Office of the President

TO THE MEMBERS OF THE COMMITTEE ON FINANCE:

DISCUSSION ITEM

For the Meeting of November 19, 2014

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 $14 billion, which represents an increase from the $13.2 billion amount as of July 1, 2013;

- An Annual Required Contribution (ARC) for fiscal year 2014-15 of $1.78 billion, consisting of:
  - A Normal Cost of $0.51 billion, approximately 5.6 percent of the University of California Retirement Plan (UCRP) covered payroll, and
  - An amortization cost of $1.27 billion, approximately 14 percent of UCRP covered payroll; and

- Projected University cash costs for fiscal year 2014-15 of $276 million, up from actual University cash costs of $271 million in fiscal year 2013-14. This represents the projected pay-as-you-go cash costs of the retiree health benefits funded by a systemwide retiree health assessment.

Results shown above are for the campuses, medical centers and Hastings. The results for Lawrence Berkeley National Laboratory and combined results are presented in the valuation report 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.

Restated July 1, 2013 Valuation Report

The July 1, 2013 valuation report was revised in July 2014 from the report originally presented to the Regents in November 2013, to reflect a subsequent decision to grandfather all current employees as of June 30, 2013 under the old graduated eligibility provisions, with the new graduated eligibility provisions now only applying to employees hired or rehired following a break in service on or after July 1, 2013, or applicable dates for employees represented by certain bargaining units. The medical enrollment distribution assumption was also updated from assumed migration between 2013 and 2014 plan options to actual 2014 medical plan elections. The above modifications increased the July 1, 2013 UAAL by $682 million and increased the Annual Required Contribution (ARC) for FYE June 30, 2014 by $161 million. The fiscal year 2013-14 results included in this discussion item are based on the updated July 1, 2013 valuation report.

Based on the valuation’s assumptions, 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. As regularly reflected in the annual valuation of the Program, a number of factors can have an impact on the long-range estimates of the UAAL. Ongoing Program costs are expected to be managed by continued cost containment and design adjustments. Also, as has been communicated to employees and retirees over the years, retiree health benefits are not accrued or vested benefits entitlements. If all assumptions during the prior fiscal year had been exactly realized, the expected UAAL at July 1, 2014 would have been $14 billion. The actual UAAL at July 1, 2014 was also $14 billion meaning there was no net gain or loss to the Program.

Additional Information on the Valuation

The Actuarial Value of Assets (AVA) of the Program as of July 1, 2014 was $65 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.

The funded ratio of the Program, which is determined by dividing the AVA by the Actuarial Accrued Liability (AAL), was 0.5 percent as of July 1, 2014.

The Net OPEB Obligation (NOO), which is included in the University’s balance sheet, was $8.2 billion as of July 1, 2014. The current fiscal year’s NOO equals the prior year’s NOO plus the fiscal year 2013-2014 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 2014-15, the annual OPEB expense is $1.28 billion. The annual OPEB expense for fiscal year 2013-14 was $1.22 billion.

The expected University pay-as-you-go cash costs for fiscal year 2014-15 are $276 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, 2013 actuarial valuation. The blue line and the dashed green line are close together due to the actual experience of the program over the past year being close to expected.

The expected NOO at June 30, 2015 is $9.1 billion, assuming $276 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 $0.9 to $1.2 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, 2013 actuarial valuation.
The UAAL as of July 1, 2014 is $14 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, 2013 actuarial valuation.

As of July 1, 2014, there were 157,221 actual or potentially eligible participants in the Program, compared to 154,930 as of July 1, 2013. Participants include:

- 118,733 active employees (potentially eligible).
- 38,488 retirees and surviving family members receiving benefits (actual).
In addition, there were 21,054 covered family members (16,802 spouses/domestic partners and 4,252 children) receiving benefits.

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 6.6 percent to ten 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.

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, Agricultural and Natural Resources, Office of the President, and Hastings is accomplished via a common retiree health benefit assessment that was set at 2.65 percent of covered UCRP payroll for fiscal year 2014-15. For the fiscal year ending June 30, 2014, the assessment was 3.24 percent. 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 of the University’s Post-Employment Benefits Task Force to gradually reduce the University’s maximum 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 different 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 2015, the University will determine its maximum contribution for retirees, as a percentage of total premiums (including standard Medicare Part B premiums) as follows:
• Medicare eligible retirees: 77 percent of aggregate premiums (including Medicare Part B premiums)
• Non-Medicare eligible retirees under age 65: 70 percent of aggregate premiums
• Non-Medicare eligible retirees age 65 and older: The same dollar amount as employees in Pay Band 2.

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:
  o Prohibiting lifetime and annual limits on the dollar value of coverage for “essential health benefits”
  o Increasing the dependent child age limit to age 26
  o Elimination of cost sharing for preventive services
  o Reflecting manufacturer discounts available to certain Medicare beneficiaries receiving applicable covered Part D drugs (mostly brand) while in the coverage gap
  o Transitional reinsurance fee
  o Out-of-pocket limit includes both medical and Rx expense
  o Excise tax on “Cadillac Plans” effective in 2018

Attachment 1 – July 1, 2014 Actuarial Valuation Report of the University of California Retiree Health Benefit Program

Key to Acronyms

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<tr>
<th>AAL</th>
<th>Actuarial Accrued Liability</th>
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<tr>
<td>ARC</td>
<td>Annual Required Contribution</td>
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<td>AVA</td>
<td>Actuarial Value of Assets</td>
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<td>COLA</td>
<td>cost-of-living adjustment</td>
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<td>DOE</td>
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<td>Lawrence Berkeley National Laboratory</td>
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<td>NOO</td>
<td>Net OPEB Obligation</td>
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<td>UAAL</td>
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