

Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

DISCUSSION ITEM

For Meeting of November 14, 2013

**ANNUAL ACTUARIAL VALUATION OF THE UNIVERSITY OF CALIFORNIA
RETIREE HEALTH BENEFIT PROGRAM**

EXECUTIVE SUMMARY

Each year, the Regents' Consulting Health Actuary performs an actuarial valuation of the University's Retiree Health Benefit Program to fulfill the University's financial reporting obligations and to inform the Regents about these obligations. Significant findings include:

- An Unfunded Actuarial Accrued Liability (UAAL) of \$12.5 billion, which represents a decrease from the \$14.5 billion amount as of July 1, 2012;
- An Annual Required Contribution (ARC¹) for Fiscal Year 2013-14 of \$1.48 billion, consisting of:
 - A Normal Cost of \$0.38 billion, approximately 4.4 percent of the University of California Retirement Plan (UCRP) covered payroll, and
 - An amortization cost of \$1.1 billion, approximately 12.9 percent of UCRP covered payroll; and
- Projected University cash costs for fiscal year 2013-14 of \$260 million, down from actual University cash costs of \$268 million in fiscal year 2012-13. This represents the projected pay-as-you-go cash costs of the retiree health benefits funded by a systemwide retiree health assessment.

Results shown are for the campuses and medical centers. The results for Lawrence Berkeley National Laboratory are presented separately.

¹Under governmental financial accounting and reporting requirements, the ARC is not required to be funded but it will be a component of the retiree health benefit expense recorded in the University's financial statements.

BACKGROUND

In fiscal year 2007-08, the Regents' Consulting Health Actuary, Deloitte Consulting LLP (Deloitte), began performing annual actuarial valuations of the University's Retiree Health Benefit Program (Program). The purpose is to report the Program's Unfunded Actuarial Accrued Liability (UAAL) at the beginning of the fiscal year and the Annual OPEB Expense for the fiscal year. (OPEB refers to "Other Post-Employment Benefits", *i.e.*, post-employment benefits other than pensions.) The valuation report also provides an analysis of the change in liability from the prior year's valuation.

Valuation results are based on the methods and assumptions that were initially approved by the Regents in May 2008 and updated based on approved recommendations from the latest UCRP experience study. Certain assumptions are updated annually (e.g., medical trend rates) and approved upon acceptance of the valuation. All of the assumptions are described in Section XI of the attached actuarial valuation report.

Total UAAL is expected to increase every year because the Program is currently not pre-funded, and the benefits accrued by active participants during the year are greater than the benefits paid for retirees. If all assumptions during the prior fiscal year had been exactly realized, the *expected* UAAL at July 1, 2013 would have been \$15.5 billion. Instead, the actual UAAL at July 1, 2013 was \$3 billion less than expected. This difference is considered a gain to the Program due to the following factors:

The overall experience of the Program resulted in a decrease in the Actuarial Accrued Liability of \$1.3 billion (8.3 percent) and in the ARC of \$165 million (8.6 percent). This gain was primarily due to the competitive bid process for medical and wellness providers undertaken in early 2013. This resulted in changes to the range of medical plans to be offered as of January 1, 2014 to employees and retirees. For Medicare-eligible retirees living in California, Anthem Plus, Anthem PPO, and CORE were replaced by Blue Shield Medicare PPO. For retirees not yet eligible for Medicare, Health Net – Full Network and Kaiser Umbrella were discontinued and Anthem Plus and Anthem PPO were replaced by UC Care.

There was a decrease in the Actuarial Accrued Liability of \$756 million (4.9 percent) and in the ARC of \$183 million (9.5 percent) due to the new graduated retiree health eligibility provisions for non-grandfathered employees. The provisions apply to employees hired or rehired following a break in service on or after July 1, 2013 and current employees who did not have age plus years of UCRP service credit totaling at least 50 with at least five years of UCRP service credit as of June 30, 2013.

The July 1, 2013 valuation also reflects a gain due to the implementation of the Medicare Exchange/Coordinator Program for Medicare-eligible retirees and Medicare-eligible covered family members living outside of California. The program is designed to help eligible out-of-state retirees and eligible family members find suitable individual coverage. For 2014, the University will provide a maximum annual contribution of \$3,000 per covered family member, subject to Graduated Eligibility, to a Health Reimbursement Arrangement (HRA), which retirees and covered family members will use to purchase individual coverage on an exchange

administered by Extend Health. It also provides a tax-advantaged funding arrangement that retirees and covered family members can use to pay for premiums and eligible medical expenses. The change resulted in a decrease in the Actuarial Accrued Liability of \$718 million (4.6 percent) and in the ARC of \$76 million (3.9 percent).

The net effect of assumption changes resulted in a decrease in the Actuarial Accrued Liability of \$194 million (1.2 percent) and in the ARC of \$18 million (0.9 percent). The primary cause of the gain was due to a change in the initial Medicare Advantage trend rates. This gain was partially offset by a decision to extend out the number of years for the trend rate to go from the initial rate to the ultimate rate of five percent from 11 years to 15 years – consistent with industry expectations of medical cost increases over time. For Medicare Advantage plans, initial trend rates were updated to be consistent with non-Medicare Advantage plans. This reflects reports from the Centers for Medicare and Medicaid Services in April indicating that it would not implement the cuts to Medicare Advantage plans previously assumed under health care reform.

Additional Information on the Valuation

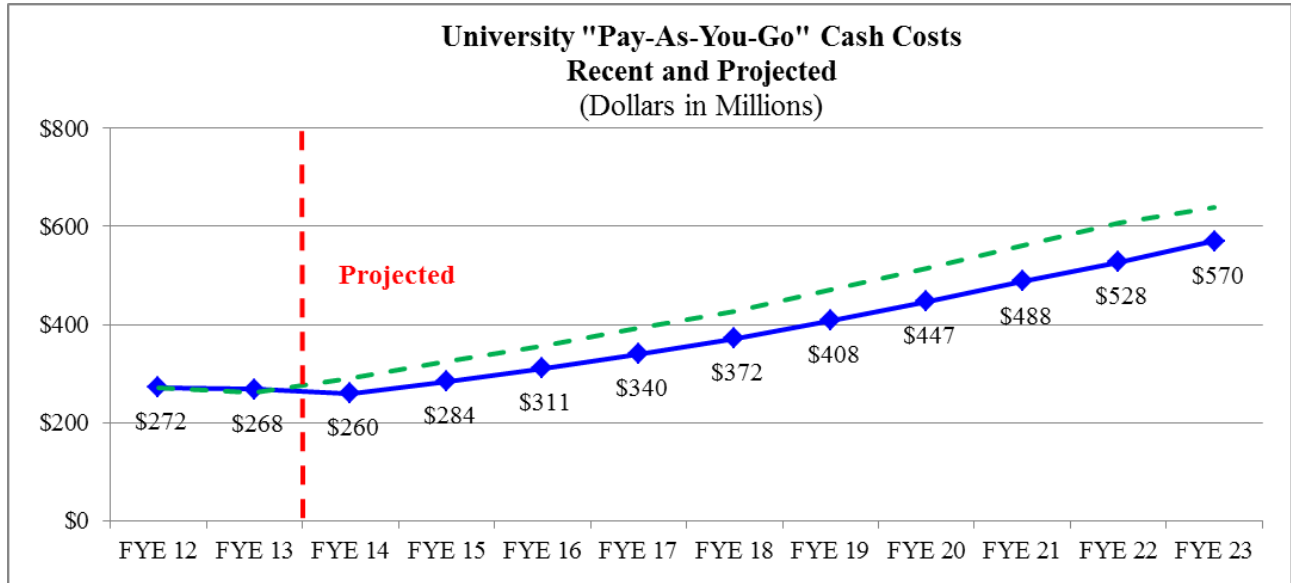
The Actuarial Value of Assets (AVA) of the Program as of July 1, 2013 was \$44 million. The Program is currently funded on a pay-as-you-go basis, but the year-end balance resulted from a combination of a one-time funding for cash flow purposes to facilitate administration and the difference between the amounts collected from locations by the retiree health assessment and the actual pay-as-you-go benefit plan costs since inception. Effective July 1, 2013, the AVA is the market value of assets, changed from a method that smoothed investment gains and losses over five years. Since the asset balance under a pay-as-you-go funding arrangement is primarily comprised of net cash flows each year, which are unrelated to investment earnings, a method that smoothes investment gains and losses adds little value. It was decided that the market value of assets would be a more appropriate methodology.

The funded ratio of the Program, which is determined by dividing the AVA by the Actuarial Accrued Liability (AAL), was 0.4 percent as of July 1, 2013.

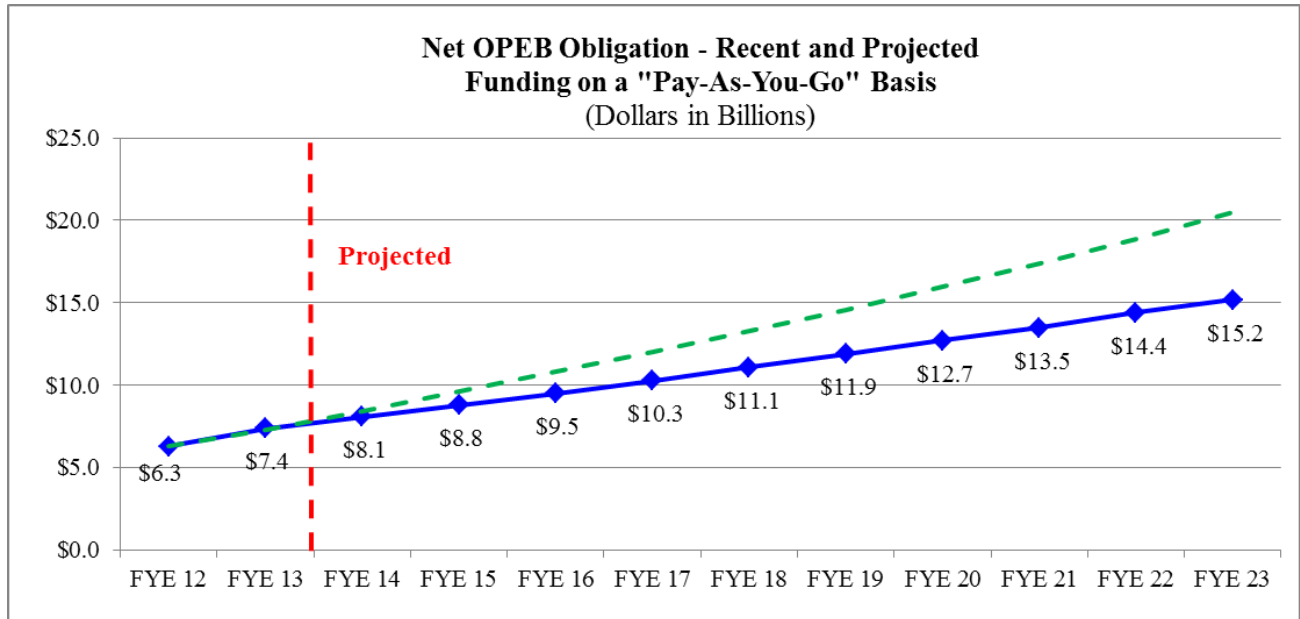
The Net OPEB Obligation (NOO), which is included in the University's balance sheet, was \$7.36 billion as of July 1, 2013. The current fiscal year's NOO equals the prior year's NOO plus the fiscal year 2012-13 OPEB expense less the University contributions to the Program.

The annual OPEB expense is the ARC plus interest on the NOO minus an ARC adjustment. For fiscal year 2013-14, the OPEB expense is \$1.06 billion. The annual OPEB expense for fiscal year 2012-13 was \$1.41 billion.

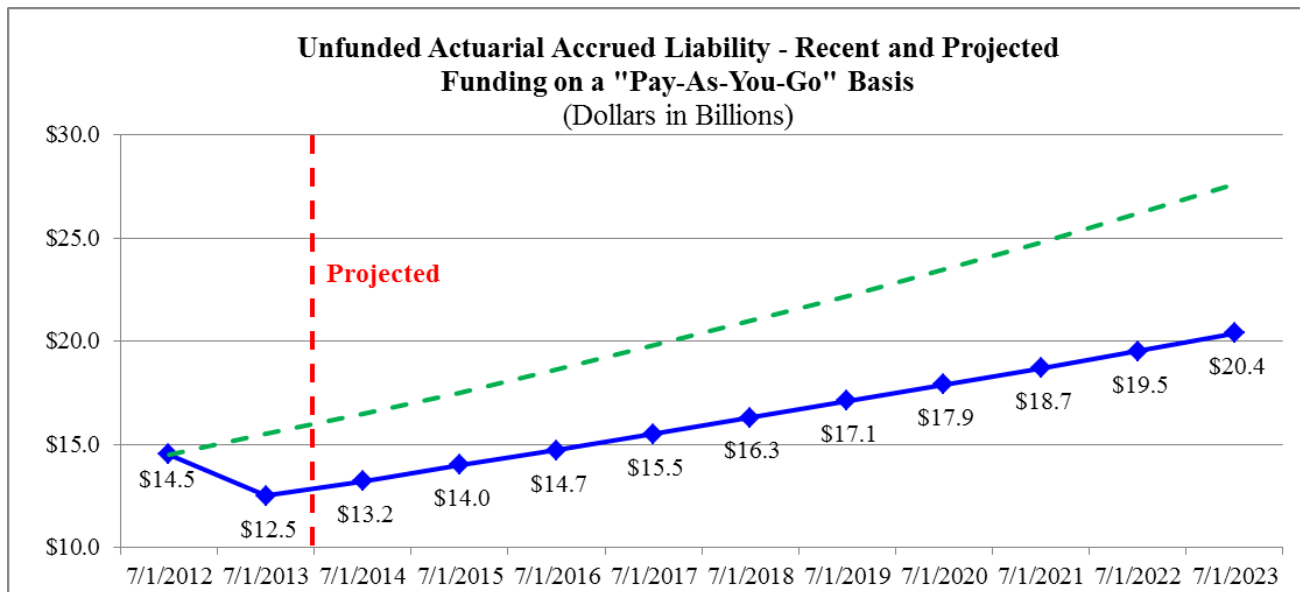
The expected University pay-as-you-go cash costs for fiscal year 2013-14 are \$260 million. The chart below shows recent history and a ten-year projection of the expected University pay-as-you-go cash costs, assuming no future programmatic or contribution policy changes. The blue line reflects current policy and assumptions. The dashed green line reflects policy and assumptions used in the July 1, 2012 actuarial valuation.



The expected NOO at July 1, 2013 is \$8.1 billion, assuming \$260 million of contributions on a pay-as-you-go basis. The chart below shows recent history and a ten-year projection of the expected NOO, assuming the Program is funded on a pay-as-you-go basis only and assuming no future programmatic or contribution policy changes other than assumed. The NOO grows by \$0.7 to \$1.1 billion a year due to the difference between the OPEB expense and the pay-as-you-go costs. The blue line reflects current policy and assumptions. The dashed green line reflects policy and assumptions used in the July 1, 2012 actuarial valuation.



The UAAL as of July 1, 2013 is \$12.5 billion. The chart below shows recent history and a ten-year projection of the expected UAAL assuming the Program is funded on a pay-as-you-go basis only, assuming no future programmatic changes. The blue line reflects current policy and assumptions. The dashed green line reflects policy and assumptions used in the July 1, 2012 actuarial valuation.



As of July 1, 2013, there were 154,930 actual or potentially eligible participants in the Program, compared to 151,458 participants as of July 1, 2012. Participants include:

- 117,723 active employees (potentially eligible).
- 37,207 retirees and surviving family members receiving benefits.

- 19,565 covered family members (15,443 spouses/domestic partners and 4,122 children).

Two of the key assumptions used in completing the valuation are the discount rate and the benefit cost trend rates. The discount rate of 5.5 percent is developed in accordance with the prescribed Governmental Accounting Standards Board (GASB) requirements. The first year medical trend rates range from 6.8 percent to 10.5 percent, decreasing to the ultimate rate of five percent over 15 years. The decrement assumptions, such as mortality, termination, and retirement, are consistent with those used in the UCRP actuarial valuation.

Similar results are presented in the attached valuation report for Lawrence Berkeley National Laboratory.

Retiree Health Benefit Trust

The University of California Retiree Health Benefit Trust (UCRHBT) allows certain University locations and affiliates that share the risks, rewards, and costs of providing for retiree health benefits to fund such benefits on a cost-sharing basis and accumulate funds on a tax-exempt basis under a trust account segregated from University assets. The Regents serve as the trustees of the UCRHBT. Currently, the University does not pre-fund retiree health benefits and instead provides for benefits on a pay-as-you-go basis through the UCRHBT. Pay-as-you-go financing for the campuses, medical centers, ASUCLA, Agriculture and Natural Resources, Office of the President, and Hastings is accomplished via a common retiree health benefit assessment that was set at 3.23 percent of covered UCRP payroll for fiscal year 2013-14. For the fiscal year ending June 30, 2013, the assessment was 3.72 percent during the period from July 1, 2012 to December 31, 2012 and 1.8 percent during the period from January 1, 2013 to June 30, 2013. In accordance with the University's contract with the Department of Energy (DOE), Lawrence Berkeley National Laboratory (LBNL) reimburses the University for the actual benefit costs paid by the University attributable to LBNL retirees. LBNL does not participate in either the UCRHBT or the retiree health benefit assessment. If pre-funding occurs in the future for campuses and medical centers, the assets will be maintained in the UCRHBT. Pre-funding is not able to be accomplished for LBNL retirees under the existing DOE contract, but the DOE is contractually obligated for LBNL retiree health costs.

Post-Employment Benefit Changes

In December 2010, the Regents approved the recommendations of the President's Post-Employment Benefits Task Force to gradually reduce the University's contribution to 70 percent of total health care premiums. For valuation purposes, it has been assumed that the pattern of a three percentage point annual decrease in the contribution percentage will continue until the floor of 70 percent is reached (separately for Medicare eligible retirees and non-Medicare eligible retirees under 65). Each year the administration will reassess the level of the University contribution, the appropriateness of an additional three percent reduction in the contribution percentage, and whether the floor should be 70 percent or a higher amount. This assessment is typically done during the annual health plan renewal process, taking into consideration overall budget resources, salary adjustments for active employees, and cost-of-living adjustments (COLAs) for retirees.

For calendar year 2014, the University will determine the maximum contribution for retirees as a percentage of total premiums (including standard Medicare Part B premiums) as follows:

- Medicare eligible retirees: 80 percent of aggregate premiums (including Medicare Part B premiums) for all Medicare eligible retirees covering only Medicare members.
- Non-Medicare eligible retirees under age 65: 72 percent of aggregate premiums for all non-Medicare retirees under age 65 covering only non-Medicare members.
- Non-Medicare eligible retirees age 65 and older: The same dollar amount as employees in Pay Band 2.
- The new eligibility provisions for retiree health also will apply.

The University will take appropriate action concerning proposed changes that may trigger notice, consultation, and meeting and conferring obligations under the Higher Education Employer-Employee Relations Act, if any such action is required. The recommendations as they apply to represented employees are subject to collective bargaining requirements.

Health Care Reform

The Patient Protection and Affordable Care Act (ACA) was signed into law on March 23, 2010. Its primary objective is to increase the number of Americans with health insurance coverage. The applicable provisions of ACA were first accounted for in the July 1, 2010 valuation. There have been no changes to the provisions determined to be applicable to this valuation; however, some methods and assumptions have changed that were used to value these provisions. In future years, there may continue to be an increased cost impact to the extent the Program experiences increased utilization due to these changes, all of which are assumed to be in place indefinitely.

The provisions of ACA considered in the valuation are as follows:

- Prohibiting lifetime and annual limits on the dollar value of coverage for “essential health benefits”
- Increasing the dependent child age limit to age 26
- Elimination of cost sharing for preventive services
- Reflecting manufacturer discounts available to certain Medicare beneficiaries receiving applicable covered Part D drugs (mostly brand) while in the coverage gap
- Early Retirement Reinsurance Program
- Excise tax on “Cadillac Plans” effective in 2018