Financial Health Review Team

Legacy Costs

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The Group's Pension Plan Recommendations were approved by FHT on July 20, 2016 and sent to Council.

East Lansing Financial Health Team

EAST LANSING FINANCIAL HEALTH REVIEW TEAM
OPEB (OTHER POST EMPLOYMENT BENEFITS) LEGACY COST RECOMMENDATIONS

Background & Scope

The Group's charge: review the City's retiree health care benefits, and the legacy cost associated with those benefits. Legacy cost is similarly determined for pension benefits; the difference is that OPEB actuarial valuations are done every two years, instead of annually. Both OPEB and pension valuations are similar in that they determine the employer's contribution rate for the upcoming fiscal year (two fiscal years for OPEB). The City's most recent OPEB valuation, covering two calendar years through 12/31/2014, was released by the Actuary on August 12, 2016. Prior to that date, the Team (and FHT) had one meeting on OPEB. After the valuation was released, the Group met five more times. The Group approved these Recommendations on November 28, 2016, and the Financial Health Team's approval was given on December 12, 2016.

FHT Comments: Since July, 1993, the City has taken many positive actions to limit or reduce future retiree health care liabilities. Initially, retiree health care provided at retirement with 25 years City service was at the City's expense. Starting in 1993, health care cost was shifted to 100% retiree expense for all new hires in 5 employee units, and over the years, the same change has occurred in other groups, and now applies to 12 of the City's 21 employee units (Attachment 1). Where the retiree pays 100% of the cost of retiree health insurance, the City incurs no OPEB liability. Active management of health plan design including deductibles and copays for active employees and retirees is a key part of the City's labor-management Health Care Task Force (Attachment 2). The City first began to prefund its retiree health care liabilities in 2008, and has made periodic contributions as finances permit since, and the retiree health care trust account now has over $13 million in assets (Attachment 3).

It is clear to FHT that the City has for many years proactively managed its health care costs and future liabilities, and the City is congratulated for those actions. For most Michigan municipalities providing retiree health care benefits, OPEB liabilities are greater than pension liabilities, with no prefunding: but not in East Lansing. This does not mean that no more remains to be done; there is, and on a continuous basis. Without these prior actions, the City's OPEB plan overall, and amount of unfunded liabilities would be considerably greater and even more difficult to address.

Health Care Benefits in Michigan

Public sector pensions in Michigan have been required to be prefunded since January 1, 1964, when Article 9 section 24 of the Michigan Constitution of 1964 took effect. Prefunding sets aside funds today to pay for future retirement benefits earned in the current fiscal year, plus an additional contribution for any unfunded liabilities of the plan. Pension contributions are placed in a pension trust, and may only be used for payment of the employer's retirement obligations.

Until about 20 years ago, it was very uncommon for a public employer to prefund retiree health care obligations, which have no prefunding requirement like pensions. Typically, retiree health care (OPEB) plans were 'pay as you go', meaning payment of health care premiums coming due each year, with no prefunding monies set aside. Nationally, over the last 20 years, there has been increasing recognition of the growing retiree health care liabilities for municipalities. A Michigan law was enacted to allow for creation of municipal retiree health care trust funds; this is an option, not a requirement. The City is a member of MERS (Municipal Employees Retirement System), and about 10 years ago, MERS created the Retiree Health Funding Vehicle (RHFV). The RHFV is a retiree health care trust fund, and the City began participating when the City first began setting aside prefunding monies shortly after opening its account in October, 2008.

Recently, Michigan State University Extension Service's Center for Local Government Finance and Policy released its report, Legacy Costs Facing Michigan Municipalities (January 8, 2016): http://msue.anr.msu.edu/uploads/resources/pdfs/GMI_044_Legacy_Costs_WP-AA.pdf

The report found that OPEB (and not pension) cost for many municipalities as their most significant legacy cost. The average funding level for 300 OPEB plans in the state was 14%, compared to 80% for pension plans. The average OPEB unfunded liability was three times (3x) larger than pension unfunded liabilities, and was nearing $11 billion overall. The report also found that 49% of OPEB plans have no assets set aside in trust. In East Lansing, in major part due to requiring retirees and spouses to pay 100% of the cost of medical insurance for those hired in many employee divisions after a date certain (beginning in 1993), and limiting health care to those who work at least 25 years for the City, the situation is reversed: East Lansing pension plan unfunded liabilities of $80 million are twice the amount of unfunded health care liabilities of $40 million.

East Lansing OPEB valuation information

Since the mid-2000's, governmental OPEB plans have actuarial valuations performed, and East Lansing has OPEB valuations done every two calendar years as required by the Governmental Accounting Standards Board (GASB) rules. The most recent OPEB valuation for the City covered calendar 2013 and 2014, and is dated December 31, 2014 (Attachment 4). This report was released on August 12, 2016. The report indicated an actuarial accrued liability of $54 million. As with pensions, OPEB assets and liabilities are exclusively those of the municipality providing retiree health care. MERS invests the trust assets in RHFV on behalf of the City. The City has made periodic contributions to its RHFV trust; as of December 31, 2014, the trust had assets of $13.073 million (2014 valuation, p 2). Thus, with an accrued liability of $54 million, and assets of $13.1 million, the unfunded accrued liability was just under $41 million, and the funded ratio of the plan was 24.2%. It is noted that the discount rate (rate of assumed investment return) was reduced in the 2014 report from the prior 7.5% to 7%, which in and of itself increased plan liabilities by about 7% ($3.4 million of the total $6.3 million increase).

In the prior OPEB valuation dated December 31, 2012 (Attachment 5) (using the higher rate of 7.5%), the actuarial accrued liability was $47.7 million RHFV assets were $7.6 million, resulting in unfunded liability of $40.3 million, and a funded ration of 15.8%. (2012 valuation, p 2).

In comparing the 2012 and 2014 OPEB valuations:

- RHFV trust assets markedly increased in the 2014 OPEB valuation by $5.5 million, to $13.1 million. The City made additional contributions to its RHFV account in 2013 and 2014. Complete details are in Attachment 3.
- Unfunded liability was $40.3 million in 2012, and just under $41 million in 2014.
- It is useful to compare future premium cost projections in the two reports for FY 2016-2020, as they forecast a slightly decreasing trend largely due to lower actual medical rates than earlier projected (2014 valuation, p A-4).

FY	2012@p B-1	2014@B-1	Improvement
2016	$2.993	$2.799	$.194
2017	$3.241	$3.048	$.193
2018	$3.487	$3.307	$.180
2019	$3.719	$3.557	$.162
2020	$3.905	$3.758	$.147

Beginning in 2025, the 2014 valuation projection ($4.622 million) is slightly higher than the 2012 valuation projection ($4.598); and in the last year where there are comparative projections (2033), the 2014 valuation figure is $5.271 million, and the 2012 figure is $5.048 million. The Health Care Inflation Rates assumptions are comparable in both valuations (p F-8 in both reports).

<u>Snapshot of covered individuals and age</u>

As of 12/31/2014 (valuation, p E-3), there were 302 health care retiree and beneficiaries covered. There were 96 with one-person coverage, 126 with two-person coverage, and 80 who have opted- out or were ineligible but may potentially return to the plan in the future. There are also 14 retirees who will become eligible when they begin receiving their MERS pension based on at least 25 years' City service. For the 302 active city employees who may work 25 years and be entitled to future health benefits, 123 retirees & spouses must pay 100% of the health benefit cost (2014 valuation, p E-2)—this group creates no OPEB liability.

Of the 222 retirees/beneficiaries, (302-80 opt-out or ineligible = 222) receiving health benefits, 101 (46%) were born before 1942, and thus are at least age 74 (MERS 12/31/2014 Interest and Valuation data). The oldest individual covered was born in 1919; and 64 of the 222 covered (29%) are age 80 or older.

Recommendations

1. **For current employees in those divisions where the City will pay 100% or 97% of the cost once entitled to retiree health benefit coverage, bargain to implement a minimum of 10% retiree & spouse share of the cost.** State of Michigan Civil Service employees and retirees pay 10% of the cost of retiree health care, until Medicare coverage begins, then the State pays the expense for a secondary-to-Medicare Part B and D plan.

2. **Study moving Medicare-eligible retirees from the present Medicare Advantage Plan to a comparable Medigap plan.**

3. **Study the feasibility of not requiring any contributions from a retiree/spouse upon reaching age 75.**

4. **Establish and monitor a robust program for verifying beneficiary health care entitlement** (must be married at MERS retirement date); **and annual verification of no health coverage available at either the retiree's or spouse's current, post-retirement place of employment**. Additionally, implement (if not in place a 'death check' program) using the Social Security database (perhaps MERS' database) to promptly remove a deceased retiree/spouse from health coverage.

5. **Bonding for OPEB under 2012 PA 329 is NOT recommended.** The Pension Plan Recommendations, #6, 7 and 9 discussed, and #9 did recommend, that pension bonding be explored by the City. OPEB total liability is $54 million, with $13 million in assets, and unfunded liability of $41 million. In contrast, pension plan total liability is $182 million, with $100 million in plan assets, and unfunded liability of almost $82 million. The City has made considerable strides in revising retiree health care availability in many employee groups, increasing the retiree/spouse contributions, raising the earliest age for health care benefits to be provided, and a host of other actions. For all these reasons, all actions which can further decrease plan liabilities should be explored and taken and the impact assessed on OPEB liabilities, prior to serious consideration of future OPEB bonding.

6. **The City is encouraged to redouble its cost containment initiatives with its Health Care Task Force, as it is clear that such efforts have a measurable positive impact in decreasing (or severely limiting any increase in) actuarial OPEB liabilities.** Some areas to explore are: over the phone medical assistance, self-insured options, City directly employing physicians (as in a City-sponsored medical clinic), consumer cost comparison for costly services with a sharing of the savings going back to the user. Such actions open up possibilities for the adding of such 'savings' as RHFV contributions so that payment toward the unfunded liabilities may occur, the funded level increase, and required City contributions become more stable and level.

Attachments

1. East Lansing retiree health care entitlement, and share of cost apportioned between City and Retiree/Spouse.
2. Chronology of City actions managing retiree, and active employee, health care benefits.
3. City of East Lansing Retiree Health Funding Vehicle (RHFV) trust detail (through June 30, 2016).
4. December 31, 2014 OPEB Actuarial Valuation, City of East Lansing.
5. December 31, 2012 OPEB Actuarial Valuation, City of East Lansing.