COUNTY OF SAN DIEGO

BOARD OF SUPERVISORS

1600 PACIFIC HIGHWAY, ROOM 335, SAN DIEGO, CALIFORNIA 92101-2470

AGENDA ITEM

DATE: December 5, 2006

TO: Board of Supervisors

SUBJECT: PROPOSED CHANGES TO RETIREE HEALTH BENEFITS (Districts: All)

SUMMARY:

Overview

The Board of Retirement of the San Diego County Employees Retirement Association (SDCERA) provides vested pension benefits to retired employees. Vested, or guaranteed, benefits are set by the County and guaranteed to employees upon their hiring. As such, SDCERA is obligated to continue making these payments. SDCERA also provides a health insurance program to retired members, their dependents, surviving spouses and registered domestic partners. As non-vested, or non-guaranteed benefits, payments for health and dental insurance premiums are awarded to eligible retirees at the discretion of the SDCERA Board.

Recent changes in the accounting standards issued by the Governmental Accounting Standards Board (GASB) have brought to the forefront the serious fiscal impact that the County of San Diego faces if SDCERA continues to subsidize retiree health benefits as they are provided today. It is estimated that the total amount the County should invest today that would cover the costs of non-vested retiree healthcare, or the "actuarial accrued liability", is $640 million. The estimated Annual Required Contribution (ARC) that the County should make for SDCERA to continue providing retiree health benefits at their current levels could be as much as $60-70 million a year and will increase in the future. When added over a 20 year period, the amount of the County's ARC payments is estimated to be $1.8 billion. These amounts represent a significant cost to the taxpayers that cannot be sustained.

Today's action asks the Board of Supervisors to urge the Board of Retirement to exercise its independent authority and eliminate the subsidy that SDCERA pays toward the health insurance premiums for Tier A safety and general members, those retired members who are entitled to the highest vested retirement payments among all retirees.

Preliminary estimates indicate that limiting these benefits only to Tier I and II members would reduce the ARC from an estimated $60-70 million a year to approximately $20-30 million, thereby reducing the total estimated cost to County taxpayers from ARC payments over 20 years from $1.8 billion to $637 million. Additionally, adoption of today's recommendations would reduce the actuarial accrued liability from about $640 million to approximately $290 million. Although the County would no longer contribute to the cost of non-vested health benefits for Tier A retirees, those retirees would continue to be eligible to participate in SDCERA's health insurance programs at their own cost. The estimated $20-30 million expense to the County is significant. However, at this time it is believed that the County can identify funds to meet an obligation at this level.

Recommendation(s):
SUPERVISOR DIANNE JACOB AND SUPERVISOR PAM SLATER-PRICE:

1. Adopt the attached resolution that directs the Chief Financial Officer to designate the County's contribution to SDCERA for retiree health care payments if the following actions have been taken by SDCERA:
   (a) By June 30, 2007, SDCERA has adopted and continues to maintain a policy limiting health care allowance payments to Tier I and Tier II members only.
   (b) Except as provided in (a) above, that SDCERA continue the provisions of its retiree health allowance program relating to qualifications for benefits and maximum payments at levels no greater than what is currently authorized.

2. Authorize the Chief Administrative Officer, through the County's designated Labor Relations representative, to continue discussions with authorized employee representatives on the development and implementation of a Voluntary Employee Benefit Association (VEBA) as a method for future funding of retiree health care.

3. Authorize the Board Ad Hoc Subcommittee on Retiree Health Benefits to send a letter, prior to the completion of SDCERA's actuarial valuation of postretirement health care benefits, to the SDCERA Board of Retirement advising it of the actions of the Board of Supervisors, and transmit with the letter a copy of this Board Letter and the adopted Resolution.

Note for the official record that all County elected officials including the members of the Board of Supervisors, whose membership in the County retirement system currently makes them eligible upon retirement for payments toward health benefits, will have such eligibility terminated as a result of the adoption of the attached resolution.

Fiscal Impact:
The current health allowance program provided by SDCERA to retirees is estimated to result in an Annual Required Contribution (ARC) of approximately $60-$70 million to a retiree medical care trust account. The County would be required to report a liability in its financial statements for Fiscal Year 2007-08 if this contribution is not made in

full. The ARC is estimated to be significantly reduced to approximately $20-30 million if the health allowance program were restricted to Tier I and Tier II retirees. By adding the ARC payments over 20 years, the total estimated costs to the taxpayers from this action would be reduced from $1.8 billion to $637 million. Because the ARC is calculated on a level percent of pay basis, the amounts grow each year as base payroll grows until the unfunded liability is reduced to zero. At that time, the ARC would be reduced to the amount necessary to sustain the benefit going forward. By limiting the benefit to Tier I and Tier II employees, the ARC would eventually be eliminated altogether, resulting in significant savings to San Diego County taxpayers. As of June 30, 2006, SDCERA has a balance of approximately $217 million in health reserve accounts funded by excess earnings of the Retirement Fund that may be used to help mitigate the County's ARC for the next few years.

Business Impact Statement:
N/A

Advisory Board Statement:
N/A

BACKGROUND:
<u>Retiree Health Insurance Benefits Provided by SDCERA</u>

In addition to the vested pension benefits that the SDCERA Board of Retirement provides to retired employees, SDCERA also makes available a non-vested health insurance program to retired members, their dependents, surviving spouses and registered domestic partners. Vested, or guaranteed benefits, are set by the County and guaranteed to employees upon their hiring. As such, SDCERA is obligated to continue making payments for vested benefits

As non-vested, or non-guaranteed benefits, payments for health insurance premiums are awarded to retirees at the discretion of the SDCERA Board. The health insurance benefits consist generally of group healthcare insurance coverage, both medical and dental, and a monetary contribution toward a portion of the group healthcare insurance premium charged to each eligible retired member who enrolls for the health insurance coverage.

In 1974, SDCERA began to pay, on a discretionary, non-vested basis, a health care allowance for retired members solely from statutorily defined "excess earnings," subject to eligibility requirements and maximum payment amounts as determined by the Board of Retirement.

In response to requirements contained in the United States Internal Revenue Code, on June 20, 2000 (24) the Board of Supervisors adopted a resolution which made Government Code section 31592.4 operative in San Diego County and facilitated the funding of the 401(h) account, which was established by the Retirement Board to fund health benefits pursuant to Internal Revenue code section 401(h). Government Code section 31592.4 allows the County's contribution to the 401(h) health account to be mitigated by investment earnings of the Retirement Fund.
Because these non-vested retiree health benefits can be reduced or eliminated at any time, there has been no requirement to pre-fund the cost of these benefits into future years. If available

resources to fund such non-vested retiree health insurance benefits run low, the proposed solution simply has been to reduce or eliminate the benefits since the program is a pay-as-you-go system based on earnings from the investments of the retirement fund, with no guarantee to future benefits.

New Nationwide Rule to Financially Account for Cost of Retiree Health Benefits

Recent major changes in nationwide accounting standards issued by the Governmental Accounting Standards Board (GASB), which are set forth in GASB Statement 45, now require that public employers must include in their financial statements any liabilities (i.e., the unfunded costs to provide these benefits now and in future years) resulting from Other Post Employment Benefits (OPEBs), such as the retiree health insurance benefits provided by SDCERA, effective in fiscal years beginning after December 2006. This new change required by GASB means that even though the SDCERA non-vested retiree health insurance benefits can be reduced or eliminated at any time, the County, commencing Fiscal Year 2007-08, must account for the costs of these benefits as if they would continue to be provided well into the future for the retirees. These changes also require the County to report an additional liability in its financial statements beginning in Fiscal Year 2007-08, to the extent the County does not fund its Annual Required Contribution (ARC) for retiree health benefits, as determined by an actuary.

Fiscal Impact on County Resulting from Retiree Health Insurance Benefits

The GASB requirements have brought to the forefront the serious fiscal impact that the County of San Diego faces if SDCERA continues to subsidize retiree health benefits as they are provided today. To date, SDCERA has not yet provided an actuarial valuation to determine the additional Annual Required Contribution (ARC) for these retiree health benefits. However, based on the amount that SDCERA pays towards a retiree's health insurance premium, and assumptions and methodology consistent with those currently used by SDCERA, it is estimated that the total amount that County should invest today that would cover the costs of retiree healthcare, or the "actuarial accrued liability", is $640 million. The estimated Annual Required Contribution (ARC) that the County should make for SDCERA to continue providing retiree health benefits at their current levels could be as much as $60-70 million a year and would continue to increase. When added over a 20 year period, the amount of the County's ARC payments is estimated to be $1.8 billion.

These amounts represent a significant cost to the taxpayers that cannot be sustained. This substantial budgetary impact would limit the County's ability to provide critical services. Additionally, it is reasonably expected that accounting for health care costs pursuant to GASB 45 without funding the ARC would result in a negative effect on the County's bond rating and substantially affect the County's ability to fund other programs unless measures are taken to reduce future costs.

Recommended Change to Retiree Health Care Allowance

The Board of Supervisors tasked us, as the Board Ad Hoc Subcommittee, with the responsibility of making recommendations to the County regarding retiree healthcare benefits for active and retired employees. We are recommending that the Board of Supervisors take action to urge SDCERA to eliminate the subsidy that is paid toward health insurance premiums for all eligible Tier A safety and general members, but continue such payment on a non-vested basis to eligible Tier I and II members, both safety and general, and maintain the other existing health insurance benefit qualifications and maximum payments such that they create a liability no greater than the current levels for those tiers. The rationale for removing the subsidy that is paid toward a Tier A member's health insurance premium is that Tier A members generally receive a substantially higher level of retirement pay than the Tier I or II members with similar years of service. Although the County would no longer contribute to the cost of health benefits for Tier A retirees, those retirees would continue to be eligible to participate in SDCERA's health insurance programs at their own cost.

It is anticipated that SDCERA's adoption of today's recommendations would result in a substantial reduction in costs to County taxpayers as well as a reduction in the liability the County must report under GASB 45. Preliminary estimates indicate that limiting these benefits only to Tier I and II members would reduce the ARC from an estimated $60-70 million a year to approximately $20-30 million, thereby reducing the total estimated cost to the taxpayers from ARC payments over 20 years from $1.8 billion to $637 million. Additionally, adoption of today's recommendations would reduce the actuarial accrued liability from about $640 million to approximately $290 million. If SDCERA has not adopted a policy as described above by June 30, 2007, the Chief Financial Officer will not designate any portion of the County's contribution to be placed in the 401(h) account. If this should occur, health insurance benefit payments would be eliminated for all retirees.

<u>Nature of the Respective Actions by the Board of Supervisors and the Retirement Board</u>

Both the Board of Supervisors and the Retirement Board are independent and separate official public bodies established pursuant to law. Each Board has the duty and responsibility to exercise independent judgment and authority in making official decisions on behalf of the public entity it represents. Should the Board of Supervisors approve the recommendations in this letter, and should the Retirement Board approve the actions requested by the Board of Supervisors, both Boards take such separate actions with the full understanding and intent that each body's respective actions constitute the exercise of its independent judgment and authority, and that no agreement between the Boards is intended or created by virtue of these actions. It is hereby confirmed that each Board shall not be bound or constrained to take different actions now or in the future because the intent of both Boards is that there is no agreement created by these actions.

Linkage to the County of San Diego Strategic Plan

These actions are aligned with the Required Disciplines of Fiscal Stability and Accountability/Transparency included in the County of San Diego's Strategic Plan for 2006-2011. Adoption of this resolution and the associated actions will support the discipline of Fiscal Stability by ensuring that the County has the resources necessary to fulfill our obligations to the citizens we serve. These actions also support the discipline of Accountability/Transparency through the implementation of GASB 45 standards as part of the County's reporting on the expenditure of public funds.

Respectfully submitted,

Supervisor, JACOB District 2

Supervisor, SLATER-PRICE District 3

SUBJECT: PROPOSED CHANGES TO RETIREE HEALTH BENEFITS (Districts: All)

AGENDA ITEM INFORMATION SHEET

CONCURRENCE(S)

COUNTY COUNSEL REVIEW	[x] Yes	
Written Disclosure per County Charter Section 1000.1 Required	[] Yes	[] No
GROUP/AGENCY FINANCE DIRECTOR	[] Yes	[] N/A
CHIEF FINANCIAL OFFICER	[x] Yes	[] N/A
Requires Four Votes	[] Yes	[] No
GROUP/AGENCY INFORMATION TECHNOLOGY DIRECTOR	[] Yes	[x] N/A
COUNTY TECHNOLOGY OFFICE	[] Yes	[x] N/A
DEPARTMENT OF HUMAN RESOURCES	[x] Yes	[] N/A

Other Concurrence(s):

ORIGINATING DEPARTMENT: District 2 & 3

CONTACT PERSON(S):

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AUTHORIZED REPRESENTATIVE: ______________________________

PREVIOUS RELEVANT BOARD ACTIONS:
February 26, 2002 (15) Adoption of Enhancements to Retirement Benefits
June 20, 2000 (24) Funding of Retiree Health Benefits

BOARD POLICIES APPLICABLE:
N/A

BOARD POLICY STATEMENTS:
N/A

CONTRACT NUMBER(S):
N/A