# Retirement News Highlights

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## OPINION: Will the OPEB Ostriches Ever Run Out of Excuses?

***Many years ago, public financiers woke up to the problem of funding "other post-retirement benefits," but then some of them went back to sleep. Younger public employees should demand an actuarial wake-up call.***

By Girard Miller
***GOVERNING***
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Flash back to 2004, when the governmental accounting community began to seriously address the balance sheet and cost-accounting liabilities for "other post-employment benefits" such as retiree health care in particular, but also certain life insurance and deferred compensation arrangements — benefits provided in addition to pension distributions and known by CFOs as OPEB.

It was a time when pension accounting was moving to the corporate model for expensing the benefits when earned and booking the liabilities on employers' balance sheets, and the practice of actuarial funding through pension reserve funds was well established. Although most systems had unfunded pension liabilities, they at least had some assets on their books. Even the commonwealth of Massachusetts, once notorious for "pay-as-you-go" can-kicking, had migrated to the pension pre-funding model in the 1980s.

But there and elsewhere, OPEB benefits were largely unfunded as a matter of practice, with many public employers relying on future taxpayers to cover the costs. That's a classic violation of the concept of intergenerational equity.

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In the following years, vigorous debates centered on the best way to address the unfunded OPEB liabilities that were popping up on state and local government financial statements. Rough estimates of a trillion dollars or more of unfunded liabilities for OPEB alone captured the attention of fiscal conservatives and hawkish taxpayer advocates. But despite all that attention, the OPEB shortfall numbers have only grown since then, as baby-boom generation public workers have retired from service with completely unfunded post-employment benefits in many jurisdictions — while their replacement workforce is also being promised the same benefits using IOUs.

After staring OPEB costs in the face, many public agencies trimmed back their OPEB plans, revised their vesting requirements and age eligibility, put caps on annual stipends, or converted to defined-contribution arrangements to mitigate the long-term liabilities. But while many public employers began to follow professional best practices and fund their OPEB benefits actuarially with a reserve trust fund like a pension program's, that could not be said for others. So today, in at least 15 states and large municipalities that account for about half the public sector's unfunded OPEB liabilities, little of consequence has been done to address massive accumulated obligations. As things now stand, grade schoolers and newborn babies will have to pick up the tab when today's workers retire.

What happened? How and why did public officials in those jurisdictions put their heads in the sand, as OPEB ostriches, while others took responsible actions to address an obvious fiscal problem?

## Roots in the Great Recession

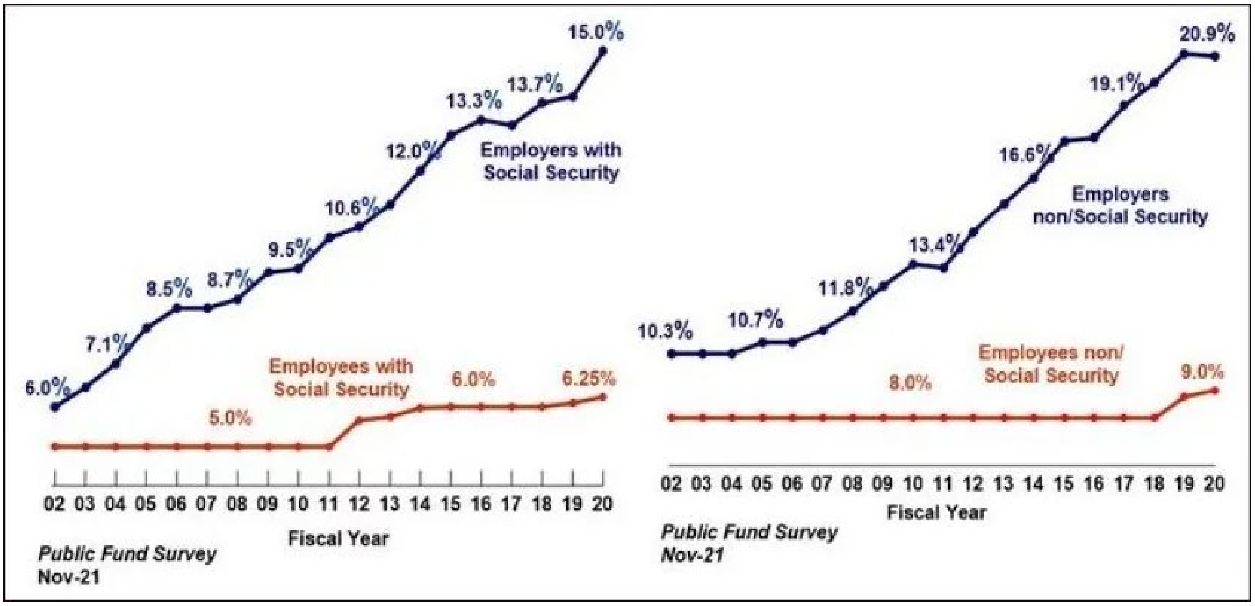
As Tolstoy wrote, "every unhappy family is unhappy in its own way," so it's impossible to generalize too much. But there are common cousins in many of these jurisdictions. The first cousins are all "victims" of the financial crisis and Great Recession of 2007-2008, which threw public budgets into a tailspin nationwide.

With layoffs the feature of the day back then, even the most diligent public budget officers faced almost impossible headwinds trying to scrape up new dollars to fund an OPEB trust fund for the first time, so progress toward installing actuarial funding was frozen in time until 2010 in many jurisdictions. At best, some employers were able to use their financial crises as a predicate for trimming benefits and mitigating the cost side of the lopsided actuarial projections.

Coming out of the Great Recession, revenues returned but rehiring took priority, and by then the worsening actuarial ratios of the public pension funds took priority over OPEB. The common thinking was that pensions were a "hard liability" like municipal bonds, whereas OPEB was a "soft liability" and hence less urgent.

On top of that, several of the now-derelict states' constitutions protected the claims of public employees to pensions as a property right. With pension hawks circling overhead in state capitols, pension reform had become a political battleground and public-employee unions saw the protection of pension rights and benefit levels as their front line of defense. OPEB could wait, as the unions and their supporters sought to shore up the pension systems and preserve those payouts as best they could. Newspapers might occasionally print a story about OPEB deficits, but those reports were a sideshow to the pension reform battles. Municipal bankruptcy courts took a similar view, treating OPEB as an expendable promise when push came to shove; the Stockton, Calif., ruling was a case in point.

By 2012, the economy had recovered sufficiently to enable most public employers to provide modest wage increases and normalize their staffing and payrolls, but pension costs kept escalating each year as the multiyear asset-smoothing process, aimed at reducing the impact of short-term market volatility, and tighter, more-realistic actuarial assumptions took hold and continued to push employer contribution rates higher and higher. The two charts below, from the National Association of State Retirement Administrators' annual survey report, depict the truly dramatic increase in pension costs as an average percentage of payroll that most states and localities experienced in the past decade.




As one stalwart finance officer once told me, "Our pension funds basically sucked up all the new revenue we'd been hoping to set aside to properly fund OPEB." Those and other priorities for spending each incremental revenue dollar continued to crowd out the opportunity to institute consistent actuarial funding for OPEB benefits; the path of least resistance for policymakers who lack foresight and a sense of fiscal responsibility has been to keep kicking the can.

So it is that between 2015 and 2019, the state and local sector had clearly sorted itself into three classes of employers: (1) those who had trimmed or modified their OPEB commitments and liabilities to sustainable levels, (2) those who had begun actuarial funding of an OPEB trust fund, and (3) those doing nothing and leaving the problem to their successors and future taxpayers.

## More Excuses for the Ostriches

Then, in 2019, the national political spotlight shifted to the Democratic presidential primaries, providing a climate that supported the most guileful of the can-kickers by providing their next excuse to keep doing nothing about OPEB: "Medicare for All" became a rallying cry in blue states, and that campaign theme became the Next Great Excuse for doing nothing about public employees' retirement health-care funding.

After all, what would be the point of pre-funding retiree medical benefits locally if Uncle Sam was inevitably going to pick up the tab? Why not let federal taxpayers foot the bill? Never mind that the current Medicare trust funds will be depleted by 2026 under the current benefit formulas.

Then came the COVID-19 pandemic, the latest in this litany of ostrich excuses. Even though states and localities came through the fiscal gauntlet of the past two years in relatively good shape fiscally, the last thing on most politicians' and constituents' minds now is the funding of employees' retirement health care. It's about as low on the list of political candy and priorities as one can imagine. In addition, the 2021 American Rescue Plan, providing bipartisan federal fiscal aid to states and municipalities, explicitly prohibited use of those funds for public pensions. It's not entirely clear whether the statute barred funding of OPEB, but so far at least I've been unable to locate a single public employer who tried to wiggle around the pension-haters' congressional language to use that money to fund an OPEB contribution. One need only look at the myriad uses that federal COVID-19 relief funds have been allotted — with nary a penny for OPEB.

As the economy emerges from the current pandemic uncertainties into a reliable growth phase, it's time for the states, municipalities and public agencies that have short-sheeted their younger workers with hollow OPEB promises to finally pay the kitty. Medicare may get reformed, but it will never be free in the foreseeable future. Perhaps we'll someday see a public option that provides Medicare access to early-out retirees and their former employers at cost (which is now about $1,000 monthly pre-65), but that's hardly the free lunch that the OPEB ostriches are fantasizing. Public employees aged 40 and under should demand that their promised benefits be funded when earned, or go to work someplace where the leadership doesn't feign belief in miracles and an alternative fiscal reality.

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