Government Finance Officers Association

BEST PRACTICE

Ensuring Other Postemployment Benefits (OPEB) Sustainability

BACKGROUND:

Compensation packages for active workers may include health-care and other similar benefits for employees who have completed their active service. Generically, these benefits are described as other postemployment benefits (OPEB) to distinguish them from pensions.[1] As with defined benefit pension plans, OPEB can represent a significant challenge in terms of its funding and long-term sustainability. Meeting this challenge will require government finance officers to ensure that these benefits are sustainable over the long term – that they are affordable to stakeholders, competitive, and sufficient to meet employee needs, and that they may be reasonably expected to remain so.

RECOMMENDATION:

GFOA recommends that governments ensure OPEB sustainability by evaluating key items specifically related to OPEB, including the structure of benefits offered, the associated benefit cost-drivers, and clear communication to stakeholders.[2] The following describes these items in more detail:

1. **Structural Considerations.** Financing other postemployment benefits as they are earned (prefunding) rather than as they come due (pay-as-you-go funding) offers significant advantages in terms of equity and sustainability and should be formalized through a specific funding policy for postemployment benefits – see GFOA's *Sustainable Funding Practices for Defined Benefit Pensions and Other Postemployment Benefits* best practice.[2] In addition, consider the following when determining a funding approach:
    1. Require employee contributions.
    2. Refrain from offering incentive packages for early separation without first considering their impact on OPEB costs.[3]
    3. Do not issue OPEB bonds to fund liabilities.[4]
2. **Managing Costs of Benefits Offered.** Carefully evaluate and design benefits to help control costs and ensure that postemployment benefits are sustainable. This can include the following:
    1. Implement health-care cost containment measures.[5]
    2. Improve coordination with Medicare benefits (e.g., adjusting the amount of the OPEB benefit provided to retirees once they are eligible for Medicare or offering the OPEB benefit only to retirees who are not eligible for Medicare).
    3. Monitor proposed changes related to Medicare and analyze resulting impacts.
    4. Clearly define responsibilities related to Medicare in order to ensure timeliness of the organization's response to any proposed changes.

5. Monitor other proposed changes to laws and regulations that could affect the benefits provided.
6. Develop vesting rules that provide levels of benefits based on years of service.
7. Establish eligibility rules that avoid including retirees, dependents, and spouses who are otherwise insured.
8. Consider a tiered system of benefits based on hiring dates.
9. Consider whether to continue using the same blended or common health-care premium for both retirees and active employees (i.e., the implicit rate subsidy), if allowed.
10. Limit annual increases to an index other than medical cost inflation.
11. Raise the eligibility age for OPEB.
12. Offer a fixed[6] subsidy or service-based[7] subsidy – which is not affected by increases in health-care costs – that the government will put toward retiree's health-care premiums to partially offset the cost.
13. Consider reserving the highest level of health-care premium subsidy for those who have been employed for a full career, as defined by the jurisdiction, but no earlier than the normal retirement date defined by the jurisdiction's pension plan.
14. Consider applying a subsidy amount for retirees who are eligible for Medicare.

3. **Trust Funds.** Create a qualified trust fund to prefund OPEB obligations.[8]
4. **Communicate.** Governments need to determine how to most effectively communicate with and educate affected stakeholders about the impact of decisions made regarding OPEB:
    1. Always consider OPEB as an integral part of an employee's total compensation package.
    2. Avoid benefit reductions that place an undue burden on employees or risk making the government uncompetitive as an employer.

Notes:

1. Some government employers choose to augment other elements of employee compensation rather than providing OPEB.
2. See GFOA's best practice, *Sustainable Funding Practices for Defined Benefit Pensions and Other Postemployment Benefits Plans* (2016).
3. See GFOA's advisory, *Evaluating the Use of Early Retirement Incentives* (2004).
4. See GFOA's advisory, *OPEB Bonds* (2016).
5. See GFOA's best practice, *Strategic Health Care Plan Design* (2009).
6. For example, a fixed amount of $250 per month for employees who have met requirements.
7. For example, if the government applies $10 a month for each year of service, a retiree who had worked for 30 years would receive $300 a month toward his or her pre-Medicare health-care premium.
8. In situations where the implicit rate subsidy is not prefunded, it may be unnecessary to use a trust. Under the implicit rate subsidy, retirees are allowed to pay the same rates as active employees, even though their age-adjusted premium would have been higher.

Applicable to Canadian Governments:

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