

Credit FAQ:

How S&P Global Ratings Will Implement Pension And OPEB Guidance In U.S. Public Finance State And Local Government Credit Analysis

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On Oct. 7, 2019, S&P Global Ratings published "Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Benefit Obligations For GO Debt, Local Government GO Ratings, And State Ratings Methodology." Here, we answer the most frequently asked questions from investors and other market participants.

Elsewhere, we have also provided an overview on our approach to U.S. state and local government pensions within the context of our three government criteria: See "Credit FAQ: Quick Start Guide To S&P Global Ratings' Approach To U.S. State And Local Government Pensions," published May 13, 2019.

Frequently Asked Questions

What is criteria guidance?

Guidance documents are not criteria, as they do not establish a methodological framework for determining credit ratings. Guidance documents provide guidance on various matters, including articulating how we may apply specific aspects of criteria, describing variables or considerations related to criteria that may change over time, providing additional information on nonfundamental factors that our analysts may consider in the application of criteria, and/or providing additional guidance on the exercise of analytical judgment under our criteria.

When will the guidance become effective?

The guidance is immediately effective upon publication. We will apply the guidance to all new issues and surveillance reviews.

What is covered by the guidance?

This document provides additional information and guidance related to our analysis of pensions and other postemployment benefit (OPEB) liabilities in our criteria, "GO Debt," published Oct. 12,

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2006; "Local Government GO Ratings Methodology And Assumptions," published Sept. 12, 2013; and "U.S. State Ratings Methodology," published Oct. 17, 2016. It is intended to be read in conjunction with those criteria.

Will ratings change as a result of the published guidance?

We expect no rating changes due to the publication of guidance, as the purpose of this guidance is to provide clarity on important pension and OPEB factors, including actuarial inputs, which we consider in applying our existing criteria. Our analysts consider the guidelines for assumptions and methods within the context of an obligor's overall credit profile, including its ability to afford rising costs and proactive management measures to address them. Our pension and OPEB analysis includes how these risks factor into an obligor's unique overall credit profile and what strengths or weaknesses arise as a result. Because guidance articulates and provides transparency about application of existing criteria, it does not necessitate a review of existing ratings covered by these criteria.

How will the guidance affect enterprises that participate in government-sponsored plans?

The guidance applies only to entities within the scope of cited government criteria. However, the guidelines on pension and OPEB funding assumptions and methods, and their impact on governments' projected costs and liabilities, may inform our analysis of enterprises participating in government-sponsored plans. For example, the guidelines may inform our expectations about projected funded ratios over time.

Will the guidance change over time?

Yes, it might. Specifically, the market periodically changes, and the discount rate and long-term medical trend guidelines may be adjusted to align with updated capital market assumptions and medical trend models.

Will the rating reports change?

Rating rationales will continue to provide S&P Global Ratings' opinion on key credit factors identified in the three government criteria associated with this guidance. To the extent that a particular actuarial assumption or method rises to the level of a driving factor of our forward-looking view of the entity, we will highlight it in our rating analysis.

Are there certain guidelines that are most important to credit analysis?

Pension and OPEB analytics are one factor of our credit score, and within that context, the discount rate and overall funding discipline are important considerations.

The discount rate is important because it is used in the measurement of the reported funding level. It also correlates with the assumed rate of return, which drives calculations for actuarially determined contributions (ADCs). We also view the government's progress toward paying down its liabilities as an equally important, if not more important, driver for a given entity. Our evaluation of funding discipline and progress includes whether or not a government fully funds its ADC and

minimum funding progress (MFP) metric, which assesses progress in paying down liabilities in a given year.

Is S&P Global Ratings adjusting reported pension/OPEB liabilities or ratios based on the discount rate guideline described in the guidance?

No. We incorporate liabilities for ratings as reported under Governmental Accounting Standards Board standards. The discount rate guideline serves to inform our view of potential for escalating contributions and susceptibility to market volatility. In addition, there are many instances where the guideline may not be appropriate for a given plan because of atypical plan characteristics.

The guidelines refer to a "typical plan"; what is an atypical plan?

Examples of atypical plans may include:

- Plans that have automatically adjusting cost of living adjustments or other risk-sharing controls in place to limit contribution escalation,
- Plans with demographics that do not align with the national average,
- Plans that are closed to new entrants, or
- Other factors that lead to different contribution volatility tolerances.

How does S&P Global Ratings evaluate governments that participate in a statewide plan and do not directly govern plan actuarial methods or assumptions?

Our pension assessment incorporates our view of the risk that contributions will escalate, regardless of whether a particular issuer has direct management over actuarial methods or assumptions. If the cost-sharing plan is measuring liabilities using aggressive assumptions or paying unfunded liabilities using aggressive amortization methodologies, then there may be escalating risk that participating employers will be required to increase contributions in the future. We will incorporate our view of each individual entity's ability to plan and manage for potentially rising costs, as well as the pension environment in the state where the entity is located.

Does the guidance address the possibility of a market shock?

Yes. Our discount rate guideline incorporates a reasonable expected limit to contribution volatility when factoring in liquidity and market risks.

Why does S&P Global Ratings use 30 as a factor in the MFP calculation?

The 30 is a factor that leads to a reasonable amount of principal unfunded liability to be paid down in a given year; it does not equate to amortization years. If a plan is meeting the MFP metric, we would expect that the contribution is equivalent to one with an amortization of less than 20 years.

How did S&P Global Ratings arrive at 20 years for the amortization period guideline?

The risk of negative amortization is mitigated when the length of amortization is 20 years or less. Furthermore, a typical U.S. pension plan is likely to have a working population that is expected to average nearly 20 years of employment before retirement, so an amortization of less than 20 years reduces the likelihood of intergenerational inequity, meaning that the funding of an employee's benefits would occur during that employee's tenure.

Related Criteria And Research

Related Criteria

- U.S. State Ratings Methodology, Oct. 17, 2016
- Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- GO Debt, Oct. 12, 2006

Related Research

- Credit FAQ: Quick Start Guide To S&P Global Ratings' Approach To U.S. State And Local Government Pensions, May 13, 2019
- The Increasing Cost Of Governmental Pensions: Discount Rate And Contribution Practices, Sept. 27, 2018
- Looking Forward: The Application Of The Discount Rate In Funding U.S. Government Pensions, Sept. 13, 2018
- Report Explains The Difference Between Criteria And Guidance, Dec. 15, 2017
- Local Government Pension and Other Postemployment Benefits Analysis: A Closer Look, Nov. 8, 2017

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