



PUBLIC AGENCY
RETIREMENT SERVICES

THE ROLE OF SECTION 115 TRUSTS IN MANAGING RETIREMENT COSTS AND OBLIGATIONS

Presented By:
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AGENDA

1. Current State of Public Pensions and Retiree Healthcare
2. Pension
3. OPEB
4. Managing Pension & OPEB Collaboratively
5. Q&A

CHALLENGES WE'RE FACING

Uncertainty

Investment/Market Fluctuation

Rising Pension/OPEB Costs

Competing Budget Priorities

“Figuring It Out” Too Late

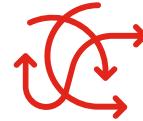
VUCA



Volatility



Uncertainty



Complexity



Ambiguity

STATUS OF RETIREMENT BENEFITS

The **Urban Institute** states that unfunded pension liabilities for state and local governments are estimated at \$4-6 trillion nationally.

- Liabilities for the 50 largest local governments alone total \$450 million

Additionally, state and local governments have over \$1 trillion of net liabilities for other post-employment benefits (OPEB) according to the **American Legislative Exchange Council (ALEC)**.

- This equates to over \$3,100 for every resident of the United States

According to **Moody's Investor Services**, pension liabilities are the largest long-term liability for many local governments

MANAGING PENSION COSTS AND LIABILITIES

WHAT RETIREMENT PLANS ARE AVAILABLE?

Defined Contribution Plan - 403b, 457 (or 401k; private sector only)

- ✓ A Defined Contribution (DC) plan is a type of retirement plan in which the employer, employee, or both make contributions on a regular basis.
- ✓ Individual accounts are set up for participants and benefits are based on the amounts credited to these accounts (through employee contributions and, if applicable, employer contributions) plus any investment earnings on the money in the account.
- ✓ *Employee is at risk to provide benefits.*

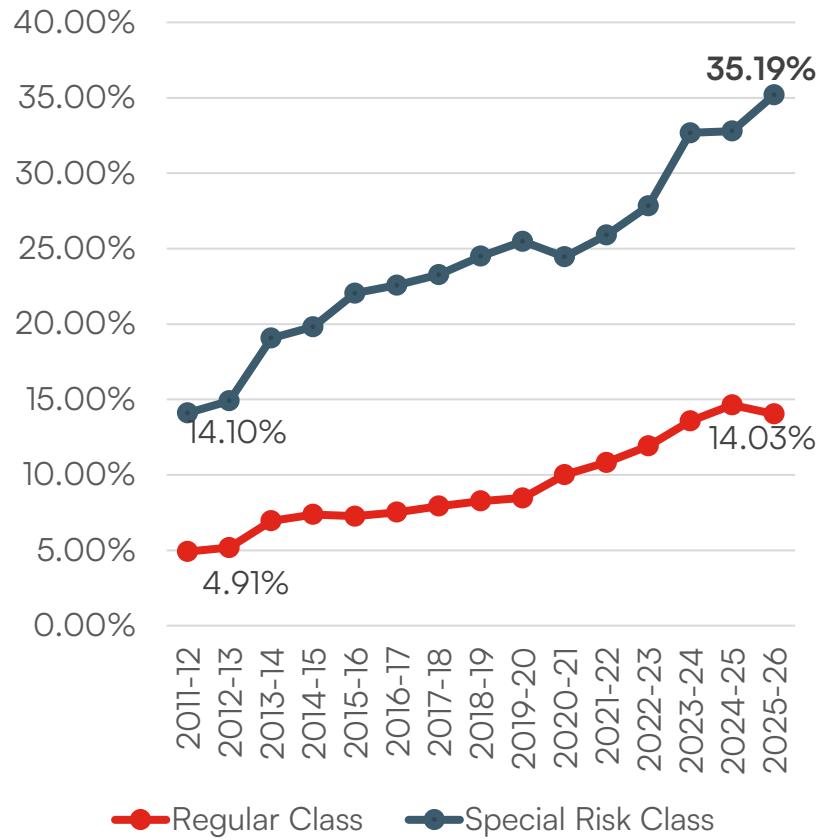
Defined Benefit Pension Plan

- ✓ A Defined Benefit Plan (DB) is an employer-sponsored retirement plan where employee benefits are computed using a formula that considers several factors, such as length of employment and salary history.
- ✓ *Employer is at risk to provide benefits.*

CONTRIBUTION RATE VOLATILITY

ASSUMPTIONS	ACTUAL EXPERIENCE
<ul style="list-style-type: none">• Discount Rate• Amortization period• Wage Growth• Longevity• Inflation• Payroll Growth• Demographic (mortality, etc.)	<ul style="list-style-type: none">• Investment Returns• Wage Growth• Payroll Growth

EXAMPLE: FRS EMPLOYER CONTRIBUTION RATE INCREASES



Data from Florida Retirement System's Employer Statutory Contribution Rates found at https://frs.fl.gov/forms/2023-24_contributions.pdf and https://frs.fl.gov/forms/2015-16_contributions.pdf

Fiscal Year	Regular Class	Special Risk Class
2011-12	4.91%	14.10%
2012-13	5.18%	14.90%
2013-14	6.95%	19.06%
2014-15	7.37%	19.82%
2015-16	7.26%	22.04%
2016-17	7.52%	22.57%
2017-18	7.92%	23.27%
2018-19	8.26%	24.50%
2019-20	8.47%	25.48%
2020-21	10.00%	24.45%
2021-22	10.82%	25.89%
2022-23	11.91%	27.83%
2023-24	13.57%	32.67%
2024-25	13.63%	32.79%
2025-26	14.03%	35.19%

OPTIONS FOR ADDRESSING PENSION COSTS

Options for Addressing Pension Costs

1

Make additional discretionary payments

2

Prefund into a contingency reserve fund

3

Issue pension obligation bonds/certificates of participation

4

Prefund into an IRS Section 115 Trust

5

Use above options in combination with each other

WHAT IS A SECTION 115 PENSION PREFUNDING TRUST?



Irrevocable

Assets can only be accessed for pension costs



For Defined Benefit Plans

Can set aside funds for state or individual pension systems



Exclusive Benefit

Assets are protected for the exclusive benefit of employees, retirees, and beneficiaries



Diversified Investments

Allowed in accordance with state law

BENEFITS OF PREFUNDING PENSION OBLIGATIONS



When contribution rates rise, assets can be transferred to the retirement system to pay or offset contribution rate increases



Agencies maintain local control over their contributions, disbursements, and investments



Assets can be diversified for potentially greater returns



Funds are protected from diversion for other uses



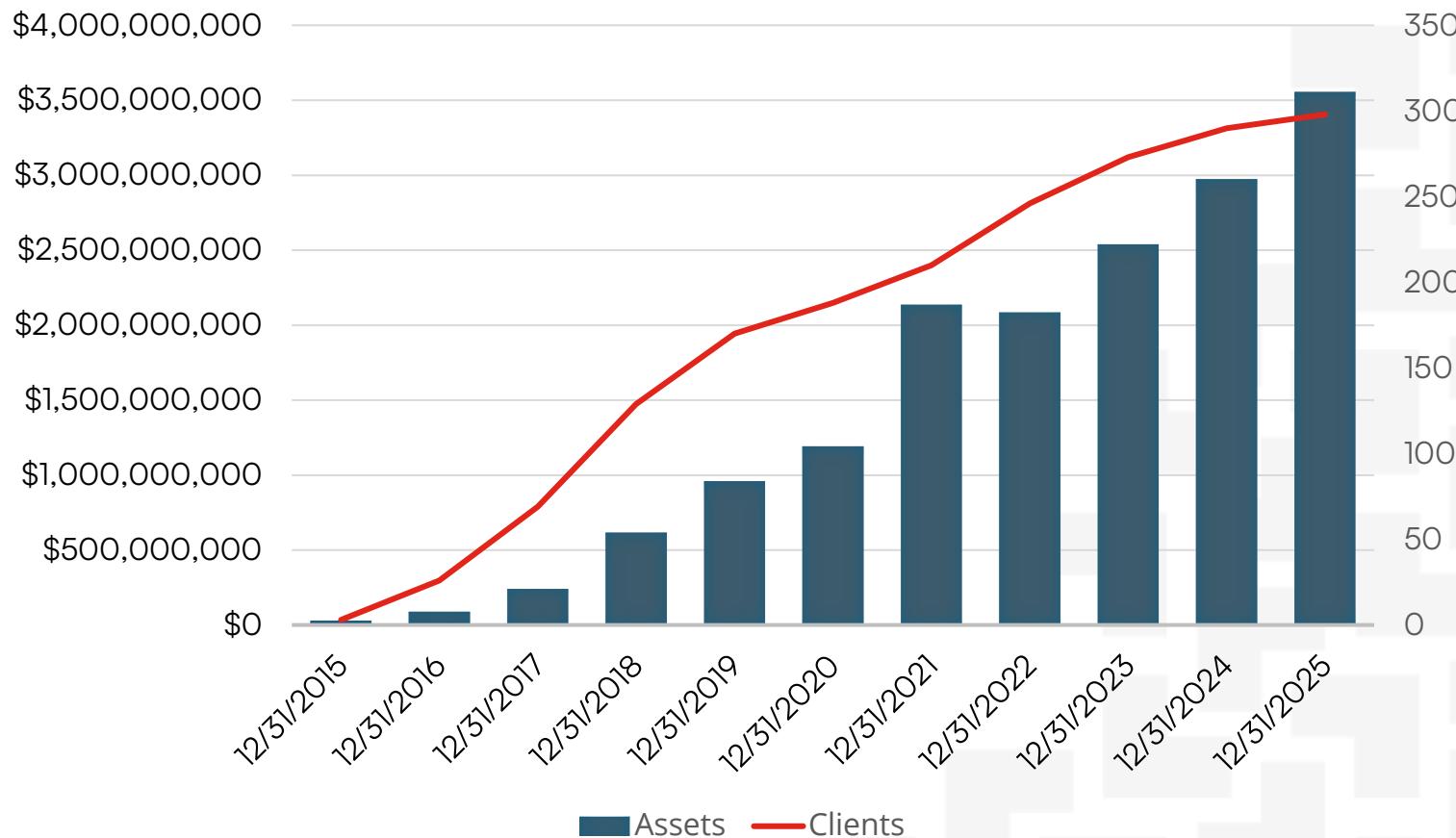
Assets can be transferred to the retirement system at the agency's direction, potentially reducing or eliminating large fluctuations in employer contribution amounts



Assets can be used as an emergency source of funds for pension-related costs under adverse economic or other conditions

GROWTH OF PENSION PREFUNDING

The following chart shows the client and asset growth since 2015 of one of the nation's largest pension prefunding trusts:*



*Data shows growth of PARS' IRC Section 115 Pension trust from 2015 to 2025. Data is provided by PARS.

MANAGING OPEB COSTS AND LIABILITIES

WHAT IS OPEB?

- Other post-employment benefits (**OPEB**) are all post-employment benefits other than pension income (death benefits, life insurance, disability, and **healthcare**, etc.) that are provided to employees by employers.
- In 2004, the Governmental Accounting Standards Board (**GASB**), a not-for-profit organization that sets generally accepted accounting principles (“GAAP”) called for OPEB, i.e., projected benefit payments to be reported as liabilities.

GASB Statement Nos. 43 and 45:

Required for state and local governments to quantify and report on the size of OPEB liabilities

GASB Statement Nos. 74 and 75:

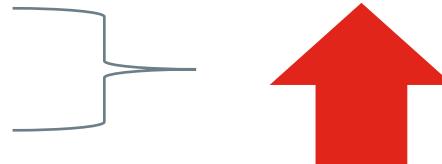
Changed the way state and local governments measure and report OPEB plan benefits in accordance with Statement No. 68 for pension benefits

GASB 75 DISCOUNT RATE REQUIREMENTS

Impact on Unfunded Liability and Costs

1. Pay-Go

Discount rate equal to 20-year high grade municipal bond rate (e.g., Bond Buyer GO 20 Index)



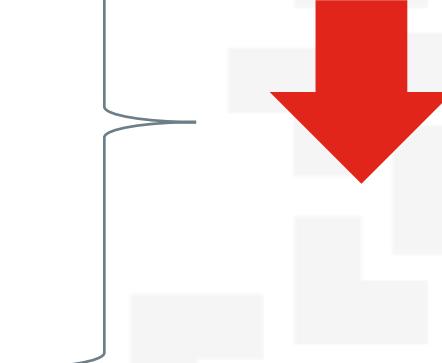
2. Prefunds Section 115 Trust

Long-term trust expected rate of return



3. Funding is greater than #1 and less than #2 above

A blended discount rate is developed on a year-by-year projection of the sufficiency of trust assets



OPEB FUNDING STATUS EXAMPLE

	Pay-as-You-Go Discount Rate: 3.69%	Percent Change	1% Increase in Discount Rate: 4.69%
Total OPEB Liability (TOL)	\$164,055,184	10.77%▼	\$ 146,386,462
Fiduciary Net Position	\$0	--	\$0
Net OPEB Liability (NOL)	\$164,055,184	10.77%▼	\$ 146,386,462
Funded Ratio (%)	0.00%		-
Annual Benefit Payments	\$7,753,833	--	\$7,753,833

Rule of thumb: For every one percent increase in the discount rate, the unfunded liability is lowered by 10-12%.

- Actual data taken from a County's Annual Financial Statements as of June 30, 2023

WHAT ARE THE OPTIONS?

1

Continue with
pay-as-you-go.

2

Set money aside in
the **General Fund**
or a stabilization
account.

3

Prefund using an
IRS Section 115
Trust.

WHY PREFUND VS. PAY-AS-YOU-GO?



Contributions are considered assets on financial statements



Assets in the trust can be diversified for a potentially greater rate of return



Actively addressing future obligations can favorably impact credit ratings



Prefunding can help against inflation, longer life expectancies, and retirement surges



Future taxpayers and employers will not bear a disproportionate burden of costs



Funds in an OPEB Trust are dedicated for future costs and are protected from diversion



Prefunding helps to offset the financial impact of GASB 75.

IMPEDIMENTS OF PREFUNDING

Knowledge

Legislation

Education

Perceived Cost

Lack of Money

Long-Term/Future Issue

Trust Irrevocability

TRUST VS. RESERVE ACCOUNT

Budget Reserve Account

Fixed income investing only

Investments not tailored for long-term use

Revocable

Can be accessed for other uses

Unprotected from creditors

No corporate trustee

Trust

Fixed Income or diversified investing available

Can be tailored for short or long-term use

Irrevocable (for non-OPEB expenses)

Dedicated solely for retiree healthcare costs

Exclusive benefit/protected from creditors

Corporate trustee to mitigate fiduciary risk

IS YOUR TRUST TRUSTWORTHY?

What makes a trust trustworthy?

✓ Trustee and Trust Agreement/Documents are a must. Trust must comply with GASB, IRS, state, and federal rules/laws

✓ GASB requires that OPEB Trust must be:

- Dedicated solely for retiree healthcare
- Irrevocable
- Free from creditors

✓ Assets must be held separately from other city, town, or district funds

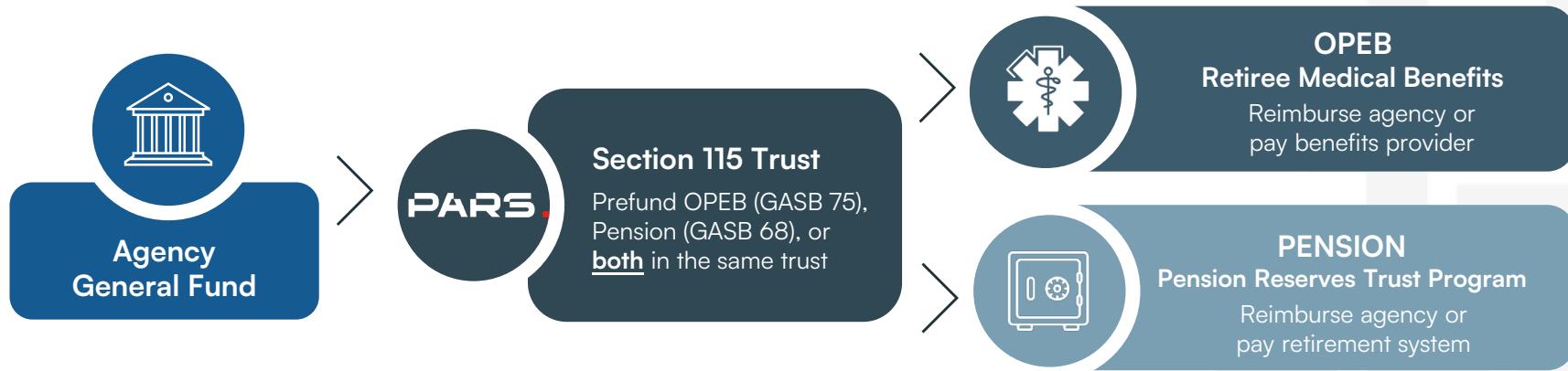
✓ Funds can revert to employer only when no beneficiaries of the plan remain

✓ Exclusive benefit of employees, retirees, and beneficiaries

✓ Cannot diversify investments without a proper trust

COMBINED PENSION & OPEB MANAGEMENT

THE COMBINATION TRUST APPROACH



1 SUBACCOUNTS

OPEB and Pension assets are individually sub-accounted, and can be divided by dept., bargaining group, or cost center

2 FLEXIBLE INVESTING

Allows separate investment strategies for OPEB and Pension subaccounts.

3 ANYTIME ACCESS

Trust funds are available anytime; OPEB for OPEB and Pension for Pension.

4 FINANCIAL STABILITY

Assets in the trust can be used to address unfunded liabilities

ELEMENTS OF AN INVESTMENT POLICY

 Time horizon

 Funded status

 Funding plans

 Risk tolerance

 Goals

 Structure

 Oversight (roles and responsibilities)

CREATE A FUNDING STRATEGY

It is important to create a Funding Policy to manage long-term costs

Funding options may include:

- A. Put in set amount annually \$1,000,000
- B. Put in set amount and then reimburse for OPEB/pension at end of year \$1,000,000 - \$500,000
- C. Put in money for OPEB one year and pension the next \$500,000
- D. Put in one-time lump sum amount and leave it to grow \$5,000,000
- E. Put in anything — something is better than nothing! ?

HOW DO YOU FIND MONEY FOR A TRUST?

1

Line item in the operating budget

2

Percentage of surplus funds at the end of the year

3

Dedicate funds from a revenue source (e.g., meals tax)

4

Surplus retiree healthcare costs at the end of the year

5

Redirect pension allocation (either now or in the future) to either the pension or OPEB Trust account

SUMMARY: BENEFITS OF PREFUNDING

Reasons to set aside money in a trust include:

- 1.** To have funds available when annual rate increase arise
- 2.** To maintain the pension/OPEB plan's funding ratio
- 3.** To pay down the agency's pension and/or OPEB liability
- 4.** To grow a surplus of funds for use in economic or budgetary downturns
- 5.** To earmark pension or retiree healthcare assets for use at a later date
- 6.** To try and earn more than the General Fund
- 7.** To diversify the agency's investments
- 8.** To help maintain a set reserve level

QUESTIONS?

THANK YOU FOR ATTENDING!

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