benefits and expenses and for developing an actuarially equivalent allocation of such value to time periods, usually in the form of a Normal Cost and an Actuarial Liability. This policy specifies use of the Entry Age Normal Actuarial Cost Method.

ACTUARIALLY DETERMINED CONTRIBUTION (ADC): The amount actuarially calculated each year required to be contributed by an employer to a retirement trust to ensure sufficient funds to pay future benefits. This amount is a combination of the employer's share of Normal Cost plus the unfunded liability amortization payment. In past years, annual contributions to a plan were known as the ARC for "actuarially required contribution" or "annual required contribution." For most purposes, the terminology of "ARC," "ADC," and Actuarially Determined Employer Contribution (ADEC) is similar.

ACTUARIAL GAIN (LOSS) (Called Actuarial Experience Gain and Loss): A measure of the difference between actual experience and that expected based upon a set of Actuarial Assumptions during the period between two Actuarial Valuation dates, as determined in accordance with a particular Actuarial Cost Method.

ACTUARIAL LIABILITY: That portion, as determined by a particular Actuarial Cost Method, of the Actuarial Present Value of projected benefits which will not be paid by future Normal Costs.

ACTUARIAL PRESENT VALUE (Present Value): The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions. For purposes of this standard, each such amount or series of amounts is: adjusted for the probable financial effect of certain intervening events (such as changes in compensation levels, Social Security, marital status, etc.); multiplied by the probability of the occurrence of the event (such as survival, death, disability, termination of employment, etc.) on which the payment is conditioned; and discounted according to an assumed rate (or rates) of return to reflect the time value of money.

ACTUARIAL VALUATION: The determination, as of a valuation date, of the Normal Cost, Actuarial Liability, Actuarial Value of Assets, and related Actuarial Present Values for the Plan. The Actuarial Valuation is presented in the form of a detailed report prepared by professional actuaries.

ACTUARIAL VALUE OF ASSETS: The value of cash, investments and other property belonging to a Plan, as used by the actuary for the purpose of an Actuarial Valuation. The purpose of an Actuarial Value of Assets is to smooth out fluctuations in market values. This way, long-term costs are not distorted by short-term fluctuations in the market. Currently, the City's OPEB Actuarial Valuation relies on the Market Value of Assets.

AMORTIZATION: The portion of the Plan contribution which is designed to pay interest on and to amortize the Unfunded Actuarial Liability.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CalPERS): CalPERS is a California state agency that administers pensions, active employee healthcare benefits, and retiree healthcare benefits for participating public employers.

DISCOUNT RATE: The estimated long-term interest yield on the investments that are expected to be used to finance the payment of benefits, with consideration given to the nature and mix of current and expected investments and the basis used to determine the Actuarial Value of Assets.

ENTRY AGE NORMAL COST METHOD: An Actuarial Cost Method under which the Actuarial Present Value of the projected benefits of each individual included in an Actuarial Valuation is allocated in a manner that produces a level annual cost over the earnings of the individual between entry age and assumed retirement age. This is the Actuarial Cost Method to be used for the City's OPEB Actuarial valuation pursuant to this policy.

EXPLICIT SUBSIDY: The Explicit Subsidy component of the City's post-employment healthcare program involves those direct payments to retirees used to offset some or all of the cost of participation in their health plans, exclusive of any Implicit Subsidy that may reduce retiree healthcare premium costs.

FUNDED RATIO: The Actuarial Value of Assets expressed as a percentage of the Actuarial Liability.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) STATEMENTS NO. 74 AND NO. 75: GASB establishes the accounting standards used in U.S. state and local government financial statements. Issued in June 2015, GASB Statements No. 74 and No. 75 set forth the accounting standards for public sector post-employment benefit retirement plans and the governments that sponsor them. GASB Statement No. 74 applies to OPEB plans that administer benefits for governments, and GASB Statement No. 75 applies to governments that participate in OPEB plans. Under GASB Statement No. 75, which is initially required for the City's FY2019 Comprehensive Annual Financial Report, the City must now reflect its full unfunded OPEB liability on its balance sheet.

IMPLICIT SUBSIDY: An Implicit Subsidy for retiree medical coverage may occur when the rates charged for active and retired employees are blended for all participants under a common plan. Because the underlying cost for retirees, on average, will be higher than the underlying costs for actives, this blended rate effectively leads to an Implicit Subsidy of the true costs for retirees in the aggregate.

NORMAL COST: That portion of the Actuarial Present Value of the Plan benefits and expenses which is allocated to a valuation year by the Actuarial Cost Method. In general terms, this represents the funding that should be set aside in each year of current service for a plan participant to ensure full funding of their post-employment benefits by the time of retirement, assuming all actuarial assumptions are met.

PAY-GO FUNDING: Also sometimes referred to as Pay-as-You-Go funding, Pay-Go Funding in the context of OPEB is the practice of paying only for the costs of benefits for those who have already retired, in contrast to prefunding post-employment benefits during a plan participant's years of active service.

PUBLIC EMPLOYEES' MEDICAL & HOSPITAL CARE ACT (PEMHCA): The PEMCHA law governs the CalPERS health programs, and includes certain requirements regarding the continuation of healthcare benefits into retirement for participating public employers.

SECTION 115 TRUST: Established under Section 115 of the Internal Revenue Code, this is an irrevocable trust dedicated for specific retirement benefits. The City's structure for prefunding OPEB is a Section 115 Trust administered by CalPERS.

UNFUNDED ACTUARIAL LIABILITY: The excess of the Actuarial Liability over the Actuarial Value of Assets.

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- Any proposed OPEB changes shall be accompanied by an actuarial valuation projecting the impact on the ADC, funded ratio, and overall OPEB actuarial liability.

4.2 <u>CalPERS Policies and Practices</u>

The City will also partner with its employee groups' representatives to explore and potentially advocate for appropriate policy changes by CalPERS, to the extent the City continues to provide retiree healthcare benefits through the CalPERS system. Such policy changes may include, but are not limited to the development of plan design changes that do not incur penalty costs under the Affordable Care Act, and the separation of rates for active and retiree healthcare plans to eliminate the implicit subsidy.

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ACTUARIAL LIABILITY: That portion, as determined by a particular Actuarial Cost Method, of the Actuarial Present Value of projected benefits which will not be paid by future Normal Costs.

ACTUARIAL PRESENT VALUE (Present Value): The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions. For purposes of this standard, each such amount or series of amounts is: adjusted for the probable financial effect of certain intervening events (such as changes in compensation levels, Social Security, marital status, etc.); multiplied by the probability of the occurrence of the event (such as survival, death, disability, termination of employment, etc.) on which the payment is conditioned; and discounted according to an assumed rate (or rates) of return to reflect the time value of money.

ACTUARIAL VALUATION: The determination, as of a valuation date, of the Normal Cost, Actuarial Liability, Actuarial Value of Assets, and related Actuarial Present Values for the Plan. The Actuarial Valuation is presented in the form of a detailed report prepared by professional actuaries.

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AMORTIZATION: The portion of the Plan contribution which is designed to pay interest on and to amortize the Unfunded Actuarial Liability.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CalPERS): CalPERS is a California state agency that administers pensions, active employee healthcare benefits, and retiree healthcare benefits for participating public employers.

DISCOUNT RATE: The estimated long-term interest yield on the investments that are expected to be used to finance the payment of benefits, with consideration given to the nature and mix of current and expected investments and the basis used to determine the Actuarial Value of Assets.

ENTRY AGE NORMAL COST METHOD: An Actuarial Cost Method under which the Actuarial Present Value of the projected benefits of each individual included in an Actuarial Valuation is allocated in a manner that produces a level annual cost over the earnings of the individual between entry age and assumed retirement age. This is the Actuarial Cost Method to be used for the City's OPEB Actuarial valuation pursuant to this policy.

EXPLICIT SUBSIDY: The Explicit Subsidy component of the City's post-employment healthcare program involves those direct payments to retirees used to offset some or all of the cost of participation in their health plans, exclusive of any Implicit Subsidy that may reduce retiree healthcare premium costs.

FUNDED RATIO: The Actuarial Value of Assets expressed as a percentage of the Actuarial Liability.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) STATEMENTS NO. 74 AND NO. 75: GASB establishes the accounting standards used in U.S. state and local government financial statements. Issued in June 2015, GASB Statements No. 74 and No. 75 set forth the accounting standards for public sector post-employment benefit retirement plans and the governments that sponsor them. GASB Statement No. 74 applies to OPEB plans that administer benefits for governments, and GASB Statement No. 75 applies to governments that participate in OPEB plans. Under GASB Statement No. 75, which is initially required for the City's FY2019 Comprehensive Annual Financial Report, the City must now reflect its full unfunded OPEB liability on its balance sheet.

IMPLICIT SUBSIDY: An Implicit Subsidy for retiree medical coverage may occur when the rates charged for active and retired employees are blended for all participants under a common plan. Because the underlying cost for retirees, on average, will be higher than the underlying costs for actives, this blended rate effectively leads to an Implicit Subsidy of the true costs for retirees in the aggregate.

NORMAL COST: That portion of the Actuarial Present Value of the Plan benefits and expenses which is allocated to a valuation year by the Actuarial Cost Method. In general terms, this represents the funding that should be set aside in each year of current service for a plan participant to ensure full funding of their post-employment benefits by the time of retirement, assuming all actuarial assumptions are met.

PAY-GO FUNDING: Also sometimes referred to as Pay-as-You-Go funding, Pay-Go Funding in the context of OPEB is the practice of paying only for the costs of benefits for those who have already retired, in contrast to prefunding post-employment benefits during a plan participant's years of active service.

PUBLIC EMPLOYEES' MEDICAL & HOSPITAL CARE ACT (PEMHCA): The PEMCHA law governs the CalPERS health programs, and includes certain requirements regarding the continuation of healthcare benefits into retirement for participating public employers.

SECTION 115 TRUST: Established under Section 115 of the Internal Revenue Code, this is an irrevocable trust dedicated for specific retirement benefits. The City's structure for prefunding OPEB is a Section 115 Trust administered by CalPERS.

UNFUNDED ACTUARIAL LIABILITY: The excess of the Actuarial Liability over the Actuarial Value of Assets.