

Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

DISCUSSION ITEM

For Meeting of November 19, 2008

**UNIVERSITY OF CALIFORNIA RETIREE HEALTH BENEFIT PROGRAM
ACTUARIAL VALUATION REPORT**

EXECUTIVE SUMMARY

To fulfill the University's financial reporting obligations and to inform the Regents on these obligations, this item presents actuarial valuation results for the University's retiree health benefit program as of July 1, 2008. The purpose of the annual valuation of the retiree health benefit program is to report the unfunded actuarial liability and the annual expense of the program for disclosure purposes and to analyze the preceding year's experience.

This item addresses only the current year retiree health benefit actuarial valuation. Other related policy issues such as pre-funding and future benefit program changes will be addressed in the future.

Issues: ***Retiree Health Benefit Program Valuation Results***

All amounts shown are for University Campuses and Medical Centers, which includes the Office of the President, Agricultural & Natural Resources and the Associated Students of UCLA, but excludes the Department of Energy (DOE) laboratory and Hastings College of the Law.

- The July 1, 2008 Unfunded Actuarial Accrued Liability (UAAL) is \$13.3 billion.
- The Annual Required Contribution (ARC) for Fiscal Year 2008/2009 is \$1.55 billion, consisting of:
 - A normal cost of \$593 million, approximately 8.2 percent of the University of California Retirement Plan (UCRP) covered payroll, and
 - An amortization cost of \$957 million, approximately 13.2 percent of UCRP covered payroll.

Under governmental financial accounting and reporting requirements, the ARC is not required to be funded but will be a component of the

retiree health benefit expense recorded in the University's financial statements.

- Projected contributions for 2008/2009 are \$225 million. This represents the projected pay-as-you-go costs of the retiree benefits funded by a system-wide retiree health assessment.

Previous Actions: May 2007: The Regents authorize the establishment of a retiree health benefit trust that satisfies the requirements of Internal Revenue Code Section 115 to facilitate the administrative functions related to implementing Governmental Accounting Standards Board Statement No. 45 (GASB 45) financial reporting requirements.

May 2008: Action item on proposed retiree health benefit actuarial valuation methods and assumptions approved by the Regents, with the July 1, 2007 actuarial valuation report included.

BACKGROUND

Beginning in Fiscal Year 2007-2008, the Regents' Consulting Health Actuary, Deloitte Consulting LLP, performs an annual actuarial valuation of the University's retiree health benefit program. The purpose is to report the Unfunded Actuarial Accrued Liability 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.

The retiree health benefit valuation results included with this item are based on the methods and assumptions that were approved by the Regents in May 2008. These are described in section XI of the attached actuarial valuation report.

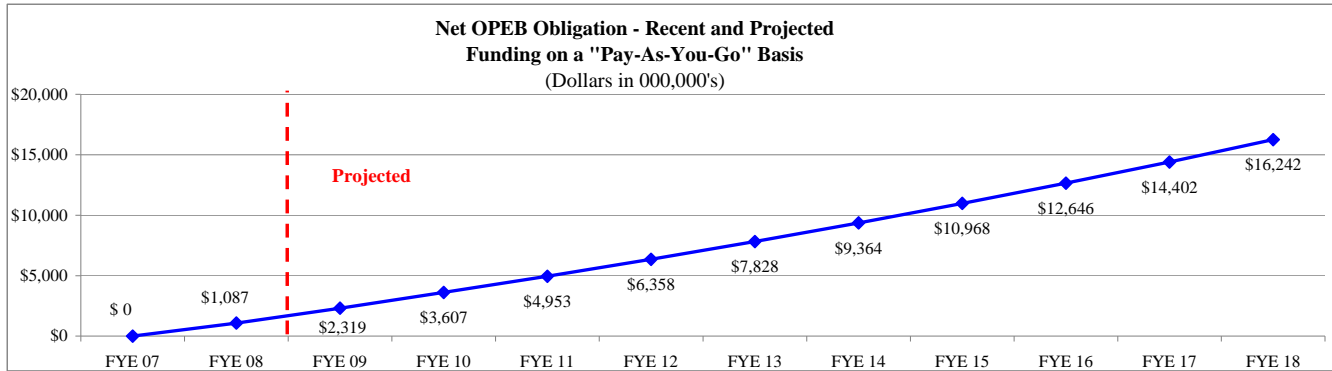
The Public Employee Post-Employment Benefits Commission (Commission), chaired by former Regent Gerald Parsky, released a report early this year, *Funding Pensions & Retiree Health Care for Public Employees*, which outlines a comprehensive eight-point plan to address the unfunded pension and retiree health care liabilities for California State and local governments. Current adoption of the retiree health benefit valuation results align with the recommendation contained in the Commission's report that each public employer shall identify its liabilities for post-employment benefits other than pensions and make them public (*From recommendation 2 of the Commission report*).

Retiree Health Benefit Program Valuation Results

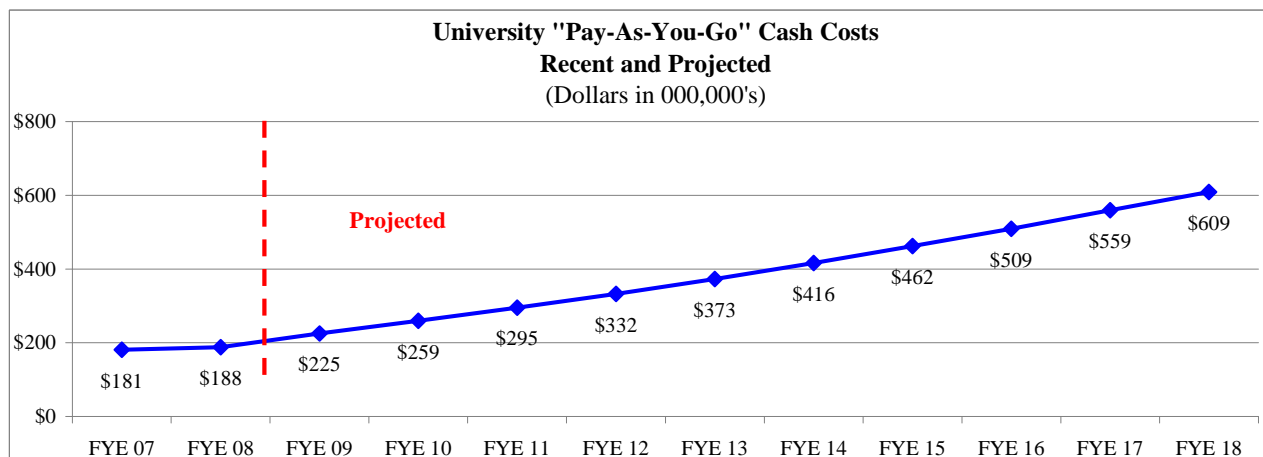
For the campuses and medical centers, valuation results are summarized below:

- The UAAL as of July 1, 2008 was \$13,251 million (\$13.3 billion). As of July 1, 2007, the UAAL was \$12.1 billion.
- The total UAAL is expected to increase every year because the plan 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 year had been exactly realized, including pre-funding of the entire Fiscal Year 2007-2008 ARC of \$1,355 million, the *expected* UAAL at July 1, 2008 would have been \$11,908 million (\$11.9 billion). The actual UAAL at July 1, 2008 was \$1,343 million higher than expected. This difference is considered an actuarial loss. The primary cause of this change in UAAL is that pay-as-you-go contributions were less than the ARC, which created a \$1,087 million loss. The remaining \$256 million loss was caused by higher-than-expected future benefit costs offset by a gain due to more terminations and fewer retirements than expected.
- The Actuarial Value of Assets (AVA) as of July 1, 2008 was \$51 million. Although the Retiree Health Benefit Program is currently funded on a pay-as-you-go basis, this year-end balance was caused by a combination of initial one-time funding for cash flow purposes and to facilitate administration and the difference between the amount collected from locations via the retiree health assessment and the actual benefit plan costs for the fiscal year. Actual cash in the Trust as of July 1, 2008 is \$20 million; the remaining \$31 million in net assets consists of receivables, prepaid items, and liabilities.
- The funded ratio is determined as the AVA divided by the Actuarial Accrued Liability (AAL). The funded ratio was 0.4 percent as of July 1, 2008.
- The ARC for Fiscal Year 2008-2009 is \$1,550 million. For Fiscal Year 2007-2008, the ARC was \$1,355 million.
- The Net OPEB Obligation (NOO) is the portion of the UAAL that is included on the University's balance sheet. Under the provisions of GASB 45, the NOO at implementation (July 1, 2007) was set to \$0. The NOO at July 1, 2008 is determined as the prior year's NOO plus the Fiscal Year 2007-2008 OPEB expense (this is the same as the ARC in the year of implementation) less the University contributions to the program. As of July 1, 2008, the NOO was \$1,087 million.
- The annual OPEB expense is the ARC plus interest on the NOO minus an ARC Adjustment. For Fiscal Year 2008-2009, the OPEB expense is \$1,502 million. As previously mentioned, the annual OPEB expense for Fiscal Year 2007-2008 was the same as the ARC, \$1,355 million.

- The expected NOO at July 1, 2009 is \$2,319 million, assuming \$225 million of contributions on a pay-as-you-go basis. The chart below shows recent history and a 10-year projection of the expected NOO, assuming the program is funded on a pay-as-you-go basis only. The NOO grows by more than a billion dollars annually due to the difference between the ARC and the pay-as-you-go costs.



- The expected University pay-as-you-go cash costs for Fiscal Year 2008-2009 are \$225 million. The chart below shows recent history and a 10-year projection of the expected University pay-as-you-go cash costs.



- As of July 1, 2008, there were 144,556 participants eligible for the University's retiree health benefit program, of which 113,083 were active employees and 31,473 were retirees and surviving family members. Of this group of active employees, 25,822 were eligible to retire and receive benefits under this plan as of July 1, 2008, and 87,261 could be eligible in the future. As of July 1, 2007, there were 141,230 participants.

- Two of the key assumptions used in completing the valuation are the discount rate and the benefit cost trend rates. This discount rate is 5.5 percent. The first-year trend rates range from 10 percent to 12 percent, decreasing to the ultimate rate of 5 percent over nine 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 other reporting entities, including Lawrence Berkeley National Laboratory (LBNL) and Hastings College of the Law.

On July 1, 2007, the University of California Retiree Health Benefit Trust (UCRHBT) was created. The Regents have fiduciary responsibility and serve as the trustee for the UCRHBT. The UCRHBT was established to allow certain University locations and affiliates (campuses and medical centers as defined above and Hastings College of the Law) 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 an arrangement segregated from University assets. 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.

- The pay-as-you-go financing is accomplished via a common retiree health benefit assessment, which was set at 3.09 percent of covered UCRP payroll for Fiscal Year 2008-2009.
- The Department of Energy laboratory (LBNL) reimburses the University for the benefit costs paid by the University attributable to LBNL retirees and does not participate in either the UCRHBT or this retiree health benefit assessment.
- If pre-funding occurs in the future, the UCRHBT will be used as the vehicle for those assets.

[Attachment 1](#)

[Attachment 2](#)

University of California Retiree Health Benefit Program

Actuarial Valuation Highlights

Campuses and Medical Centers

(Dollars in 000,000's)

Valuation Date	<u>7/1/2007</u> ¹	<u>7/1/2008</u> ¹
Actuarial Valuation Results		
1. Annual Required Contribution (ARC) ²		
a. Normal Cost	\$ 531	\$ 593
b. <u>Amortization Cost</u>	<u>824</u>	<u>957</u>
c. Total	\$ 1,355	\$ 1,550
2. ARC as % of Payroll ²		
a. Normal Cost	7.9%	8.2%
b. <u>Amortization Cost</u>	<u>12.3%</u>	<u>13.2%</u>
c. Total	20.2%	21.4%
3. Unfunded Accrued Actuarial Liability (UAAL)	\$ 12,075	\$ 13,251
4. Pay-As-You-Go Cash Costs ³	\$ 188	\$ 225
5. Net OPEB Obligation		
a. Beginning of the Year	\$ -	\$ 1,087
b. End of the Year	\$ 1,087	\$ 2,319

¹ Liabilities and costs reflect the economic and demographic assumptions adopted for the July 1, 2007 valuation.

² The ARC and its components are expressed as of the end of the fiscal year.

³ Historical cash costs are actual amounts paid; current year cash costs are projected.

Attachments: July 1, 2008 Valuation Presentation; University's Retiree Health Benefit Program Actuarial Valuation Report as of July 1, 2008.