Orange County – Retiree Medical Program

Board Workshop
June 20, 2006

Introduction - Topics for Discussion

- Retiree Medical Program – Current Status
- Options for Solving the Retiree Medical Problem
- Presentation of Multiple Employer Trust Concept
- Open Discussion

Background – Retiree Medical

- Problems maintaining adequate revenues for the Retiree Medical Program surfaced several years ago as excess earnings in the investment account dwindled.

- In January 2005, the County began working with an ad hoc committee comprised of labor representatives, retirees, and the County's health care consultant at the time, to address the funding shortfall.

- In FY 05-06, for the first time since the program was established in 1991, the County began making contributions (1%) to the Retiree Medical Program.

Background – Retiree Medical

- A County contribution of 1% of payroll and $5M transfer from the 295 Account was made to continue funding until a solution is adopted.

- The Board was aware that this action was not a permanent solution to the problem and that additional adjustments to the program would be necessary in the future.

Background – Retiree Medical

- Another concern was compliance with Government Accounting Standards Board (GASB) 45 by Fiscal Year 07-08.

- If the County did not do something to significantly reduce the $1.4B unfunded liability, the annual amortization of the liability (UAAL) will be reported in the Comprehensive Annual Financial Report (CAFR) starting in Fiscal Year 07-08.

- The reporting requirement of GASB 45 is more than just “a paper liability.”

Background – Retiree Medical

- The issue of whether the Retiree Medical Program is a vested right needed to be addressed to determine the appropriate course of action.

- If the issue of vesting is litigated, the outcome is uncertain and impossible to predict.

- What is certain is that retiree medical benefits are subject to meet and confer, making negotiation the best way to proceed.

- Based on current MOU provisions with most units, the County would not have the opportunity to address Retiree Medical until June 2007. The concept of “global compensation” was presented to the Board in August 2005 to address the 2006 wage re-opener and Retiree Medical early.

Background – Retiree Medical

- Staff and Labor Organizations began discussions in late August 2005.

- Options to solve the negative cash flow and find ways to address the unfunded liability were presented and discussed.

- Some of the options discussed were:
  - Changing the grant amount and/or usage
  - Freezing the grant
  - Changing the eligibility requirements, increasing years of service and age requirements

Background – Retiree Medical

- Factors contributing to the current problem - revenue shortfall and unfunded liability - are:
  - The benefit is a lifetime benefit (i.e., does not end when retiree attains a certain age)
  - The increasing cost of health care
  - The program is a pay-as-you-go and not pre-funded
  - The current program provides for an automatic inflationary factor for the grant
  - The “implied subsidy” created by pooling retirees with actives for health care plan costs must be reported as an unfunded liability

Options – Do nothing

- The County could continue the Retiree Medical Program as is, but the cost would exceed the revenues by March or April 2007

- Additional funding (at least additional 1% or $10M per year) would need to be provided by the County until changes are made

Options – Do nothing (continued)

- Continuing to fund the Retiree Medical Program without any changes does not address the unfunded liability (UAAL)

- As the number of retirees grow and the cost of healthcare increases, the County's UAAL will also increase

- This is a very costly option as there are no cost controls in place to adequately protect the County in the out years

Options – Structural Changes

- Many structural changes to the Retiree Medical Program can be made

- All structural changes require negotiations

Options – Structural Changes (continued)

- Some, and not all, structural changes may be addressed such as:
  - **Freezing the grant –**
    Advantage:
    - Immediately reduces UAAL approximately 20% - 30%

    Disadvantages:
    - Cash flow issue not immediately resolved
    - Real value of the grant diminishes (purchasing power) as cost of healthcare increases (especially if pool is split)
  - **Separating retirees from the actives for health care plan premiums -**
    Advantage:
    - Immediately reduces UAAL approximately 30% - 35%
    - Generates County savings for active employee plan rates

    Disadvantages:
    - Cash flow issue not immediately resolved, so savings from splitting the pool will likely be used to continue funding the program
    - Real value of grant diminishes if plan design changes are not made to retiree health care plans

Options – Structural Changes (continued)

- Change eligibility requirements from 10 years and age 50 retroactively (applies to current retirees as well as future retirees) to:
  - 15 years of service and age 55 –

    Advantage:
    - Helps somewhat with funding issue IF applied retroactively

    Disadvantages:
    - Does not have immediate impact on reducing UAAL
    - Immediate elimination of benefit for current retirees

  - Benefit not available for "early retirees" retiring pre-65

    Advantage:
    - Minimal savings
    - Employees may stay longer with the County

    Disadvantages:
    - Minimal impact on reducing UAAL or funding requirements since majority of current grant recipients are over age 65
    - Immediate elimination of benefit for current retirees

Options – Structural Changes (continued)

- Change eligibility requirements from 10 years and age 50 prospectively (new retirees only) to:
  - 15 years of service and age 55 –
    Advantage:
    - *Establishes major structural change*

    Disadvantages:
    - Does not address either funding or UAAL issue until future years
    - Creates a two-tier system

  - Not available for "early retirees" retiring pre-65
    Advantage:
    - Establishes major structural change
    - Encourages employees to stay with County

    Disadvantages:
    - Does not address either funding or UAAL issue until future years
    - Creates a two-tier system

Options – Structural Changes (continued)

- Currently, amount of grant based on years of service times monthly amount, irrespective of amount of pension or bargaining unit

- Change calculation of grant amount and tie to amount of pension retiree receives
  - *For example*:
    - Monthly pension <$2500 – grant = $400
    - Monthly pension $2500 - $3500 – grant = $300
    - Monthly pension $3501 - $5000 – grant = $200
    - Monthly pension >$5000 – No grant

- As with other structural changes – little impact on reducing liability or addressing revenue shortfall unless retroactively applied

Options – Impose Changes

- In order to impose changes, the County must first comply with the Meyers, Millias Brown Act (MMBA) and negotiate in good faith with labor and try to reach agreement on the issues

- In the interim, during the negotiation process, the County must continue funding the program (effective April 2007, the County's contribution will likely increase by at least 1%, making the total contribution over $20M annually)

- If no agreement is reached – the impasse procedures in the Board-adopted Employee Relations Resolution must first be exhausted

Options – Impose Changes (continued)

- Until impasse procedures are exhausted, the County cannot unilaterally change or discontinue the Retiree Medical Program

- Like the “Do Nothing” option, this is also a very costly option

- Depending on the County’s last, best and final proposal, upon unilateral imposition, a number of issues may be challenged, such as the vesting issue and the possible long-term liability it entails

Options - continued

- All options (except do nothing) require negotiations
- Depending on the options pursued, getting agreement with the labor organizations may not be sufficient to change the existing program
- There is an additional statutory requirement to also provide retirees an opportunity to hear and provide input prior to the Board taking action on implementing changes (AB111)

Staff Recommendation

After analyzing all options noted here, staff recommends:

- Creating a Multiple Employer Trust consistent with GASB 45 and 43 requirements

- Benefit becomes a hybrid Defined Contribution Plan – greatly reduces (may eliminate) unfunded liability as only GASB reportable amount is cost of annual contribution

- Establish a set a contribution level

Benefits of a Trust

- Trust reimburses participating retirees from the County and other related organizations for health and/or Medicare premiums

- The Trust pays only as much for the grant as it can afford while maintaining the actuarial soundness of the Trust

- Split the active and retiree pool effective January 2007

- Offer alternative health care plans for retirees to minimize impact of splitting the pool

Benefits of a Trust

- Reduces the risk that all plan benefits (grant and 1% lump sum) are determined to be a vested right through potential litigation
- The pool is split between active employees and retired employees (reduces unfunded liability by approximately 30% -35%)
- County's unfunded liability for the grant is eliminated when the Trust assumes responsibility for the grant*
- GASB 45 reporting requirement is limited to reporting required contribution
  - CAFR footnote must refer to the Trust's financial statements. Trust has liability for grant.
- Growing cash flow problem is solved
- Employer and employee defined contribution as a percentage of payroll

* Assumes Trust continues to meet GASB definition of multiple employer cost sharing plan

Benefits of the Trust (continued)

- County will have a financially sound retiree medical program for retired County employees.

- County retirees will have access to a financially sound retiree medical program.

- The Trust has taken on
  - Responsibility for the grant
  - Risk of investment earnings
  - Determining future changes in grant levels, and
  - Disclosure of liabilities

Status of Retiree Medical – Other Jurisdictions

- Other public agencies have begun working with their labor organizations and retirees to address the GASB 45 issue

- Based on a recent survey by CSAC – Orange County began its review much earlier than most jurisdictions

- Not all jurisdictions have the same issues as Orange County, for example
  - Fresno County began phasing out pooled rates for retirees three years ago. Because of the GASB 45 requirement, they've accelerated splitting the pool
  - San Bernardino County eliminated pooled rates years ago
  - Riverside County heavily subsidizes their retiree rates and provide a grant of $25/month

Status of Retiree Medical – Other Jurisdictions

- Other jurisdictions are also considering establishing a similar retiree medical trust
  - Riverside
  - San Diego

Conclusion

- The problem facing Orange County is not unique
- Because of differences in retiree medical benefits for each jurisdiction, there is no silver bullet approach

Questions/Discussion