UNIVERSITY OF CALIFORNIA, ACADEMIC SENATE

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*1111 Franklin Street, 12th Floor*
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July 6, 2017

**JANET NAPOLITANO, PRESIDENT**
**UNIVERSITY OF CALIFORNIA**

**Re: Regents Item on Retiree Health**

Dear Janet:

At its June 28, 2017 meeting, the Academic Council unanimously endorsed the attached letter from the University Committee on Faculty Welfare (UCFW) opposing a proposed Regents item scheduled for discussion in July that would remove the 70% floor for aggregate expenditures on retiree health, and allow placement of a cap on the rate of growth of the maximum UC employer contribution to an individual retiree's health coverage at 3%.

It does not appear that anything has changed since the Post-Employment Benefits Task Force and its consultative process concluded in 2010 with the resultant Regents' item: "The University's aggregate annual contribution to the Retiree Health Program [will] be lowered, over time, to a floor of 70 percent." This action followed extensive analyses and thorough consultation through a broadly representative task force to reach a broad social contract. At that time, it was absolutely known that medical inflation would continue, that the University would continue to grow in size, and that baby-boomers would retire. These very factors are now cited as the reason to rescind the floor. Interestingly, medical cost trends have steadily decreased over these intervening years; the rate of medical inflation has actually decreased. It is not surprising that the retiree health liability has increased and will continue to increase, but a key reason is simply the growth in size of the university and the number of retirees – nothing unanticipated in 2010.

The other reason that the liability has increased is the new GASB rules. These new rules do not change the University's cost of contributing to retiree healthcare; they do move the liability from a footnote to the balance sheet and calculate the liability at a risk-free interest rate, a 20-year municipal bond rate, greatly inflating its size. Our costs do not change, nor do our operations. Actuaries and rating agencies should know this. Investing in risk-free bonds to pre-fund retiree health is something that the University would never do. That rate is substantially lower than long-term average returns from other University investments: STIP, TRIP, UCRP and the endowment. We can and do cover the cost of providing retiree health through a moderate payroll tax, currently just over 3%.

The only consultation with the Senate that has occurred about this proposal has been a limited discussion concerning how a 3% cap on per capita growth in the University's contribution affects the liability calculated under new GASB rules. UCFW notes that UCOP has not vetted the 70% proposal with the full UCFW membership, its Health Care Task Force, the Task Force on Investments and Retirement (TFIR), or any stakeholder group, and has not responded to UCFW's request for additional modeling that would allow the Senate to evaluate the effect of the proposed changes on costs for current and future retirees. Likewise, TFIR has been not been able to evaluate the fiscal impact of the proposal on the University.

It is impossible to evaluate the effects of any proposed change in benefits without the requested modeling. Though it is not hard to imagine some of the knock on effects of this proposal and the harm it will do to the University, we have been told that UC's liability can be reduced by one third with a cap of 3% on annual growth in the per capita contribution to a retiree's health coverage. However, we have seen no justification for 3%. Would positive effects from reducing the liability—which have not been demonstrated—be sufficiently great from a 4% or 5% cap? What would be the consequences from having no cap, beyond preserving the benefit by spending more? UC's mission is not to manage future liabilities or maximize its borrowing capacity, so the focus cannot be solely on the financial aspects of benefits. This entire process neglects the critical role they play in recruitment, retention, and retirement behavior, and in determining the welfare of current retirees, especially those who have been long-retired (with pensions that may have eroded considerably due to inflation and our imperfect COLA protection). It is also troubling that the proposal will be presented to the Regents Finance and Capital Strategies Committee rather than the Governance and Compensation Committee, which has the topic of benefits in its charter.

As noted above, the very minimal consultation that occurred with the Academic Senate concerned only a putative 3% cap, not the current proposal to rescind the floor of 70% on aggregate contributions. A 3% cap would not only directly reduce living standards for many retirees, but it would also shift the entire risk and burden of future healthcare inflation from the employer to the retiree. It cannot be forgotten that the University is not only an employer, but also a provider of healthcare services to many retirees and active employees; such an inherent conflict of interest must be carefully managed.

As noted above, the establishment of the 70% floor was a significant aspect of the recommendations from the first Post-Employments Benefits process, in which faculty, staff, and retirees demonstrated their willingness to support appropriate cuts in benefits that preserve their sustainability. While UC's retiree health benefits may exceed those offered at some comparison institutions, it is worth noting that many employees—including those nearing retirement and a large number of retirees—accepted lower salaries to remain at UC. Moreover, employees now pay a significant monthly contribution to UCRP. The competitiveness of retiree health benefits cannot be modeled in isolation, and as recent studies of total remuneration have shown, UC already lags the market.

As we work to build a more diverse faculty, those faculty are likely to bring with them higher levels of student debt and few family assets that support living in expensive California communities; thus total remuneration, and post-retirement benefits are important to recruitment.

It is well understood that retiree-health benefits are funded on a "pay as you go" basis and are affordable. They represent less than 4% of payroll, with two-thirds of that amount coming from non-core funds. However, the proposal seems driven solely by debt considerations. The liability is a balance-sheet construct, and it has become so large mainly due to the new GASB rule that we use

an unrealistically low discount rate (which inflates the liability), and has moved the liability from a footnote to the balance sheet. The calculation is surely understood for what it is by bond-rating agencies and others. We have seen no evidence that UC's ability to borrow has been affected by the retiree-health liability, or will be affected by this or other changes to plan design.

In short, by letting Finance get ahead of Human Resources, both shared governance and the thoughtful management of benefits have been disregarded. The alternative is to engage in a thorough consultative process assessing all options and including all stakeholders: retirees, active employees, the Senate and its Health Care Task Force (which contains some of the nation's preeminent experts), before making any changes to retiree health benefits.

Thank you for considering the Senate's views on this matter. Please do not hesitate to contact me if you have any questions or concerns.

Sincerely,

Jim Chalfant, Chair
Academic Council

Encl.

Cc: Chief Financial Officer Brostrom
Chief Operating Officer Nava
Vice President for Human Resources Duckett
Academic Council
Senate Director Baxter
Senate Executive Directors

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June 27, 2017

**JIM CHALFANT, CHAIR**
**ACADEMIC COUNCIL**

**RE: Proposed Changes to Retiree Health Benefits and Valuations**

Dear Jim,

The University Committee on Faculty Welfare (UCFW), after consultation with the Task Force on Investment and Retirement (TFIR) and the Health Care Task Force (HCTF), recommends that you strongly oppose the proposed Regents item that would remove the 70% contribution floor agreed upon during the Post-Employment Benefits process. Not only are the health impacts of this proposed change unknown, the process that has led to this point has been far from transparent.

You will recall that HCTF requested recalculation of the retiree health liability using Medicare rates, rather than the overall medical inflation rate currently employed by UCOP (enclosed). This recalculation has not occurred. As a result of high projections, UCOP seems to fear limitations on its liquidity and borrowing capacities. To protect those, UCOP proposes to cut benefits support to retirees by capping on a per-capita basis annual retiree medical inflation at 3% while removing the 70% guaranty of premium support to retirees. UCOP purports that these changes will lower the retiree health liability by one-third.

Unfortunately, the proposed cap and cut have not been vetted by any stakeholder group, and the item before the Regents includes neither a justification nor an impact analysis on retirees. This secretive process raises red flags on several fronts. First, the 70% contribution guaranty was a critical component of the PEB process. Reneging on that agreement unilaterally will not help UCOP, especially in the current hyper-critical environment. At a time when UCOP is struggling for credibility, and when health care in general is under intense scrutiny, one-party, top-down changes of this nature will only compound UCOP's difficulties. The Regents item also proposes to remove the Regents from future decisions of this nature, vesting that power directly with the President. We note that further opacity and delimitation of the vetting process will not serve the University well. Meaningful consultation, supported by data, must occur before such drastic changes are enacted. Stakeholder groups, including the Senate, its subject-matter experts, and retiree and emeriti groups, must understand, if not approve, the proposals.

Second, in order to understand the proposals, comprehensive analyses – not only of financial reporting, but also of health outcome changes, purchasing power declines for current and near retirees, and long-term total remuneration for those in the newest pension tier – must be provided and debated openly.

Finally, we question the assumptions UCOP has made regarding the reporting changes required. The new regulations only require that UC move the liability from a footnote to the ledger. Credit ratings agencies will not see the University's total liability suddenly increase because of a reporting change; the debt is not new; its place in the report is moving. Concerns about newly constrained borrowing capacities thus seem unfounded. As UCOP embarks on improving budget and finance presentations to the Regents, and faces unabated legislative attention, clear and careful statements are required.

Thank you for your concern to these important topics.

Sincerely,

Lori Lubin, UCFW Chair

Robert May, HCTF Chair

David Brownstone, TFIR Chair

Encl.

Copy: UCFW<br>HCTF<br>TFIR<br>Hilary Baxter, Executive Director, Academic Senate

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May 26, 2017

**NATHAN BROSTROM, EVP AND CFO**
**RACHAEL NAVA, EVP AND COO**

**RE: Retiree Health Liability Valuations**

Dear Nathan and Rachael,

The Health Care Task Force is concerned that in response to the liability calculations UC may prematurely adopt policy changes regarding retiree health benefits in order to guarantee a fixed growth rate for per retiree health costs. The HCTF thinks it is a mistake that the retiree health liability projections being developed for UCOP assume that per retiree health benefit costs will increase by approximately 7% per year for the next decade. There are alternative estimates developed by credible sources, such as the projections produced the U.S. Department of Health and Human Services for the Trustees of the Medicare program. As shown in Table V.D.1 on page 200 of the 2016 Medicare Trustees Report, per beneficiary spending for Medicare beneficiaries is projected to increase by an average of 4.3% per year from 2016 through 2025 (enclosed). The rate of increase in Medicare spending per beneficiary is projected to be lower than the rate of increase in spending per privately insured person primarily because price increases are projected to be lower for Medicare beneficiaries.

The overwhelming majority of UC retirees are Medicare beneficiaries. We are not aware of any reason to expect that UC costs per retiree should increase more quickly than Medicare spending per beneficiary, and urge the retiree health liability projections to be no higher than the per beneficiary estimates made by the Medicare Trustees.

We think it would be a mistake to make policy changes at this point. We suspect that the kinds of UC policy changes that would be implemented to satisfy the fixed growth rate will necessarily entail cuts in benefits and higher costs for UC retirees. We do not believe that efficiencies in plan design are likely possible that would be costless to UC retirees with respect to both additional financial burdens and disruptions in provider availability. The priority at this point should be to ensure that the accounting calculations of liability projections be as accurate as possible before creating triggers for policy changes.

Thank you for your continuing cooperation,

Sincerely,

Robert C. May, UCFW-HCTF Chair

Encl.

Copy: UCFW-HCTF
Jim Chalfant, Chair, Academic Council
Shane White, Vice Chair, Academic Council
Hilary Baxter, Executive Director, Academic Senate
Cathy O'Sullivan, Chief of Staff to COO
Oren Gabriel, Chief of Staff to CFO

Table V.D1.—HI and SMI Average Incurred per Beneficiary Costs

| Calendar year | Average per beneficiary costs | | | | Average percent change[1] | | | |
|---|---|---|---|---|---|---|---|---|
| | | SMI | | | | SMI | | |
| | HI | Part B | Part D | Total | HI | Part B | Part D | Total |
| Historical data: | | | | | | | | |
| 1970 | $270 | $115 | — | $385 | 13.8% | 13.8% | — | 13.8% |
| 1975 | 472 | 205 | — | 677 | 11.8 | 12.3 | — | 12.0 |
| 1980 | 929 | 423 | — | 1,352 | 14.5 | 15.6 | — | 14.8 |
| 1985 | 1,579 | 795 | — | 2,373 | 11.2 | 13.4 | — | 11.9 |
| 1990 | 1,979 | 1,355 | — | 3,334 | 4.6 | 11.3 | — | 7.0 |
| 1995 | 3,194 | 1,867 | — | 5,061 | 10.0 | 6.6 | — | 8.7 |
| 2000 | 3,383 | 2,496 | — | 5,879 | 1.2 | 6.0 | — | 3.0 |
| 2005 | 4,439 | 3,839 | — | 8,278 | 5.6 | 9.0 | — | 7.1 |
| 2006 | 4,601 | 4,116 | $1,461 | 10,179 | 3.7 | 7.2 | — | 23.0 |
| 2007 | 4,759 | 4,313 | 1,630 | 10,703 | 3.4 | 4.8 | 11.6% | 5.1 |
| 2008 | 4,996 | 4,574 | 1,662 | 11,232 | 5.0 | 6.0 | 2.0 | 4.9 |
| 2009 | 5,174 | 4,798 | 1,730 | 11,702 | 3.6 | 4.9 | 4.1 | 4.2 |
| 2010 | 5,182 | 4,907 | 1,808 | 11,897 | 0.1 | 2.3 | 4.5 | 1.7 |
| 2011 | 5,305 | 5,038 | 1,858 | 12,201 | 2.4 | 2.7 | 2.8 | 2.6 |
| 2012 | 5,221 | 5,173 | 1,840 | 12,234 | −1.6 | 2.7 | −1.0 | 0.3 |
| 2013 | 5,177 | 5,177 | 1,875 | 12,229 | −0.8 | 0.1 | 1.9 | 0.0 |
| 2014 | 5,033 | 5,395 | 2,035 | 12,464 | −2.8 | 4.2 | 8.6 | 1.9 |
| 2015 | 5,019 | 5,522 | 2,203 | 12,744 | −0.3 | 2.4 | 8.3 | 2.3 |
| Intermediate estimates: | | | | | | | | |
| 2016 | 5,067 | 5,636 | 2,223 | 12,925 | 0.9 | 2.1 | 0.9 | 1.4 |
| 2017 | 5,175 | 5,810 | 2,348 | 13,333 | 2.1 | 3.1 | 5.6 | 3.1 |
| 2018 | 5,322 | 6,022 | 2,615 | 13,960 | 2.8 | 3.7 | 11.4 | 4.7 |
| 2019 | 5,500 | 6,355 | 2,835 | 14,690 | 3.3 | 5.5 | 8.4 | 5.2 |
| 2020 | 5,714 | 6,712 | 3,023 | 15,449 | 3.9 | 5.6 | 6.7 | 5.2 |
| 2021 | 5,939 | 7,061 | 3,181 | 16,182 | 3.9 | 5.2 | 5.2 | 4.7 |
| 2022 | 6,182 | 7,437 | 3,347 | 16,966 | 4.1 | 5.3 | 5.2 | 4.8 |
| 2023 | 6,433 | 7,861 | 3,523 | 17,817 | 4.1 | 5.7 | 5.3 | 5.0 |
| 2024 | 6,675 | 8,278 | 3,707 | 18,660 | 3.8 | 5.3 | 5.2 | 4.7 |
| 2025 | 6,901 | 8,642 | 3,861 | 19,405 | 3.4 | 4.4 | 4.2 | 4.0 |

[1]Percent changes for 1970 represent the average annual increases from 1967 (the first full year of trust fund operations) through 1970. Similarly, percent changes shown for 1975, 1980, 1985, 1990, 1995, 2000, and 2005 represent the average annual increase over the 5-year period ending in the indicated year.

https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/TR2016.pdf (p. 200)