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Diverging Trends Underlie Stable Overall U.S. OPEB Liability

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Diverging Trends Underlie Stable Overall U.S. OPEB Liability

Total unfunded state other postemployment benefit (OPEB) liabilities have been stable, according to Standard & Poor's Ratings Services' latest survey of U.S. states OPEB liabilities, decreasing by only 0.1% compared with our previous report (published Nov. 25, 2013, on RatingsDirect). In that report, we found that unfunded state OPEB liabilities actually declined 3% between our 2011 and 2013 survey, suggesting an emerging trend of overall stability despite the fact that the actuarial accrued liability for most state OPEB remains largely unfunded. Although the largely unfunded status of OPEB trusts, pay-as-you-go funding by most states, and the rising costs of health care would suggest rising OPEB liabilities over time, we believe proactive measures by some states to address OPEB liabilities have slowed the growth in total unfunded liabilities in the past several years.

We have seen regular instances of states implementing OPEB reform, which we have highlighted in our surveys of state OPEB since 2009, following GASB disclosure requirements. Our current survey highlights a few states that have had large absolute declines in their actuarial OPEB liability as reported in the last year after making changes to plan design or committing themselves to pre-fund their OPEB with corresponding changes in actuarial assumptions. Funding ratios have also improved slightly for most states that have established OPEB trusts, and changes to certain states' OPEB plan design or eligibility requirements have also led to declines. Other states have relatively minimal liabilities or implicit rate subsidies that are not likely to change significantly from year to year. Conversely, some states continue to report rising OPEB liabilities that could eventually pressure budgets and credit unless addressed.

Overview

- Unfunded OPEB liability across states totaled \$529.8 billion as of the most recent valuation reports, practically unchanged from our 2013 survey, although trends diverge across states.
- Total OPEB liability is largely unfunded across states, but overall funding ratios have improved slightly for states that have established OPEB trusts.
- Benefits vary widely among states and OPEB liabilities are reported using different actuarial cost methods and amortization periods.

OPEB Offered By States Vary

State OPEB benefits primarily represent retiree health care benefits, although they could also include retiree life insurance, disability, or other benefits offered to retired government workers. States offer varying OPEB benefits and administer these benefits through single-employer or multiple-employer plans. More than a third of states administer the largest portion of their OPEB liability through a cost-sharing, multiple-employer plan the state shares with many participating employers -- including local governments and non-state entities in some cases -- which obscures the state's share of the liability. North Carolina, for example, offers OPEB through its State Health Plan to state employees as well as to community colleges, local school boards, and local government employees. At one end of the spectrum,

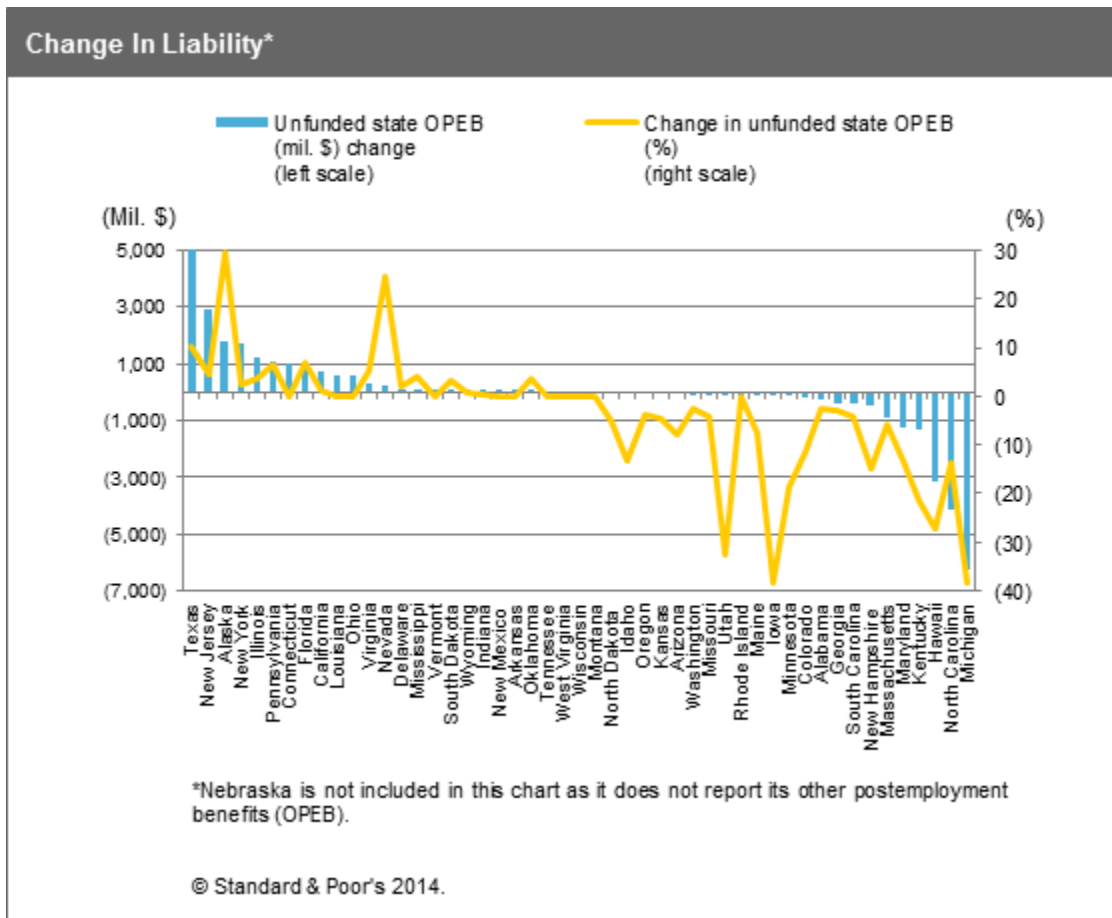
some states offer limited benefits or report only a small implicit rate subsidy because they allow higher-cost retirees to participate in a state's health care plan with active employees. At the other end, some states offer generous benefits funded on a pay-as-you-go basis. Actuarial estimates differ depending on the actuarial cost method used as do actuarial assumptions related to health care cost trends, discount rates, and amortization periods, among others.

We believe the recent proposal by the Governmental Accounting Standards Board (GASB) to conform future OPEB reporting to many of the same features as the new GASB 67 and 68 standards for pension reporting -- such as proportional reporting of the OPEB liability at the employer level for multiple-employer cost-sharing plans and the use of one actuarial cost method -- could enhance the ability to compare reported OPEB liabilities across states. Although the proposal divorces actuarial funding and its disclosure from the OPEB liability, which could obscure information on a state's funding progress in future comprehensive annual financial reports (CAFRs), the proposed GASB measures could also prompt states to implement additional reform and focus on long-term funding just as the most recent GASB reporting requirements (GASB 43 and 45) heightened awareness of these long-term OPEB liabilities and spurred reform in many states (see GASB article, entitled "Proposed GASB Changes To OPEB Reporting Could Enhance Comparability But Reduce Information On Funding Progress," to be published on RatingsDirect following this report).

States That Commit To OPEB Funding Or Reform Report A Decline In OPEB Liabilities

Our survey found that the unfunded OPEB liability across states totaled \$529.8 billion as of the most recent valuation reports, unchanged from our 2013 survey. Despite this overall stability, several states have reported large changes in their actuarial unfunded liability since our last survey (see chart 1). The largest absolute decline in unfunded OPEB liabilities based on updated OPEB valuations in the past year occurred in Michigan, North Carolina, and Hawaii. Michigan recorded a \$6.3 billion decline in its OPEB unfunded actuarial accrued liabilities (UAAL) as of September 2012 compared with September 2011, reflecting a change in the assumed discount rate used for its state and state police retirement system liabilities to 8% from 4% after it established an OPEB trust and capped benefits. North Carolina's UAAL declined by \$4.1 billion or 14% as of December 2013 compared with December 2011, reflecting changes the state made to plan design and increased employee premiums. Hawaii's OPEB UAAL fell by \$3.2 billion (or 27%) as of July 2013, compared with the last valuation, assuming a higher discount rate after the state established a new funding policy to meet the OPEB actuarial required contribution (ARC) by 2019. In contrast, Texas posted the largest absolute increase in OPEB UAAL with a \$5.7 billion, or a 10% increase as of August 2013 compared with the last actuarial valuation primarily due to ongoing payroll and salary growth.

Chart 1



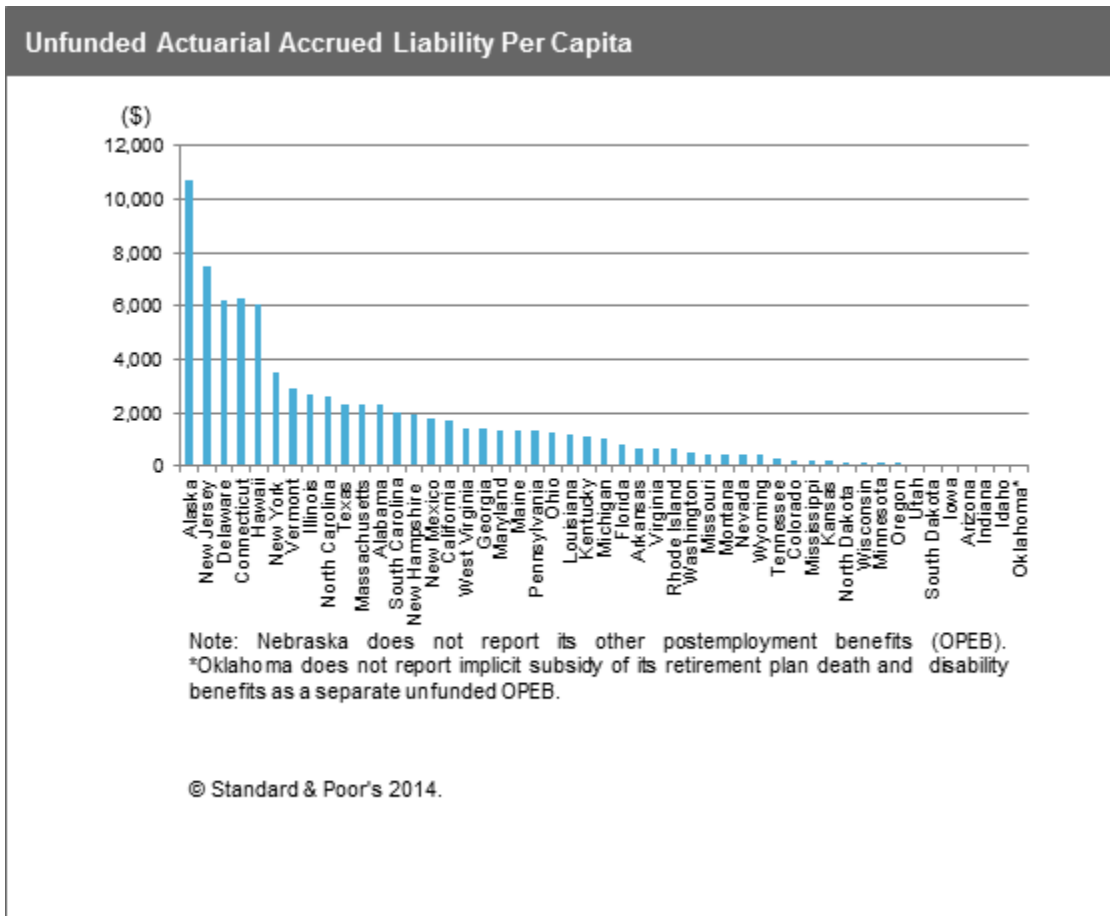
Most States Have Some Flexibility to Make Changes

Most states may not be contractually obligated to provide OPEB, unlike pension liabilities, and have the flexibility to cut OPEB by changing eligibility, increasing employee contributions, or eliminating the benefit altogether. South Dakota, for example, has historically recorded a low implicit rate subsidy for OPEB, but recently increased retiree contribution rates to eliminate the blended subsidized premium and to better reflect the respective cost. As such, state officials expect to report no OPEB liability in South Dakota's next valuation. Notably, at the local government level, both Detroit and Stockton recently eliminated retiree health care benefits through settlements and as part of their restructuring plans in bankruptcy. In contrast, the legal framework and contractual limitations in some states, such as Illinois and Connecticut, pose obstacles to OPEB reform. In Illinois, for example, the state supreme court recently ruled that health insurance premium subsidies are a benefit of membership in a pension or retirement system -- a decision that could impede OPEB reform the state had authorized in 2012.

Given the different levels of benefits, actuarial assumptions, and multiple-employer participants in an OPEB plan, exact comparisons among states is difficult. Nevertheless, we believe it's still possible to make general credit distinctions among states with high and low unfunded OPEB.

Excluding Oklahoma, which doesn't report a minimal capped subsidy for retirement plan death and disability benefits as a separate unfunded OPEB, Idaho has the lowest OPEB per capita at \$45. Alaska, when including the teachers plan in this year's survey, posts the largest per capita liability at \$10,726, surpassing Hawaii. The median state unfunded OPEB in our survey was \$1,023 per capita and an average of \$1,656 per capita.

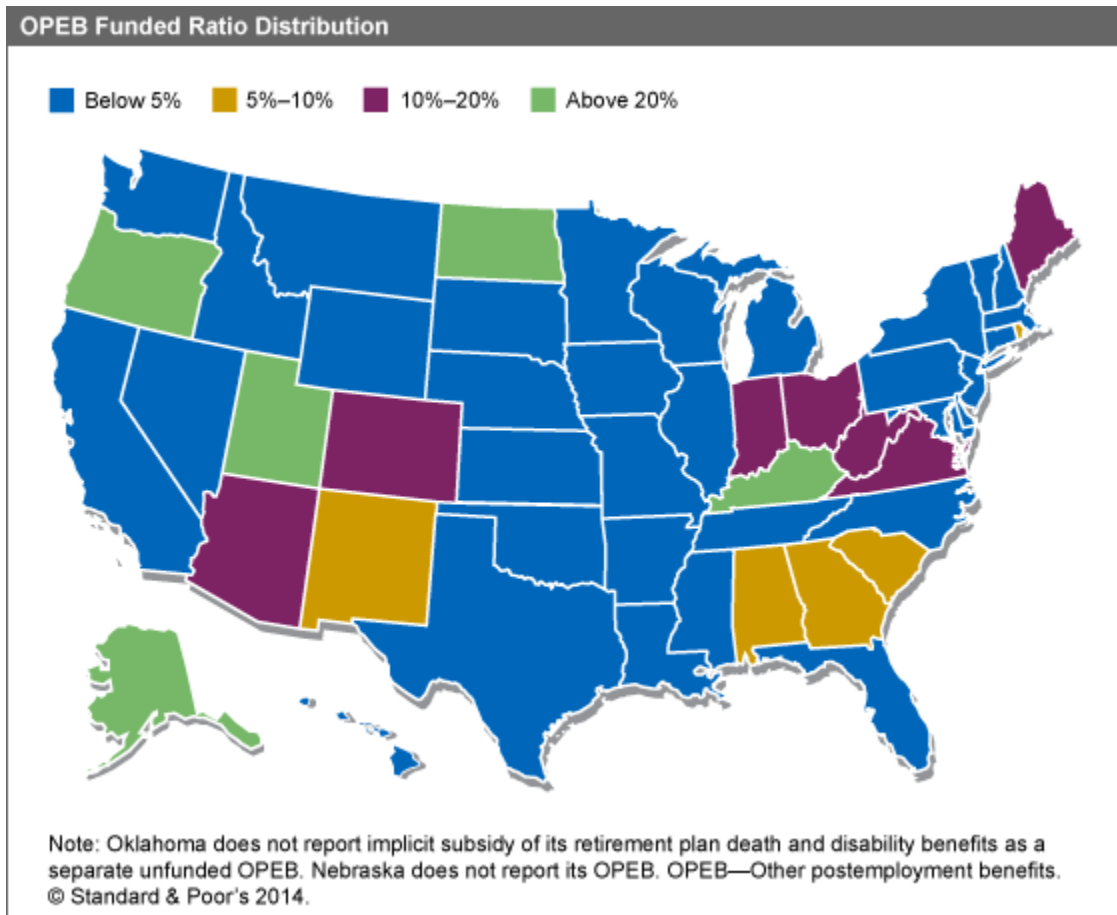
Chart 2



Funding Methods Vary, But More States Are Establishing Trusts

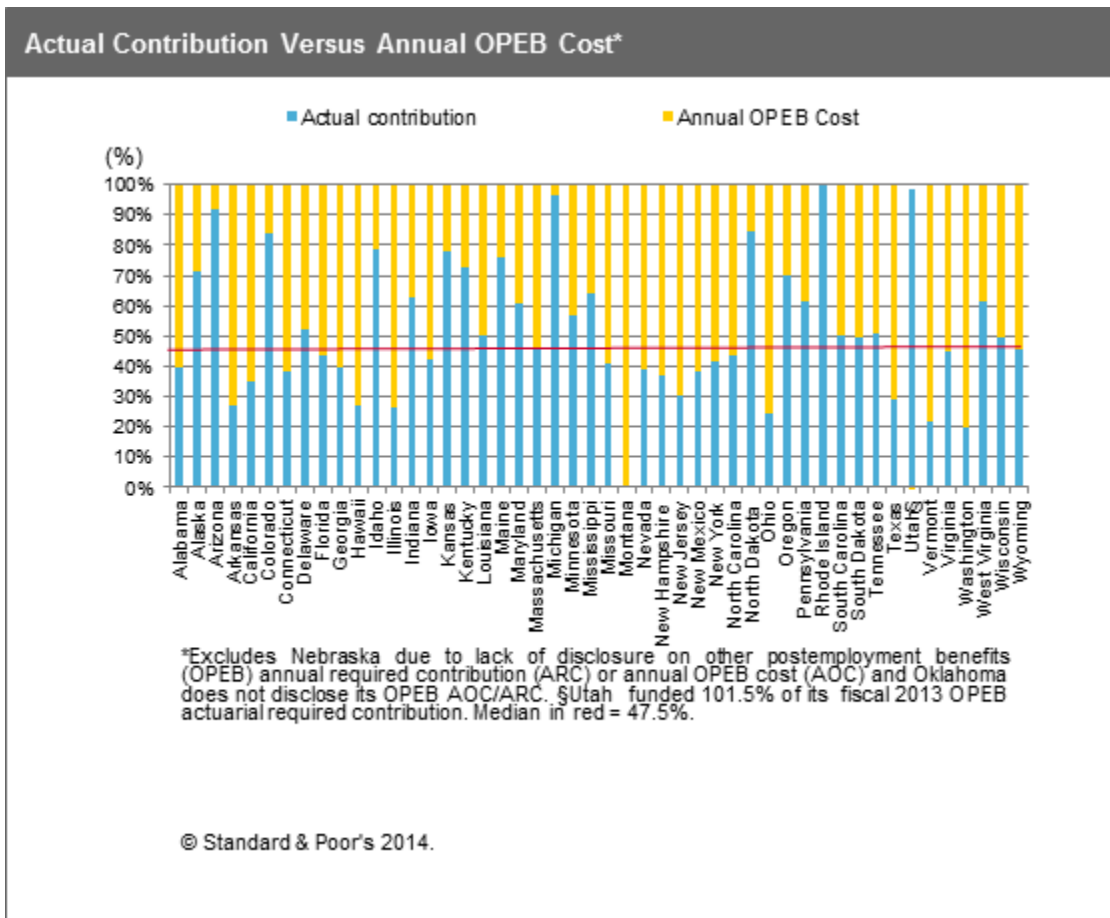
Funding ratios for OPEB liabilities are significantly lower than for pension liabilities, and most states fund OPEB on a pay-as-you go basis. Still, more states are beginning to prefund OPEB by setting aside money in an irrevocable OPEB trust fund. We count 32 states with some amount in trust compared with 26 states with trusts as of our September 2011 survey, although these amounts remain very low, with 93% of the total liability for states unfunded. For most states that have been contributing to a trust, funding ratios are growing. Arizona continues to have the highest combined funded ratio across plans of 77.7%, compared with 75.9% as reported in our 2013 survey, and has one of the lowest unfunded OPEB per capita at \$68. Most of the states with the highest funded ratios have relatively low-to-moderate OPEB liabilities per capita. Alaska is an exception in that, although it has the third-highest combined funded level, it still posts the largest unfunded OPEB per capita. (See map for states with the highest OPEB-funded

ratios.)



Only a handful of states base their annual OPEB contributions on the ARC, while most fund annual costs on a pay-as-you go basis (see chart 3). Some states set contribution levels based on statute or leave it to the legislature to determine the annual contributions. For the few states that are funding close to the full actuarial required amount, the annual OPEB cost is only a small component of total governmental expenditures. We calculate that Utah's OPEB contribution, which funded 101.5% of its actuarial annual OPEB cost in fiscal 2013, represented only 0.36% of total governmental expenditures. Rhode Island's fiscal 2013 state employee OPEB contribution represented 99.8% of its actuarial annual OPEB cost and 0.7% of total governmental expenditures. On the other hand, Hawaii has an annual OPEB cost that represents a relatively high 9.5% of total governmental expenditures but, despite the relatively higher cost, it has recently implemented reform with a commitment to fund the full OPEB ARC by fiscal 2019. Although budgetary estimates are complicated somewhat by some states' reporting of total contributions toward non-state employers in cost-sharing, multiple-employer plans, we estimate that the average actual annual contribution for OPEB across states is about 1% of total governmental expenditures, and the average annual OPEB cost, on an actuarial basis, represents about twice that amount. We believe the average is fairly representative of the manageable budgetary OPEB burden for most states, although it doesn't capture the variance of annual OPEB costs across all states, which we estimate range from 0.1%–9.5% of total governmental expenditures.

Chart 3



Highlights Of OPEB Reform

States vary in their approach to addressing their reported long-term OPEB liability. These measures include establishing trusts, changing eligibility requirements for retirees, increasing employee contributions, initiatives to manage health care costs, capping benefits, and changing actuarial assumptions.

North Carolina revised its retiree health care plan to implement a consumer-directed health plan option and introduced fully insured Medicare Advantage options for Medicare retirees. Previously, the state also increased retiree health-care vesting requirements, eliminated its most expensive health plan, and increased employee premiums in addition to establishing the retiree health care trust fund. Michigan capped certain benefits and began prefunding a trust fund, currently at a 3.8% funding level, which allowed it to change its assumed discount rate to 8.0% from 4.0%. Similarly, Hawaii revised its discount rate to 7% from 4% and, while it did not have assets in trust as of June 30, 2013, it initiated a multiple-year process of increasingly prefunding its OPEB liability until it is required to meet actuarial OPEB required contribution (ARC) funding in 2019. (See "Hawaii Moves To Tame Its OPEB Liability," published July 23, 2013, on RatingsDirect.)

The Effect Of The Patient Protection And Affordable Care Act: Time Will Tell

It might still be too soon to determine the effect of the Patient Protection And Affordable Care Act (ACA) on the long-term cost of health care; however, the act could provide both opportunities and costs. Since the passage of the ACA, some states have shifted prescription drug benefits for eligible Medicare retirees to an employer group waiver plan (EGWP), which offsets the OPEB liability with cost savings derived from federal subsidies under GASB accounting rules. Connecticut, Delaware, New Jersey, and Vermont are among the states that have recently made this switch to EGWP from a retiree drug subsidy program. States might also have an opportunity to redesign OPEB plans to shift costs for eligible retirees health care coverage to health insurance exchanges under the ACA. Although the act has unveiled potential opportunities for OPEB savings, some actuaries have incorporated projected future costs associated with the ACA's post-2018 40% "Cadillac" excise tax on per capita medical benefits exceeding certain thresholds.

How Standard & Poor's Assesses OPEB Risk

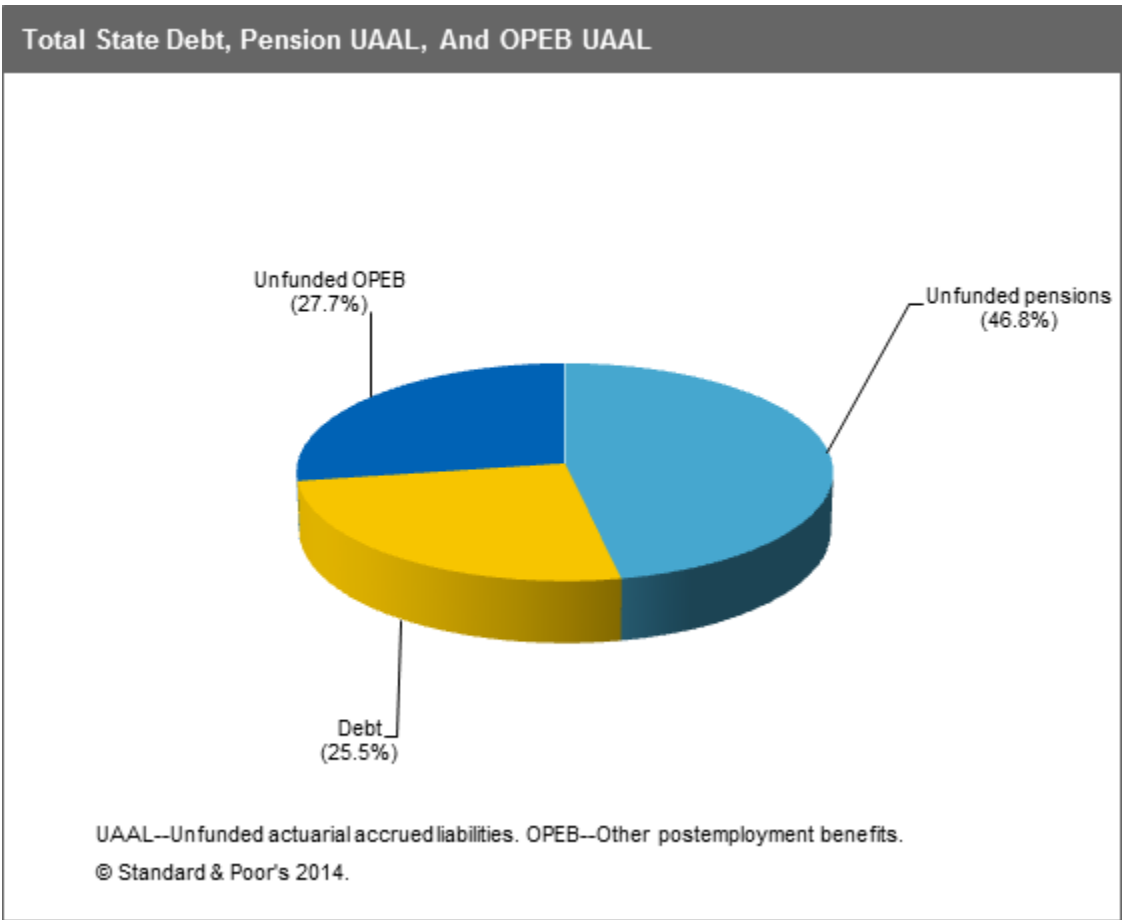
Under our criteria (see "USPF Criteria: State Ratings Methodology," published Jan. 3, 2011, on RatingsDirect), a state's debt and liability profile is one of the five major factors that determine a state rating. Within this factor, debt, pension liabilities, and OPEB are the key metrics that we score individually.

Because pension and retiree health benefits are long-term obligations that require funding over time, our analysis weights the size and management of these liabilities equally with debt. Our criteria focus on the nature and flexibility of the benefits provided, the relative size of the liability, the fixed cost it represents and how it affects budget flexibility, and the ability and funding trends reflecting the willingness of states to control future OPEB costs. Following a review of this information, we assign a risk assessment of "low," "moderate," "elevated," and "high" as outlined in our criteria.

OPEB as a component of the long-term liability profile

The relative stability in reported overall state unfunded OPEB liabilities in recent years ties to the willingness and ability of some states to take on OPEB reform. Changes to actuarial assumptions, such as discount rates, can provide one-time reductions to these liabilities between periodic valuations; however, long-term stability in future liabilities will require meaningful OPEB reform or asset accumulation. In addition to OPEB, we evaluate other long-term liabilities such as pensions and debt liabilities (see "U.S. State Pension Funding: Strong Investment Returns Could Lift Funded Ratios, But Longer-Term Challenges Remain," published June 24, 2014 and "U.S. State Debt Review: New Issuance Remains A Lower Priority," published Oct. 13, 2014.) As shown in chart 4, unfunded pension liabilities represent almost 47% of the states' total long-term liabilities, while debt and OPEB liabilities make up 25.5% and 27.7% of the share, respectively. Although unfunded OPEB liabilities make up just one component of a state's long-term liability profile, states that are willing and able to adjust OPEB benefits or funding and implement reform to stabilize or reduce liabilities will be better positioned to weather other long-term capital and pension pressures.

Chart 4



Survey Methodology

Our calculation of OPEB liabilities was derived from the most recent state CAFR, bond official statements, and benefit plan actuarial reports currently available to us. We have combined multiple OPEB plans for each state into one combined funded figure. Our survey includes those OPEB plans that states disclose as a state obligation, although we use the combined OPEB for multi-employer plans when both state and local governments participate in the OPEB plan. Some states provide a state general fund contribution to local teacher OPEB plans, and for these we have also included teacher OPEB. In most cases, OPEBs of public university systems are not included, unless a state considers these a direct state responsibility or if they are not reported separately from the states' cost-sharing, multi-employer plan. Some states do not perform annual actuarial valuations and some states do not perform OPEB actuarial valuations as often as they perform pension system valuations. We have used the most recent OPEB valuations available; in some cases these will be for 2013 or 2014, for others, it could be earlier. About 15% of the aggregate OPEB UAAL was based on a valuation date that did not change from our last report, including 10% reflecting New York State's OPEB UAAL as of an April 1, 2012, valuation date.

In this survey, with the following exceptions, we have used the same state OPEB plans that we included in our 2013 survey, validating comparisons we made with the OPEB amounts in that report. The restated OPEB liability from last year now incorporates the Alaska teacher plan, to which the state contributes. We also restated Connecticut's OPEB liability to include the teacher health care liability based on state general fund contributions and we excluded the local government portion of the public employees benefits board liability for Washington State. For a more detailed description of which funds we have included in our table and recent state actions affecting OPEB, if any, refer to Table 2.

In Table 1 we list the actuarial annual OPEB cost for each state's OPEB plan included in our survey, as shown in state CAFRs for fiscal 2013, although the valuation of unfunded OPEB we used in this table may be taken from a more recent actuarial report than that reported in the 2013 state CAFR. The annual OPEB cost represents the amount an OPEB plan must pay to keep the unfunded actuarial OPEB from growing on a yearly basis. This differs slightly from the actuarial ARC, in that the annual OPEB cost is the ARC adjusted for accruals and interest expense on the net OPEB obligation. In a minority of cases where we were not able to find the annual OPEB cost, we have instead used the ARC, a procedure we believe is reasonable because of the typically small variation between the annual OPEB cost and ARC.

Table 1

U.S. States' OPEB Liabilities And Ratios

State	Unfunded state OPEB (mil. \$)	Total OPEB liability (mil. \$)	Combined funded ratio for all OPEB funds (%)	Unfunded OPEB per capita (\$)	Fiscal 2013 combined actuarial annual OPEB cost (mil. \$)	Combined actual annual payment (mil. \$)	Percent of annual actuarial cost paid
Alabama	11,008	12,210	9.8	2,277	1,086	432	39.7
Alaska	7,885	14,882	47.0	10,726	693	495	71.4
Arizona	453	2,031	77.7	68	111	102	92.0
Arkansas	2,056	2,056	0.0	695	206	56	27.2
California	65,963	65,990	0.0	1,721	4,993	1,764	35.3
Colorado	1,263	1,557	18.9	240	87	73	84.0
Connecticut	21,966	22,109	0.7	6,108	1,497	570	38.1
Delaware	5,766	5,988	3.7	6,228	398	207	52.0
Florida	15,580	15,801	1.4	797	1,037	451	43.4

Table 1

U.S. States' OPEB Liabilities And Ratios (cont.)							
Georgia	14,224	15,132	6.0	1,424	1,370	545	39.8
Hawaii	8,530	8,530	0.0	6,075	868	236	27.2
Idaho	73	73	0.0	45	8	6	78.5
Illinois	34,488	34,488	0.0	2,677	2,378	625	26.3
Indiana	315	388	18.7	48	31	19	62.7
Iowa	233	233	0.0	75	24	10	42.3
Kansas	528	553	4.5	182	85	66	77.7
Kentucky	4,845	6,428	24.6	1,102	529	383	72.5
Louisiana	5,495	5,495	0.0	1,188	372	187	50.3
Maine	1,819	2,032	10.5	1,370	133	101	76.1
Maryland	8,121	8,344	2.7	1,370	649	393	60.6
Massachusetts	15,377	15,786	2.6	2,298	1,286	585	45.5
Michigan	10,124	10,523	3.8	1,023	834	804	96.4
Minnesota	652	652	0.0	120	67	38	57.0
Mississippi	690	690	0.0	231	46	29	64.1
Missouri	2,671	2,760	3.2	442	215	88	41.0
Montana	447	447	0.0	440	58	0	0.0
Nebraska	N.A.	N.A.	0.0	N.A.	N.A.	N.A.	N.A.
Nevada	1,181	1,183	0.1	423	130	50	38.7
New Hampshire	2,545	2,567	0.8	1,923	138	51	37.2
New Jersey	66,805	66,805	0.0	7,507	6,076	1,838	30.3
New Mexico	3,688	3,915	5.8	1,769	354	135	38.1
New York	68,212	68,212	0.0	3,471	3,376	1,405	41.6
North Carolina	25,610	26,943	4.9	2,354	2,085	913	43.8
North Dakota	119	185	35.7	164	16	13	84.3
Ohio	14,639	31,859	54.1	1,265	2,163	535	24.7
Oklahoma	5	5	0.0	1	N.A.	47	N.A.
Oregon	391	687	43.1	100	35	25	70.3
Pennsylvania	17,339	17,490	0.9	1,357	1,173	724	61.7
Rhode Island	674	723	6.7	641	55	55	99.8
South Carolina	9,724	10,352	6.1	2,037	828	416	50.3
South Dakota	68	68	0.0	80	7	4	49.3
Tennessee	2,077	2,077	0.0	320	201	102	50.7
Texas	61,178	61,729	0.9	2,313	4,693	1,362	29.0
Utah	268	423	36.7	92	39	40	101.5
Vermont	1,841	1,860	1.0	2,937	119	26	21.5
Virginia	5,358	6,555	18.3	649	348	155	44.6
Washington	3,707	3,707	0.0	532	347	69	19.9
West Virginia	2,673	3,263	18.1	1,442	307	188	61.2
Wisconsin	893	893	0.0	166	78	39	49.8
Wyoming	244	244	0.0	418	20	9	45.7
Total	529,811	566,921	N/A	N/A	N/A	N/A	N/A

Table 1

U.S. States' OPEB Liabilities And Ratios (cont.)							
Median	2,673	3,263	N/A	1,023	N/A	N/A	48.0
Average	10,812	11,570	N/A	1,656	N/A	N/A	52.0

N.A.--Not available. N/A--Not applicable.

Table 2

U.S. States OPEB Liabilities And Funding Progress

Alabama

The state's other postemployment benefit (OPEB) unfunded liability is moderate in our opinion. In 2007, the state legislature created irrevocable trust funds to help fund future retiree health care costs. Alabama provides postretirement health care benefits through two plans: the State Employees Insurance Board's State Employees' Health Insurance Plan (SEHIP), which is a single-employer plan, and the separate Public Education Employees' Health Insurance Plan (PEEHIP) for retired education employees, which is a cost-sharing, multiple-employer plan. SEHIP's unfunded actuarial accrued liability (UAAL) improved slightly to \$3.09 billion as of Sept. 30, 2012, compared to the previous year, and the funded ratio was 3.95%. PEEHIP's estimated long-term unfunded liability of \$7.9 billion, based on a Sept. 30, 2013, actuarial valuation, did not change much from the liability as of September 2012 but represents a significant decrease from 2009 estimates. The plan is 10.4% funded and assumes a 5.0% discount rate. In fiscal 2013, the PEEHIP and the SEHIP actual contributions represented 39.7% of the combined \$1.09 billion annual OPEB cost.

Alaska

Alaska provides OPEB benefits mainly through its defined-benefit, cost-sharing, multiple-employer plans: the Public Employees Retirement System (PERS) and the Teachers' Retirement System (TRS). The PERS OPEB UAAL of \$4.5 billion, based on a June 30, 2012, valuation date, also includes those of other participating local governments and incorporates more than \$5 billion in health care trust funds for a 54% funded ratio. The PERS OPEB UAAL did not change significantly compared with the 2011 valuation date, but represents a marked improvement from 2009, when the funded ratio was 32% and the UAAL was \$8.6 billion. The TRS, which includes the University of Alaska as a participating employer, had an OPEB liability of \$3.37 billion, which was 33.2% funded as of 2012, down significantly from 43.8% as of 2011. The actuarial estimate assumes an 6.88% and 5.00% blended discount rate to calculate the PERS and TRS OPEB liability, respectively. The state's judicial retirement system OPEBs were overfunded by \$2.6 million, and the elected officials' retirement system had an unfunded OPEB of \$4.4 million. The combined state and local governmental employers' unfunded OPEB for PERS, TRS, and the judicial and elected official plans, included in the table, of \$7.9 billion based on the 2012 valuation is much smaller than the \$11.9 billion UAAL as of the 2009 valuation date, but higher than the \$6.1 billion in 2011 primarily because of medical cost assumptions and investment performance, which the system's five-year smoothing of assets reflects. The state is required by statute to fund the annual contributions to the system at the actuarially recommended level. Alaska reports its PERS unfunded OPEB costs for its legacy defined-benefit plan as part of its combined reporting of the defined-benefit pension system's unfunded retirement costs. PERS defined-benefit OPEB contributions in fiscal 2012 equaled 73.6% of the \$498 million OPEB ARC. For TRS, the OPEB ARC for fiscal 2012 was \$192.7 million, of which the state and other employers contributed \$126 million, or 65.4%. However, on July 1 of each year or as soon as funds are available thereafter, the state is required by statute to contribute sufficient additional funds to bring the total PERS and TRS contribution for the prior fiscal year to the ARC.

Arizona

Three major systems provide OPEB for eligible employees at the state level: the ASRS (Arizona State Retirement System), a cost-sharing, multiple-employer plan that benefits state employees, political subdivisions, and public schools; the Public Safety Personnel Retirement System (PSPRS), an agent, multiple-employer system that serves firefighters and police employed by the state and subdivisions; and the Corrections Officer Retirement Plan (CORP), an agent, multiple-employer plan that services corrections employees at the state and county level. We view overall OPEB liabilities as low. For ASRS, the OPEB liability is made up of two components: a health insurance premium benefit program and a long-term disability program. As of the June 2012 actuarial valuation date from the fiscal 2013 audit, the combined UAAL for the health insurance premium benefit program and the long-term disability program was \$364 million, with an 81% funded ratio, a liability we view as low, primarily due to the state's buildup of almost \$1.6 billion combined in actuarial OPEB assets in a trust fund. Arizona does not include an estimate of the state portion of the multiple-employer liability in its annual financial statements. PSPRS and CORP OPEB liabilities consist of contributions in excess of the systems' health insurance subsidy in the overall pension plan. As of a June 30, 2013, actuarial valuation date, unfunded OPEB liabilities for PSPRS and CORP were \$29 million and \$60 million, respectively, and there was no OPEB trust. PSPRS and CORP contributions were 75% and 42% of the annual actuarial OPEB cost, respectively.

Arkansas

We view Arkansas' OPEB risk to be moderate, given the relatively limited benefits provided, discretion to change benefits, and an annual OPEB cost that is relatively low in relation to the state budget, compared with that of other states. The state provides two single-employer defined-benefit OPEB plans: the Arkansas State Police Medical and Rx Plan and the Arkansas State Employees Health Insurance Plan. The total UAAL for Arkansas' state employee OPEB plans, based on a July 2012 valuation and assuming a 4.25% discount rate, totaled \$1.95 billion. The state police medical plan UAAL totaled \$103 million as of July 2011. The combined funded ratio of 0%, as the state is funding OPEB on a pay-as-you-go basis.

Table 2**U.S. States OPEB Liabilities And Funding Progress (cont.)****California**

California's OPEB liabilities, recorded in its California Employers' Retiree Benefit Trust Fund, represent a significant unfunded long-term obligation of the state. The state's June 2013 actuarial valuation estimates \$64.6 billion OPEB UAAL, up slightly compared with \$63.8 billion in the previous year. When including the trial courts OPEB liability, the combined OPEB UAAL totals almost \$66 billion, or \$1,721 per capita. The state does not provide full funding of annual actuarially accrued costs, but instead funds the retiree health expenses on a pay-as-you-go basis. In fiscal 2013, the actuarial annual OPEB cost was \$4.99 billion, including the separate trial courts system, of which the state contributed \$1.76 billion on a pay-as-you-go basis, or 35% of the actuarial cost.

Colorado

The state's OPEB obligations health care trust fund, funded through the state's Public Employees' Retirement Association (PERA), is a cost-sharing, multiple-employer plan with a health care trust fund covering state employees, some school district employees, some local districts, and judicial employees. PERA had a \$1.26 billion unfunded liability at Dec. 31, 2013, slightly below \$1.4 billion the year before, and a funded ratio of 18.8%, not including the public schools \$61 million UAAL. The actuarial estimate of the UAAL uses a 7.5% rate-of-return assumption. The state funded 84% of the OPEB actuarial annual required contribution (ARC) and calculates its UAAL using a 30-year open amortization period. Recognition of investment gains in the previous few years as well as elimination of the liability associated with the retiree drug subsidy program effective January 2014 contributed to the lower UAAL. We consider Colorado to have a moderate OPEB exposure. Not included in the summary table is the \$407 million unfunded OPEB from the University of Colorado and \$95 million unfunded OPEB from Colorado State University, as listed in the state's comprehensive annual financial report (CAFR).

Connecticut

Connecticut's OPEB liability is significant, but recent actions to lower the liability have substantially lowered the growth trajectory. The state received an updated OPEB valuation for fiscal 2013 that shows the single-employer, state employee OPEB plan UAAL increasing to \$19.5 billion from \$17.9 billion based on a June 2011 valuation date. Despite the increase in the UAAL, the liability is much lower than it had been at \$26.6 billion at June 30, 2008, before certain plan and actuarial changes. The lower trend in liabilities is attributable to a change in the discount rate to 5.7% from 4.5% due to the creation of a trust fund, lower liabilities resulting from changes in plan design negotiated with the State Employees Bargaining Agent Coalition (SEBAC), and various health care cost-containment initiatives. Before the plan changes and updated actuarial report, OPEB costs had been forecast to rise sharply, reaching approximately \$45 billion by fiscal 2017. Connecticut still funds OPEB on a pay-as-you-go basis, and there are limited resources in the trust at this time (\$143.8 million as of June 30, 2013). Pay-as-you-go costs for funding the state retiree health was \$543 million in fiscal 2013, which was in contrast to the sizable combined annual OPEB cost of \$1.3 billion. In fiscal 2014, the state budgeted \$548.7 million for retiree health care compared with an OPEB ARC of \$1.6 billion. The state also funds one-third of the cost of the Retired Teacher Healthcare Plan (RTHP) OPEB liability from its general fund plus any portion of the balance of such costs that is not funded from the amounts available in the RTHP and a monthly health insurance subsidy for certain retired teachers. The state resumed general fund contributions to the RTHP in fiscal 2012 and fiscal 2013 after making no appropriations in fiscal years 2010 or 2011. Table 1 includes the RTHP liability for a combined OPEB UAAL of \$22 billion.

Delaware

The state, through legislation effective July 1, 2007, created a Delaware OPEB trust fund, which had \$222 million in actuarial assets in fiscal 2013. As of July 1, 2013, Delaware's OPEB UAAL is what we consider a sizable \$5.8 billion, using a blended rate-of-return assumption of 4.25%. The annual OPEB cost was \$398 million in fiscal 2013, compared with actual contributions of \$207 million, or about 3% of total governmental expenditures. The state has actively managed this liability, in our view, and we expect these efforts to continue. Legislation from 2011 instituted various reforms to the state's pension and OPEB. The legislation establishes a fixed cost share in the state's health insurance programs for both active employees and retirees and increases the time to vest for retiree health care benefits. The liability was also lowered by the state's participation in an employer group waiver plan (effective Jan. 1, 2013), which offsets costs of retiree pharmacy benefits subsidized by the Centers for Medicare and Medicaid Services. Also effective in fiscal year 2014, the state passed legislation to redirect a portion of surplus abandoned property revenue to OPEB.

Florida

Florida provides OPEB in two ways. The state allows retirees to participate in its health insurance program; however, because retirees are required to pay 100% of the premium amount, this benefit is considered an implied subsidy for providing retirees health insurance. The OPEB UAAL for the implicit rate subsidy as of July 1, 2012, was \$6.8 billion. The state also participates in the Retiree Health Insurance Subsidy (HIS) program, a cost-sharing, multiple-employer program that includes non-state participating employers including county agencies, cities, special districts, and hospitals. The benefit is available to retirees under a state-administered retirement system who can provide proof of health insurance coverage, including Medicare. The benefit is paid monthly and calculated based on years of creditable service times five dollars. The benefit is no less than \$30 but no more than \$150 per month. According to the state, HIS benefits are not guaranteed and are subject to annual legislative appropriation and the legislature could cancel or reduce HIS payments. The program is funded by required contributions by participating employers as set by the legislature. The last valuation for the HIS program was done on July 1, 2012, and reflected a total UAAL of \$8.8 billion, up from \$8.2 billion in July 2010. Our table uses the combined fiscal 2012 ARC for HIS, and the fiscal 2013 ARC for the implicit subsidy, based on the most recent publicly available data.

Table 2**U.S. States OPEB Liabilities And Funding Progress (cont.)****Georgia**

As plan sponsor, Georgia reports the OPEB liability for the State Employees Postemployment Benefit Fund (SEPBF), the School Personnel Postemployment Health Benefit Fund (SPPHBF), and the State Employees' Assurance Department (SEAD). In addition, although not included in the table, the Board of Regents had an unfunded OPEB of \$3.8 billion at July 1, 2012. The SEPBF -- which includes members of the Employees' Retirement System, the Judicial Retirement System, and the Legislative Retirement System -- had a \$3.6 billion OPEB UAAL as of June 2013 and a 0% funded ratio. The SPPHBF, which includes members of the Teachers' Retirement System and the Public School Employees' Retirement System (and for which the state sets the benefit levels and required local school employer contribution rate, but is not directly responsible for funding) had an unfunded OPEB of \$10.8 billion as of June 2013, and a 0% funded ratio. The SEAD's OPEB (that provides life insurance) is overfunded by \$153 million and had a 120% funded ratio. The combined OPEB UAAL, excluding the Board of Regents liability, totaled \$14.2 billion, which is down slightly from \$14.6 billion as of June 2012 driven by plan changes and changes in claims and contribution experience. The SEPBF had an ARC of \$388 million and the SPPHBF had an ARC of \$982 million in fiscal 2013 of which the state paid 47% and 37%, respectively.

Hawaii

Hawaii provides certain health care and life insurance benefits through the Employee-Union Health Benefits Trust Fund (EUTF), an agent multiple-employer plan. In fiscal 2013, the state spent \$236 million on EUTF OPEB, which, given its pay-as-you-go approach, equaled just 27% of the annual OPEB cost. The new fiscal 2014 budget included \$100 million of prefunding in fiscal 2014 and as required by statute, there is another \$117.4 million for fiscal 2015. State lawmakers and the governor enacted legislation establishing an upwardly trending contribution glide path so that, by fiscal 2019, the state's annual funding would match the ARC. Due to the new funding policy, the EUTF OPEB UAAL declined significantly to \$8.5 billion based on the July 2013 valuation assuming a 7% discount rate compared with \$11.7 billion as of July 2011 with a 4% assumed discount rate. Because the new funding policy will take several years to ramp up, the benefits of funding the OPEB expense as the liabilities are accrued may not be realized in the short term. Moreover, assuming If economic and tax revenue trends were to materially soften at some point in the next several years, we believe the state's commitment to the new higher contributions could be tested. Nevertheless, we view Hawaii's new funding policy as an important step to help preserve its fundamental solvency into the future. In general, we view the state's willingness to begin confronting its OPEB liability as favorable.

Idaho

We consider Idaho's OPEB liability to be low. In our view, the state substantially reduced its OPEB exposure beginning in 2010, with the exclusion of Medicare-eligible retirees or dependents from the state-sponsored health benefit and its fixing of the maximum benefit at \$1,860 per year rather than the historical practice of indexing to changes to the benefits given to current employees. Based on a July 1, 2012, valuation date, the state calculates its OPEB UAAL at \$16 million for its retiree health plan, and \$58 million for its combined long-term disability and retiree life insurance plans, levels we consider low. Under the state's pay-as-you-go funding approach, in fiscal 2013 all contributors paid about \$6 million, or 69% of the annual actuarial OPEB cost of \$7.6 million, not including \$39 million of unfunded OPEB for the University of Idaho. The University of Idaho funded more than its actuarial OPEB cost, building up its trust fund, which had \$25 million of actuarial assets at July 1, 2012.

Illinois

Illinois provides health, dental, vision, and life insurance benefits for retirees and their dependents for two of its retirement systems -- the State Employees' Retirement System and the State Universities Retirement System. The actuarial accrued liability continues to grow significantly in our view. As of June 30, 2013, the OPEB UAAL is estimated at \$34.5 billion compared with \$33.3 billion as of June 2011. Illinois believes that it is not responsible for OPEB for retirees under the Teachers' Retirement System or the remaining two state-sponsored retirement systems. In fiscal 2013, the total annual OPEB paid on a pay-as-you-go basis was \$625 million, compared with the \$2.38 billion annual OPEB cost. Progress on OPEB reform authorized in 2012 is in question following the Illinois Supreme Court's reversal of the trial court's dismissal of the case. The Supreme Court ruled that health insurance premium subsidies are a benefit of membership in a pension or retirement system. Depending on the lower court outcome, there could be immediate fiscal implications. The state identified \$90 million of premiums to be collected in the current fiscal year under the statutory process authorized in 2012.

Indiana

In fiscal 2012, Indiana began putting money aside in an OPEB trust, with \$44 million of actuarial assets in the state personnel health care plan, \$21 million in the Indiana State Police Health Care Plan, and \$7 million in the Conservation and Excise Police Health Care Plan for a 18.7% combined funded ratio. The relatively small legislature's health care plan had no OPEB trust assets. The combined OPEB UAAL as of June 30, 2013, was \$315 million, which was the same as of the June 2012 valuation. The state is funding the OPEB liability on a pay-as-you-go basis and contributed \$19.3 million, or 62.7% of its annual OPEB cost. The total OPEB liability has decreased by 40% since 2010 due to state actions to increase premiums, deductibles, and co-payments made by the Indiana state policy members and increased premiums by 25% for the Conservation and Excise Plan.

Iowa

Iowa does not pay for health care benefits for retirees, who are allowed on their own to buy the same health insurance policy that covers active employees. The state, however, under Governmental Accounting Standards Board (GASB) 45, reports a liability for its retiree health care benefits due to the implied subsidy that is deemed to exist when retired workers pay the same for health insurance as younger active workers. The resulting unfunded OPEB for state employees under the single-employer health care plan was reported as \$233 million based on the last actuarial valuation date of June 30, 2012, with a 0% funded level, as reported in the state's 2013 CAFR. The actuarial annual OPEB cost in fiscal 2013 was \$24 million (down from \$41 million in fiscal 2012), of which contributors paid 42% under the state's pay-as-you-go funding. (In addition, three state universities had an unfunded OPEB liability of \$293 million as of a June 30, 2012, valuation date, which is not included in the above figures.)

Table 2**U.S. States OPEB Liabilities And Funding Progress (cont.)****Kansas**

We view the state's OPEB risk to be low, given the relatively limited benefits provided, Kansas' discretion to change benefits, and an ARC that is relatively low in relation to the state budget, compared with that of other states. Kansas provides two OPEB plans: a death and disability plan administered by the Kansas Public Employees' Retirement System (KPERs) and a postemployment health insurance benefit plan administered by Kansas Health Policy Authority. The UAAL for the health insurance plan, which is funded on a pay-as-you-go basis, was \$278 million as of June 30, 2013. Including the KPERs OPEB liability, the total combined UAAL for the two plans is \$528 million with a 4.5% funded ratio. The state funded about 78% of the combined \$85 million actuarial annual OPEB cost in fiscal 2013.

Kentucky

The state primarily provides OPEB through insurance funds in its Kentucky Employees Retirement System (KERS) and Kentucky Teachers' Retirement System (KTRS) with additional OPEB provided through the state police, judicial, and legislators retirement systems. The aggregate unfunded OPEB liability of \$4.85 billion as of June 30, 2013, declined 22% from the June 2012 valuation estimates due, in part, to a change in the assumed discount rate used to value assets in the non-hazardous KERS plan to 7.75% compared with 4.50% in the previous year. As of June 30, 2013, the KERS had an OPEB UAAL of \$1.65 billion, significantly below the \$2.7 billion last year. In April 2010, the governor signed into law House Bill 540. The bill created the KTRS insurance trust fund to supplement the current medical insurance fund, specifically dedicated to health benefits. The bill's purpose is to increase employee and employer contributions to KTRS over a six-year period. Under a separate bill, House Bill 531, the state authorized Asset and Liability Corp. to issue up to \$875 million in funding notes to repay KTRS pension for loans made to KTRS medical insurance fund and to refinance those obligations. The KTRS' OPEB liability declined slightly to \$3.1 billion as of June 30, 2013, from \$3.3 billion the past year. In fiscal 2013, the state contributed \$383 million, or 72.5% of the combined OPEB ARC. In the past, the state has issued notes to cover loans made from the pension fund to the medical insurance trust fund and to cover its funding obligation for medical insurance. In the 2012-2014 biennium budget, the state authorized the issuance of \$152 million in notes for this purpose. No such notes are contemplated in the fiscal 2015-2016 biennium budget.

Louisiana

Louisiana primarily provides retiree health care benefit programs and life insurance through a defined-benefit, agent multiple-employer plan administered through the Office of Group Benefits. The state had an unfunded OPEB actuarial liability of about \$5.5 billion as of July 1, 2013, the most recent actuarial valuation, which translates to a OPEB liability per capita of \$1,188. There is an additional \$2.1 billion OPEB UAAL from Louisiana's component units, including the state universities. During the 2008 legislative session, the state approved the creation of an OPEB trust, although it has not been funded as of year-end 2013. In fiscal 2013, Louisiana contributed \$185 million, or about 50% of the actuarially recommended annual OPEB cost, which was funded on a pay-as-you-go basis.

Maine

Maine funds retiree health benefits for retired state employees and funds a portion of the health premiums for retired teachers. Additional OPEB includes group life insurance and for first responders. In fiscal 2013, the state reduced medical benefits for early retirees and put a cap on the state's contribution to the retiree medical premium, contributing to a reduction in OPEB liabilities. As of June 30, 2013, the combined unfunded OPEB liability was \$1.8 billion, down from \$1.96 billion as of June 2012. In fiscal 2013, the combined OPEB trust funds had an actuarial value of \$213 million for a 10.5% funded ratio. Statutory law requires that beginning in fiscal 2009, Maine may not create an unfunded OPEB liability other than that resulting from experience losses, which must be amortized over 10 years, and requires other unfunded OPEB liabilities to be retired in 30 years or less from July 1, 2007. However, in fiscal 2010 the state paid only pay-as-you-go OPEB costs, although it budgeted a transfer of \$14.4 million into its OPEB trust fund in fiscal 2011 to reduce the unfunded liability. In fiscal 2013, Maine contributed about 78% and 68% of the actuarial annual OPEB cost for the state employee and teachers, respectively.

Maryland

Maryland provides OPEB through its State Employee and Retiree Health and Welfare Benefits Program. As of June 30, 2013, the actuarial accrued OPEB unfunded liability was \$8.1 billion compared with \$9.4 billion in fiscal 2012, which incorporates an assumed 4.75% discount rate compared to a 4.25% from the 2012 valuation. The updated liability estimate for fiscal 2013 is well below the \$15.9 billion recorded before the health care benefit reforms approved by the General Assembly in 2011. The reforms included increased premium payments and prescription drug copayments. Chapter 355 of the Laws of 2007 created the postretirement Health Benefits Trust Fund as an irrevocable trust. The amount held in trust for OPEB as of June 30, 2013, was about \$223 million for a 2.7% funded ratio. Fiscal 2013 contributions provided for 60.6% of the actuarial annual OPEB cost, which includes some prefunding as well as pay-as-you-go costs. Maryland Transit Administration's retiree health care benefit also has an unfunded OPEB liability of \$671 million, not included in this table.

Massachusetts

Massachusetts has a \$15.4 billion unfunded actuarial accrued OPEB liability, which we consider sizable, but we note the decline from \$16.3 billion recorded in 2012 due to favorable claims experience and as various reform measures were phased in. The commonwealth paid \$585 million for OPEB in fiscal 2013, which represented 45.5% of the actuarial annual OPEB cost. Massachusetts established a trust fund to begin to accumulate assets toward the liability and is dedicating tobacco settlement revenues to the trust fund (to be phased in over 10 years) to provide a permanent funding source, which we consider a credit positive. The retiree health trust had assets of about \$407 million as of Jan. 1, 2013, for a 2.6% funded ratio. Given the low funding level, the OPEB UAAL assumes a discount rate of 4.5%. Included in the OPEB table is the Massachusetts School Building Authority, which had no unfunded OPEB liability and OPEB plan assets of \$1.9 million.

Table 2**U.S. States OPEB Liabilities And Funding Progress (cont.)****Michigan**

Michigan provides health, dental, and vision benefits, as well as life insurance coverage, to retirees of all state pension plans to which it makes contributions, except the military retirement plan. The majority of the state's retiree benefits payments go toward retirees under the State Employees Retirement System (SERS), with retirees in the State Police Retirement System (SPRS) making up most of the remainder. Michigan has an unfunded OPEB obligation of \$10.1 billion (as of a Sept. 30, 2012, valuation date), or \$1,023 per capita, a level we consider as average compared to other states, with a decline from \$15.4 billion the year before, and we expect it to decline further in succeeding valuations due to a trend of funding actuarial OPEB ARC during fiscal years 2012-2015, which we expect to continue in future years. The decrease in OPEB in 2012 was due to the capping of various future benefits and the change in the actuarial assumed investment rate of return to 8% as of the September 2012 valuation date from 4% as of September 2011 to reflect \$377 million of assets put aside into an OPEB trust fund for the SPRS and SERS for a 4% funded ratio. In fiscal 2013, Michigan paid 96% of the actuarial annual OPEB cost across its various OPEB retirement systems, although it contributed 103% for SERS' actuarial annual OPEB cost. The recently enacted fiscal 2015 state budget appropriates for OPEB costs at a level equal to actuarial ARC, which should continue to decrease unfunded OPEB in future years. Unlike accrued pension benefits, state courts have ruled that health care benefits are not protected as a matter of law, indicating in our view potential legal ability on Michigan's part to cut OPEB liabilities under new union contracts. The teachers' pension system calculated unfunded teacher OPEB at \$13.5 billion as of Sept. 30, 2012, which is not included in the table. Although the state does not pay teacher OPEBs, it does provide operating aid to local school districts.

Minnesota

The state allows retirees to participate in its active employee health care plan with the same premium rate, thereby creating an implicit rate subsidy. Minnesota also subsidizes health care premiums for certain retirees until age 65. As of July 1, 2012, the most recent actuarial valuation, the unfunded UAAL for the state's OPEB declined to \$651.9 million from \$799 million as of July 1, 2010, although the assets remain at 0. The UAAL per capita is what we consider low at \$120. The annual other postemployment payment was equal to 57% of the \$67.3 million benefits cost in fiscal 2013, a decline from the 67% level in fiscal 2012. These figures do not include about \$95 million of unfunded OPEB from the University of Minnesota, which has been funding its OPEB on a pay-as-you-go basis.

Mississippi

Mississippi provides just one OPEB plan, a medical plan and life insurance program administered by the State and School Employees' Health Insurance Management Board. Based on the plan's most recent valuation on June 30, 2013, the total UAAL is about \$690 million, which largely reflects the implicit rate subsidy. The state finances the plan on a pay-as-you-go basis. The state funded 64% of the \$46 million actuarial annual OPEB cost in fiscal 2013, which reflected pay-as-you-go costs. We view the state's OPEB risk to be low to moderate compared with other states, given the state's discretion to change benefits and an ARC that is relatively low in relation to the state budget.

Missouri

Missouri's OPEB are provided by three funds. The UAAL for the state's OPEB was \$2.67 billion at the end of fiscal 2013, or about \$440 per capita, a slight decrease from fiscal 2012. Missouri has \$89.5 million of assets in one of the funds, which provides for an overall funded ratio of 3.2% for the three funds. The actual contributions in fiscal 2013 were equal to 41% of the actuarially determined annual OPEB costs during the year.

Montana

We consider Montana's unfunded OPEB liability to be low, consisting only of an implicit rate subsidy. The state's unfunded OPEB liability was \$447 million, with a combined actuarial annual OPEB cost of about \$58 million. This is the combined liability for both the state and the Montana University System (MUS) plans, with valuation dates of Dec. 31, 2011, and June 30, 2012, respectively. Both plans allow retirees to participate, as a group, at a blended rate with active employees in which retirees do not cover all of their own related costs. This results in the reporting of an implicit rate subsidy in the related financial statements. We consider the state's unfunded OPEB liability per capita of \$440 relatively moderate compared to other states. The actuarial annual OPEB cost in fiscal 2013 was \$42 million for the state plan and \$16 million for the MUS plan. The state plans to continue funding the health insurance plan on a pay-as-you-go basis.

Nebraska

The state's liability for other postemployment benefits is minimal because it does not directly offer postemployment benefits. Nebraska's liability for OPEB is limited to the participation of retirees before the age of 65 in the state health care plan, which creates an implicit rate subsidy for retirees. Retirees are not eligible to participate after age 65, thereby only creating a modest implicit unfunded actuarial liability. The state does not disclose an actuarial valuation of its implicit OPEB subsidy.

Table 2

U.S. States OPEB Liabilities And Funding Progress (cont.)

Nevada

Nevada provides OPEB through its State Retirees' Health and Welfare Benefits Fund, which had an unfunded OPEB liability of \$1.18 billion as of July 1, 2012, which reflects a 20% increase compared with \$977 million in July 1, 2010. The UAAL increased by 25% compared with the 2010 valuation due to a combination of plan design and assumption changes, use of trust fund assets, and estimated costs associated with the Patient Protection and Affordable Care Act provisions imposing a 40% excise tax on per capita medical benefit costs exceeding certain thresholds after 2018. In fiscal 2011, the legislature directed \$24.7 million of assets from the Retirees' Benefits Investment Fund toward its cost of providing benefits that year although there were no additional investments or withdrawals in the fund through fiscal 2013. As of July 1, 2012, the trust fund only had \$1.3 million in assets compared with \$29.9 million as of July 1, 2010. The increase in the UAAL follows a previous large decline in the liability after the 2009 and 2011 legislatures reduced OPEB benefits and increased employee contributions. During the 2011 legislative session, health care benefit eligibility was ended for state employees hired after Jan. 1, 2012. This action, in addition to changing to a high-deductible health plan and increasing beneficiary premiums, reduced the state's OPEB UAAL to \$947 million as of July 1, 2010, from \$1.85 billion as of July 1, 2009, and the state's actuarial annual OPEB cost declined as of fiscal 2011 to about \$110 million from \$213 million at June 30, 2010. The annual OPEB cost has drifted back up somewhat, to \$130 million in fiscal 2013; the state paid \$50.4 million for the cost of providing benefits on a pay-as-you-go basis, \$16.8 million of which was in the form of an implicit rate subsidy and not a direct cash outlay by the state.

New Hampshire

New Hampshire provides OPEB through its single-employer Retiree Benefit Risk Management Fund (RBRMF) as well as through the New Hampshire Retirement System's medical premium subsidy program for a closed group of retirees. The state's combined OPEB UAAL as of fiscal 2013 totaled \$2.5 billion, down 15% compared with \$2.99 billion reported last year. The decline is attributed primarily to a reduction in the OPEB UAAL of the RBRMF, which declined 18% between the most recent Dec. 31, 2012, valuation date and the Dec. 31, 2010, valuation date to \$1.86 billion. The actuarial annual OPEB cost for the RBRMF was \$138 million in fiscal 2013 based on the 2012 valuation, for which the state paid \$51 million on a pay-as-you-go basis. The actuarial annual cost for the medical premium subsidy is not available. The state's 2012-13 biennium budget eliminated New Hampshire's contribution to local governments for local government pensions and the medical subsidy which reduced state costs. In recent years, the state also imposed a monthly fee for the RBRMF for employees under the age of 65. In fiscal 2011 and fiscal 2012, the state passed legislation to increase the required years of service for OPEB eligibility for certain groups of employees. The medical premium subsidy's last OPEB actuarial valuation was June 30, 2013, with an unfunded OPEB of \$688 million, including \$22 million of assets.

New Jersey

New Jersey provides OPEB through its Health Benefits Program for state, teachers, and local government employees. As of July 1, 2013, the date of the last OPEB actuarial valuation, the total UAAL was \$66.8 billion, with a funded ratio of 0%, which was composed of \$53 billion for state and education employees and \$13.8 billion for local government employees, some of whose other OPEB becomes the obligation of the state upon their retirement. New Jersey's aggregate OPEB liability increased in 2013 compared with the 2012 valuation; however, the UAAL is still significantly below 2010 levels due to changes in the state's prescription drug plan and the 2011 Pension and Health Benefits Reform Legislation passed on June 28, 2011. At the time, the state's liability declined by \$11.3 billion, or 16%, to \$60.01 billion as of July 1, 2011. Of this amount, \$9.4 billion was due to changes in the prescription drug Medicare integration from a retiree drug subsidy program to an employer group waiver program. Under this program, the state became an official Medicare Part D plan, which entitles it to collect larger subsidies from the federal government. The impact of the legislation was a \$2.5 billion reduction in the UAAL. The legislation requires all public employees to contribute more to their health insurance coverage and also requires future retirees to contribute to the cost of their postemployment medical coverage. New Jersey funds OPEB on a pay-as-you-go basis. In fiscal 2013, the state paid \$1.5 billion, or about 31% of the actuarial annual cost for the state and education employee postemployment medical benefits. In addition, included in the table is \$322 million of employer contributions made toward a \$1.2 billion ARC in fiscal 2013 for the local employee postemployment medical benefits. In fiscal 2014, the state spent \$1.4 billion on pay-as-you-go state and education postemployment medical benefits. For fiscal 2015, the budget increases by approximately \$300 million to \$1.70 billion. Management expects this cost to continue to increase, but for the rate of growth to decrease in the future.

New Mexico

The state provides medical, dental, vision, and life insurance plans to retired state employees. The New Mexico Retiree Health Care Authority's (RHCA) fiscal 2013 CAFR indicates an unfunded OPEB obligation in its multi-employer retiree health care fund of about \$3.6 billion, which was 5.8% actuarially funded by \$227 million of assets in an OPEB trust fund as of a June 30, 2012, actuarial valuation date. The fiscal 2013 OPEB ARC was about \$354 million of which 38% was funded. Employer and employee contribution rates for OPEB are set by statute, and phased increases beginning July 1, 2012, brought the employer contribution rate to 2.000% from 1.666%, and the employee contribution rate to 1.000% from 0.833%. New Mexico estimates the OPEB trust fund is solvent through 2033. Although the legislature did not pass proposed increases to employer and employee contributions last year, the RHCA board plans to again propose increases in payroll contributions, institute minimum age requirements, and increase years of service required for eligibility to extend solvency of the plan to 2040.

New York

We view New York State's unfunded OPEB liability as high and growing due to underfunding of the ARC and lack of a fund to prefund OPEB costs. In addition to the New York State Health Insurance Program's OPEB liability, New York considers the State University of New York's (SUNY) OPEB a state obligation. The state's combined OPEB UAAL was \$68.2 billion based on an April 1, 2012, actuarial valuation date, using the frozen entry age actuarial cost method and an assumed 3.1% discount rate. In fiscal 2013, the actuarial annual OPEB cost was \$2.6 billion for the state system and \$784 million for the SUNY, but New York State contributed combined pay-as-you-go funding of only \$1.4 billion.

Table 2**U.S. States OPEB Liabilities And Funding Progress (cont.)****North Carolina**

North Carolina administers two OPEB plans: the Retiree Health Benefit Fund and the Disability Income Plan. Although North Carolina's OPEB liabilities as of Dec. 31, 2013, continue to be high, in our view, with a combined OPEB UAAL per capita of \$2,600 the state has made adjustments to the benefits of new employees and established an employee benefit trust fund in an effort to control costs and provide a mechanism to accumulate assets. The state also revised its retiree health care plan to implement a consumer directed health plan option and introduced fully insured Medicare Advantage options for Medicare retirees. These changes as well as a change to the assumed per capita health costs contributed to a 22% reduction in the combined retiree health and disability income OPEB UAAL to \$23.2 billion between the Dec. 31, 2011, and the Dec. 31, 2012 valuation. As of Dec. 31, 2013, the state's combined OPEB UAAL increased 10% compared to the previous year to total \$25.6 billion, net of a combined \$1.3 billion in assets in trust, which incorporated updated demographic and plan experience assumptions. In fiscal 2013, all participating employers in the retiree health care plan contributed total OPEB costs of \$849 million (of which the state and its component units contributed its statutorily required contribution of \$411 million). The disability income plan reported a \$80.5 million unfunded liability as of Dec. 31, 2013, and participating employers funded 100% of the \$64 million OPEB ARC for the disability income plan, of which the state contributed its statutorily required amount of \$34 million.

North Dakota

We consider North Dakota's OPEB obligations to be low, due to relatively modest retiree benefits. The state's multiple-employer health insurance credit fund had an unfunded OPEB liability of \$48 million as of June 30, 2013, with \$66 million in trust assets, for a 34.7% funded ratio. The state also has an implicit health care subsidy for retirees who are not eligible for Medicare with an implicit unfunded OPEB of \$65 million at June 30, 2011, the last valuation date. There is a small unfunded OPEB liability of \$6 million for Job Service North Dakota, a single-employer plan. For all state plans on a combined basis, North Dakota paid \$13 million for retiree benefits, or about 84% of the OPEB ARC in fiscal 2013.

Ohio

Ohio has assessed its OPEB regularly and has been one of the few states to actively manage this liability and accumulate assets to fund it. Health care benefits are not vested and benefits and contributions are subject to adjustment according to the state. For the Public Employees Retirement System (PERS), the UAAL decreased substantially as of Dec. 31, 2012, to \$7 billion compared with \$18.9 billion as of 2011. The state had accumulated assets of \$12.2 billion as of Dec. 31, 2012, for a 63.6% funding ratio. This is substantially improved from a 39.1% funding ratio in 2011 due to various reforms included in the most recent health care preservation plan approved by the legislature. These reforms include various eligibility and benefit changes as well as higher employer contributions being diverted to fund OPEB. For the State Teachers Retirement System, the UAAL is \$1.2 billion with accumulated assets of \$3.5 billion (74.4% funded ratio) as of Jan. 1, 2014. The Ohio Police and Fire Pension Fund had a UAAL of \$3.3 billion (22% funded ratio) as of Jan. 1, 2013. In 2013, the School Employees Retirement System health care, Medicare B, and death benefit funds had a \$2.8 billion UAAL and \$517 million of assets (13% funded ratio) as of June 30, 2013. The Highway Patrol Retirement System had a UAAL of \$337 million (23.3% funded ratio) at Dec. 31, 2013.

Oklahoma

The state sponsors seven public employee defined benefit retirement plans: the Oklahoma Public Employees Retirement System (OPERS), Teachers Retirement System (TRS), Uniform Retirement System for Justices and Judges (URSJJ), Firefighters Pension and Retirement System, Police Pension and Retirement System, Law Enforcement Retirement System (LERS), and Wildlife Conservation Retirement Plan (WCRP). Oklahoma provides other postemployment benefits (OPEB) including disability and death benefits as part of its OPERS, TRS, URSJJ, LERS, and WCRP plans. Benefits are provided through the State and Education Employee Group Insurance Board (SEEGIB) and are statutorily capped at \$105 per employee per month. The Department of Wildlife Conservation is the only department that makes a contribution on behalf of its retirees and had an OPEB liability of \$4.6 million with an actuarial annual OPEB cost of \$324,000 in fiscal 2013, of which the department contributed \$187,000 on a pay-as-you go basis. This small OPEB liability (combined contributions totaled \$47 million for fiscal 2013) is included in the state's pension liabilities. Oklahoma has determined that SEEGIB does not constitute an OPEB plan, according to the provisions of GASB Statement 43.

Oregon

Many of the state's former employees are eligible for health care benefits through the multiple-employer Oregon Public Employees' Retirement System (PERS). For these retirees, Oregon offers two types of benefits, which entail an explicit subsidy. The larger of the two relates to the PERS' retirement health insurance account program, which had a total UAAL of \$180 million, net of the \$292 million in trust assets, as of Dec. 31, 2012. The state's retiree health insurance premium account had an unfunded liability of \$56 million as of the same valuation date, which is entirely allocable to the state. Oregon's Public Employees Benefits Board (PEBB) also allows employees not in the PERS insurance plan to purchase pre-Medicare insurance benefits at a rate subsidized by the state. This translates to an estimated UAAL of about \$155 million as of July 1, 2011, the last valuation date. The total OPEB UAAL, therefore, as of 2011 for PEBB, and 2012 for the explicit liabilities was \$391 million. The state is funding its actuarially determined contribution for the PERS postemployment health care benefit obligation, but management reports that the state does not plan to set aside a reserve for the PEBB plan.

Table 2**U.S. States OPEB Liabilities And Funding Progress (cont.)****Pennsylvania**

Based on the most recent valuations, Pennsylvania's OPEB unfunded liability for its retired Employee Health Care Program and its retired Pennsylvania State Police Program was about \$16.3 billion as of June 30, 2013. The commonwealth paid \$682 million in fiscal 2013, or 63% of the actuarial annual OPEB cost. The commonwealth employs a pay-as-you-go system and has consistently not funded its full ARC payment, a liability that Standard & Poor's expects will increase. In the past, Pennsylvania had taken some steps to contain the growth, including increasing employee contributions, raising the years of service for early retirement to 20 years from 15, introducing alternative plans, and offering the option for employees to enroll in a Medicare health management organization or preferred provider organization plan. The table also includes separate OPEB plans for the judiciary, house, and senate with combined OPEB UAAL of \$1 billion as of the latest valuation dates.

Rhode Island

The unfunded liability for the state's OPEBs, as of June 30, 2013 (the latest valuation), was \$674 million, excluding the board of education liability. The liability is about \$641 per capita. Rhode Island budgeted for the full OPEB annual required contribution for fiscal years 2011 through 2013, and began funding its OPEB trust fund during 2011, with actuarial assets of \$49 million at the end of fiscal 2013.

South Carolina

The South Carolina Retiree Health Insurance Trust Fund is funded on a pay-as-you-go basis with minimal additional fund accumulation to pay health benefits for state and public school retirees and their covered dependents. The state also has a Long-Term Disability Insurance Trust Fund, which was overfunded by \$12 million as the result of \$36 million held in trust on an actuarial basis. The combined UAAL for retiree health and dental insurance benefits and long-term disability insurance benefits earned as of June 30, 2012, was an estimated \$9.7 billion, down \$10.1 billion from June 30, 2011. The fiscal 2013 combined OPEB ARC was \$828 million, which South Carolina funded at 50%. The state established the two OPEB trust funds in 2008, and the general assembly has incorporated a recurring \$2.4 million annual appropriation for OPEB into its budget. Additionally funded with a payroll surcharge and investment income, the actuarial value of the combined OPEB trust balances totaled \$625 million as of the last valuation date resulting in a 6% funded ratio.

South Dakota

In our opinion, the OPEB liability is low and is limited to an implicit rate subsidy. The UAAL was only \$68 million, or \$80 per capita as of July 1, 2012, the last valuation date. We understand the governor recently notified retirees that respective rates in fiscal 2015 will reflect total cost and retirees will remain responsible for paying their full premium. Because of this change, state officials expect no implicit OPEB liability will be recorded on a generally accepted accounting principles (GAAP) basis in their future financial statements.

Tennessee

Tennessee's most recent actuarial unfunded OPEB liability as of a July 1, 2011, valuation date, was \$1.48 billion for its state employees, \$221 million for its state Medicare supplement plan, \$217 million for the state share of the Teachers Group Plan, and \$163 million for the teachers Medicare supplement plan. However, the \$1.48 billion unfunded OPEB liability includes \$533 million in implicit subsidy, leaving an explicit subsidy of \$943 million. The state has been funding its OPEB liability on a pay-as-you-go basis and has not funded an OPEB trust fund. In fiscal 2013, the state portion of the annual actuarial OPEB cost was \$201 million for all four plans, of which it paid \$102 million, or 51% in aggregate. Officials are likely to continue to use pay-as-you-go financing to fund this liability.

Texas

Texas provides retiree health benefits through a State Retiree Health Plan (SRHP) administered by the cost-sharing, multiple-employer Employees Retirement System. The state also provides OPEB benefits through a separate cost-sharing, multiple-employer Teacher Retirement System benefit fund (TRS-Care). The SRHP had an unfunded OPEB liability of \$23.0 billion as of Aug. 31, 2013, up from \$20.8 billion at Aug. 31, 2012. The main driver of the increase in the actuarial UAAL estimate reflects ongoing payroll and salary growth as well as changes to actuarial assumptions based on plan experience that more than offset minimal savings from recent plan changes to retiree contribution rates based on years of service. The TRS-Care OPEB UAAL totaled \$29.3 billion in 2013, up from \$26.8 billion in 2012, incorporating a minimal \$551 million of actuarial assets in trust as of Aug. 31, 2013 (1.9% funded ratio). The actuarial estimate incorporates minimal savings from changes made in 2013 to raise the eligibility age for TRS-Care health benefits to 62 from 60. The state's aggregate OPEB UAAL of \$61.2 billion across plans as of Aug. 31, 2013, increased 10% compared with the Aug. 31, 2012, valuation and is higher than the median for U.S. states. The SRHP had a "reverse" OPEB implicit subsidy in fiscal 2013 as a result of federal Medicare subsidies, whereby excess retiree contributions for health care actually subsidized active employees by \$74.5 million. The SRHP has been funded on a pay-as-you-go basis and has no actuarial assets. TRS-Care funding from retirees, active employees, local school districts, and the state in fiscal 2013 totaled \$477 million, or 25% of the ARC. Also included in the summary table is the University of Texas' unfunded OPEB of \$6.9 billion and Texas A&M University's unfunded OPEB of \$1.9 billion.

Table 2**U.S. States OPEB Liabilities And Funding Progress (cont.)****Utah**

Utah has two OPEB funds -- one for state employees and one for elected officials -- with an aggregate \$268 million OPEB UAAL as of Dec. 31, 2012, the most recent valuation date. The state's employee OPEB plan is capped; only state employees entitled to receive retirement benefits and hired before Jan. 1, 2006, are eligible to receive OPEB health and life insurance benefits. The unfunded OPEB liability for state employees was \$259 million as of the Dec. 31, 2012, valuation date. Since then, Utah has contributed virtually 100% of its OPEB ARC for both plans, including \$40.1 million paid in fiscal 2013, which was slightly more than its actuarially annual OPEB cost of \$39.5 million. The employees' OPEB trust fund was 36.7% funded in 2012, and annual OPEB costs will likely decline due to the cap on new employees. The Elected Officials OPEB trust had a \$9.21 million unfunded OPEB liability at Dec. 31, 2012 and a funded status of 36.6%. The actuarial assumptions include a 4.5% discount rate and a remaining 20-year open amortization period.

Vermont

Vermont offers postemployment medical insurance, dental insurance, and life insurance benefits to retirees of the single-employer Vermont State Retirement System (VSRS) and the multi-employer Vermont State Teachers' Retirement System (VSTRS). The actuarial annual OPEB cost in fiscal 2013 was \$70 million for the VSRS, of which Vermont paid 36% under pay-as-you-go funding. The VSTRS also uses pay-as-you-go funding, but Vermont did not break out the actual employer contribution historically, instead including it through the pension fund without an explicit appropriation. In 2014, Vermont passed legislation to establish a retired teachers benefit fund and increase certain employee contributions, impose a health care fee for new hires, and appropriate state money toward annual retired teacher health benefit costs. The VSTRS plan's OPEB UAAL improved to \$713 million as of June 30, 2013, from \$827 million in June 2012 primarily reflecting a change to a Medicare Part D EGWP for prescription drug benefits from a retiree drug subsidy program. As of June 30, 2014, however, the VSTRS OPEB UAAL increased to almost \$767 million reflecting recent demographic experience and other refinements. The state has established an OPEB trust fund for the VSRS, but as of June 30, 2014, it contained only \$18.9 million of assets, for a 1% actuarial asset funded ratio. We understand the VSRS will also offer Medicare prescription drug benefits through an EGWP beginning in Jan. 1, 2015. Before this change, VSRS had been contributing Medicare Part D refunds from a Retiree Drug Subsidy program into the irrevocable trust fund. Assuming no pre-funding, the June 30, 2014, valuation assumed a lower 4% discount rate (from 4.25%) and higher-than-expected increases to per capita costs resulting in about \$1 billion OPEB UAAL. The separate multi-employer Vermont Municipal Employees Health Benefit Fund for local government is administered by the state, but has no liability to the state, and is not included in our OPEB calculations.

Virginia

The commonwealth has five postemployment benefit programs (retiree health insurance credit, group life insurance, Virginia sickness and disability plan, pre-Medicare retiree health insurance program, and line-of-duty death and health insurance benefits). It estimates its OPEB liability under GASB Statement 45 to be \$6.55 billion, with actuarial assets valued at about \$1.2 billion in its combined OPEB trust for a combined funded ratio of 18% and a \$5.36 billion liability as of June 30, 2012. For fiscal 2013, the combined actuarial annual OPEB cost was \$348 million, of which Virginia contributed \$155 million, or 45% in fiscal 2013. The University of Virginia and the Virginia Housing Development Authority have OPEB funds, but their actuarial financial position was not disclosed in the state's CAFR and has not been included in our summary table.

Washington

Washington State's OPEBs produce an implicit liability from allowing retired employees to purchase health, life, and vision insurance in the same pool as current employees at a subsidized rate. In addition, the state provides an annually determined set dollar amount to subsidize retired members' monthly premiums for enrollment in Medicare Parts A and B. On an actuarial basis, the state's portion of the UAAL totaled \$3.71 billion as of Jan. 1, 2013, up slightly from \$3.5 billion as of Jan. 1, 2011. The January 2013 valuation assumes an actuarial rate of return of 4.0% compared with 4.5% used in the 2011 valuation. The actuarial annual OPEB cost was \$347 million in fiscal 2013, of which the state contributed \$69.1 million for current pay-as-you-go expenses for retiree benefits. Washington funds its OPEB on a pay-as-you-go basis and we understand that the state does not plan to fully fund the ARC for the foreseeable future. We have excluded the Public Employees Benefits Board OPEB UAAL related to Kindergarten to grade 12 and political subdivisions.

West Virginia

West Virginia's OPEB plan is a cost-sharing, multiple-employer plan that covers state government and its agencies, state-related colleges and universities, county boards of education, county and municipal governments, and other employers allowed under statute. The Public Employees' Insurance Agency (PEIA) funds retiree health benefits. The West Virginia legislature created the West Virginia Retiree Health Benefits Trust Fund in 2006, which PEIA administers. The state's OPEB UAAL as of June 30, 2013, was \$2.7 billion, which reflects significant improvement compared with \$7 billion in June 30, 2009, after the state passed legislation in fiscal 2011 to impose either higher premium or lower benefits to retirees. The legislation also redirected a portion of personal income tax revenues annually into an OPEB trust fund and into a trust fund to assist employees hired after July 1, 2010. The significant previous decline in liability since 2009 primarily reflected the new board policy that eliminated the explicit subsidy for retirees and a change to the discount rate from 3.56% to 6.10% to reflect assumptions about future contributions under the new funding plan. The June 30, 2013, valuation assumed a further change to the discount rate to 6.7% reflecting the funding plan. There was \$590 million in actuarial assets in the trust fund as of the most recent June 30, 2013 actuarial valuation, for an 18% funded ratio, up from a 5% funded ratio in 2009. The fiscal 2013 ARC was \$307 million, of which actual employer contributions totaled \$188 million, or 61% of the ARC.

Table 2

U.S. States OPEB Liabilities And Funding Progress (cont.)

Wisconsin

The state allows retirees to continue their participation in its health care plan at their own expense, which gives rise to an unfunded implicit rate subsidy under GASB 45. Retirees can pay for their health care benefits with unused sick leave. The most recent Jan. 1, 2013, actuarial valuation showed an OPEB UAAL for the state's health insurance program of \$893 million. Wisconsin funds the OPEB liability on a pay-as-you-go basis and paid \$39 million for the implicit rate subsidy in fiscal 2013, or almost 50% of the actuarial annual OPEB cost. The state does not expect to set up a trust fund to accumulate assets against its OPEB unfunded liability at this time.

Wyoming

Wyoming has what we consider to be a low unfunded OPEB liability of \$218.7 million for state employee retiree health care in its Retirees Health Plan as of a July 1, 2011, actuarial valuation date. This OPEB consists wholly of an implicit subsidy, whereby retired and current state employees pay a single blended rate for health care premiums, which are fully paid each year under Wyoming's pay-as-you-go funding. In fiscal 2013, the state Retirees Health Plan's actuarial annual OPEB cost was \$17 million, to which the state contributed \$8.4 million. The University of Wyoming has a separate \$24.5 million unfunded OPEB, as of the most recent July 1, 2012, valuation date that is included in the table.

Related Criteria And Research

Related Criteria

USPF Criteria: State Ratings Methodology, Jan. 3, 2011

Related Research

- 2014 U.S. State Debt Reviews: New Issuance Remains A Lower Priority, Oct. 13, 2014
- U.S. State Pension Funding: Strong Investment Could Lift Funded Ratios, But Longer-Term Challenges Remain, June 24, 2014
- U.S. State OPEB Liabilities Decline Slightly, But Continue To Vary Widely, Nov. 25, 2013
- Hawaii Moves To Tame Its OPEB Liability, July 23, 2013

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