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Chair of the Assembly of the Academic Senate
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University of California
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October 5, 2017

JANET NAPOLITANO, PRESIDENT
UNIVERSITY OF CALIFORNIA

Re: Retiree Health

Dear Janet:

At its September 27 meeting, the Academic Council unanimously endorsed the attached letters from the University Committee on Faculty Welfare (UCFW) and its Task Forces on Investment and Retirement (TFIR) and Health Care (HCTF), in support of a plan for maintaining UC retiree health benefits. The letters respond to the UCOP proposal for Regents' action to remove the 70 percent floor for the University's annual aggregate contribution to the retiree health benefit program.

UCFW, TFIR, and HCTF worked hard over the summer to analyze projections related to this change, anticipating that the Regents would be discussing such a proposal in November. UCFW, TFIR, and HCTF found that the proposed changes are not justified by a financial emergency, nor does the retiree health benefit represent an undue financial burden for the University. The *Retiree Health Benefit Program TFIR Modeling Request* (appended) shows that, with or without retiree health spending caps, the total cost of all retirement benefits slowly rises to the high teens as a percentage of payroll, but then begins to steadily decrease around 2027.

The importance of these projections is that they show that we are not facing a crisis. The total cost of retirement benefits is not trivial, and we feel that it is incumbent upon us all to continue to examine these costs. However, there is some reason to think that the assumed rate of inflation is a pessimistic one, so the projections are constrained to be similarly pessimistic about the University's costs. Most important, however, is the main message from the projections: The pay-as-you-go cost is manageable as a budget category, and the benefit is sustainable going forward. The letter recommends no change to retiree health policy and encourages UC to involve all stakeholders in an effort to develop a funding strategy that maintains the benefit. Certainly, it is the Senate's view that it would be premature to make permanent changes in benefits policy without such an exercise.

The Academic Council was grateful for your visit to its September 27 meeting, at which you announced your intention to apply a 4% increase in the retiree health budget so as to largely

maintain the status quo through the coming year, and to assemble a working group in early 2018 to make recommendations germane to any future Regents' decisions on retiree health from the 2019 budget forward.

The Council strongly supports this course of action. It provides a way for the Academic Senate and other stakeholders to move forward in partnership with the administration on a plan to examine the issue in depth and develop a plan to preserve the benefit. Accordingly, we understand that any Regents' action item that may be needed on this topic will be postponed until after the working group completes its work.

Regarding the membership of the proposed working group, we suggest appropriate Senate representation, and note that the membership of HCTF and TFIR includes faculty members with preeminent subject-matter expertise in health care and retirement issues. We also suggest that the working group include the customary representation of active staff, retirees through emeriti and retiree associations, as well as of central and divisional administrations.

We believe that the task force should be charged to develop policy for funding of the retiree health benefit so as to maintain the current overall plan design and quality. Guiding principles are that UC retiree health benefits continue to be sustainable, and competitive in the context of total remuneration. A comprehensive funding policy that will accommodate year-by-year responses to environmental changes should be created, not a fixed arbitrary level or limit. It is important to remember that benefits design should incentivize appropriate employee behavior, including timely retirement.

Council shares your view that retiree health is a critical issue both for retirees and for current employees. As you know, the 2014 faculty total remuneration study found a total remuneration gap of 10% between UC faculty and our peer comparators; decreasing retiree benefits would only widen the gap. Retirees, some long retired, made retirement planning decisions under the assumption that the existing retiree health benefit structure would persist. Retiree health is a lifeline for these individuals.

The 2010 Post-Employment Benefits Task Force process resulted in an understanding that 70% would be the absolute floor for University contributions to retiree health, a social contract by the employees with the employer, a reduction in the employer contribution so that the benefit would be sustainable. Breaking this commitment could undermine the confidence of current and future UC employees, so it should not be a choice that is made casually. If a new policy is to come out of this process, the Senate's view is that we look for ways to convey some form of commitment. While we recognize that the administration wants to emphasize that these are not vested benefits, it is also worth keeping in mind that any benefit has value only to the extent that employees feel it can be expected to be maintained with a reasonably high degree of confidence. Put differently, the recruitment and retention benefits from any program are attenuated by anything that casts doubt on their permanence. Such an outcome is not in anyone's interest.

Please do not hesitate to contact me if you have questions. Thank you again for your commitment to shared governance on this issue.

Sincerely,

A handwritten signature in black ink, appearing to read "Shane N. White", written over a horizontal line.

Shane N. White, Chair
Academic Council

Encl

Cc: EVP Brostrom
EVP Nava
Academic Council
Senate Director Baxter
Senate Executive Directors



UNIVERSITY COMMITTEE ON FACULTY WELFARE (UCFW)
Roberta S. Rehm, Chair
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September 25, 2017

**SHANE WHITE, CHAIR
ACADEMIC COUNCIL**

RE: Reframing Retiree Health Discussions

Dear Shane,

The University Committee on Faculty Welfare (UCFW) has reviewed the enclosed memorandum jointly authored by UCFW's two standing task forces, the Task Force on Investment and Retirement and the Health Care Task Force, and we support their conclusions unanimously. We ask that you convey these findings to the UC administration.

In short, HCTF and TFIR assert, and UCFW agrees, that new federal accounting standards promulgated by GASB that require UC to list its retiree health liability in the ledger do not represent a significant new cost to the University, and attempts to portray it as such are misdirected. UCOP overestimates the size of the liability due to faulty inflation assumptions, and even if the administration assumptions are accurate, the response – to lower University contributions and cap spending – is disproportionate and hasty. Instead, adequate consideration of alternate funding strategies must be given publicly, with the inclusion of impacted stakeholder groups.

Thank you for your attention to this fast-moving and important issue.

Sincerely,

A handwritten signature in black ink that reads "Roberta S. Rehm".

Roberta S. Rehm, UCFW Chair

Copy: UCFW
Hilary Baxter, Executive Director, Academic Senate

Encl.



UNIVERSITY COMMITTEE ON FACULTY WELFARE (UCFW)
TASK FORCE ON INVESTMENT AND RETIREMENT (TFIR)
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September 21, 2017

ROBERTA REHM, CHAIR
UNIVERSITY COMMITTEE ON FACULTY WELFARE

RE: Retiree Health Valuations

Dear Roberta,

The University Committee on Faculty Welfare (UCFW) Task Force on Investment and Retirement (TFIR) and the Health Care Task Force (HCTF) begin by noting that UCOP raised the proposal to remove the 70% floor on retiree health costs during the summer with a very short time to respond. Therefore, Academic Senate involvement has been limited to UCFW's two standing task forces, the HCTF and TFIR. We invite UCFW's sister committee, the University Committee on Planning and Budget (UCPB), and the full UCFW membership to be involved as well, not to mention faculty and staff retiree groups. After consulting with experts from the Office of Chief Financial Officer (CFO) and the Office of the Chief Investment Officer (OCIO), TFIR and HCTF have concluded that:

1. Projected increases in retiree health care liabilities, per revised Government Accounting Standards Bureau (GASB) requirements, are unrealistically high, and inexplicably higher than projections made by the Office of the Actuary at HHS, which is the federal government agency responsible for projecting Medicare cost increases¹;
2. Even with unrealistically high assumptions about health care cost increases, the impact on the University's operating budget and borrowing costs are manageable; and
3. Current retiree health costs are sufficiently manageable, and coupled with the administration's welcome decision to maintain the floor for another year, there is no need to make changes in haste without full consultation with Academic Senate, staff, and retiree groups.

For active employees, retiree health benefits need to be viewed as part of total remuneration, and it is important to note that the current "pay as you go" costs of retiree health benefits (about 3% of payroll) are small relative to the employer costs of employee health care (about 15% of payroll) and employer contributions to UCRP (15% of payroll, not counting interest on STIP borrowing). The competitive position of the University in recruiting and retaining faculty has continued to deteriorate since the most recent [Total Remuneration Study](#) (2014), as we continue to reduce the employer-provided value of benefits while providing relatively modest salary increases, barely keeping up with inflation, let alone our comparators.

¹ 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.

Post-employment benefits provide incentives to recruit and retain faculty and staff, and these benefits provide large tax advantages to both employer and employee. However, these incentives only work if employees are confident that they will receive these benefits after they retire. At the time of the first Post-Employment Benefits reforms, the University preserved confidence that retirees could count on health benefits by instituting a 70% floor on the University's aggregate contribution. However, this confidence will be severely eroded if the 70% floor is breached without full consultation and careful justification. If current employees doubt that they will receive retiree health benefits, they will have an incentive to take a lump sum distribution when they retire (since taking a lump sum can provide protection against erosion of benefits due to our incomplete COLA mechanism). This uncertainty may cause unexpected liquidity problems for the UCRP pension fund.

Offering retiree health benefits is also advantageous to the operating budget, in that it represents deferred compensation. It seems counterproductive to reduce these benefits without full consideration of the likely results: 1) the need to pay higher cash compensation currently, 2) reduced effectiveness in recruitment and, 3) reduced effectiveness in both retention and targeting retirement at certain ages. A UC employee contemplating retirement might delay that decision if he or she concludes that remaining active preserves a higher contribution to health-care costs from the University.

TFIR and HCTF reject the balance-sheet argument that begins with a large-scale retiree-health liability increase to argue that change is needed. The calculation produces an artificially high estimate of the liability, due to a low discount rate dictated by GASB and high rates of *general* health care cost inflation, to portray our retiree-health benefit as unsustainable. In the projections TFIR and HCTF have been shown, even while using unrealistically high projected health care cost inflation, and while still maintaining the 70% floor, UC's total post-employment benefit costs (again, currently 18% of payroll) increase to a maximum peak of 19.7% in 2027 and soon decline to less than 18% in 2034. We believe that these numbers are close to a worst-case scenario, and we note that even small declines in the assumed rates of health care cost inflation and/or small increases in the bond index used for discounting lead to large declines in the GASB-reported liabilities. Costs approaching 20% of payroll are not trivial, but the projections bring important perspective: UC is managing these costs currently, and their projected increase is only a marginal adjustment. It is more productive to frame the retiree health discussion as a budget topic, concerning our annual pay-as-you-go approach to retiree health, instead of reacting to startling—but ultimately meaningless—liability calculations.

Furthermore, we recognize that all of these statements are based on projections—as is the claim that retiree health spending is unsustainable. TFIR and HCTF further note that the retiree health spending projections are much more uncertain than projected UCRP costs since no one can accurately predict the outcome of current political debates over the U.S. health system. Uncertain health care costs have a larger impact on current active employee health costs, and UC has successfully managed these costs by annually reviewing our active employee health benefits with consultation from the Academic Senate (especially the HCTF). This model is successful and should be replicated for retiree health benefits.

TFIR and HCTF would also urge UCOP to consult annually with the Academic Senate and other stakeholders about the budget “cap” applied to increases in these expenditures (currently 4%). Given the tax advantages of providing retiree health care benefits, not to mention their role in retention of employees mid- to late-career, it seems prudent to do everything possible to preserve these benefits.

In short, we recognize that all health care benefits—for active and retired employees—represent a significant cost concern that requires on-going consultation. The Academic Senate should expect active consultation, which should also extend to staff and to retirees. But neither TFIR nor HCTF

have seen evidence supporting the need for any permanent new policy, such as a fixed cap on annual increases in UC's costs. This change is not a crisis.

To close, we want to reiterate that there is an important difference between uncertainty in active employee health benefits and uncertainty in retiree health benefits. Both are harmful, but if our current employee benefits drop too far, employees (especially high-performing faculty) will move to competitor institutions with higher total compensation. Active employees may also choose to delay retirement, which may not be desirable from the perspective of workforce renewal. Retirees, on the other hand, have already made all of the decisions available to them: they cannot un-retire, nor can they move if their health benefits fall, since they chose to retire and then made an irrevocable choice between taking a pension (with the implicit promise of health benefits) or a lump sum distribution. In any consultation that occurs, it is important to keep these distinctions in mind. The University is not well-served by the perception that established commitments made to retirees can be forfeited for budgetary convenience.

Sincerely,

David Brownstone, UCI
TFIR Chair

Lori Lubin, UCD
HCTF Chair

Copy: UCFW-TFIR
UCFW-HCTF
Hilary Baxter, Executive Director, Academic Senate



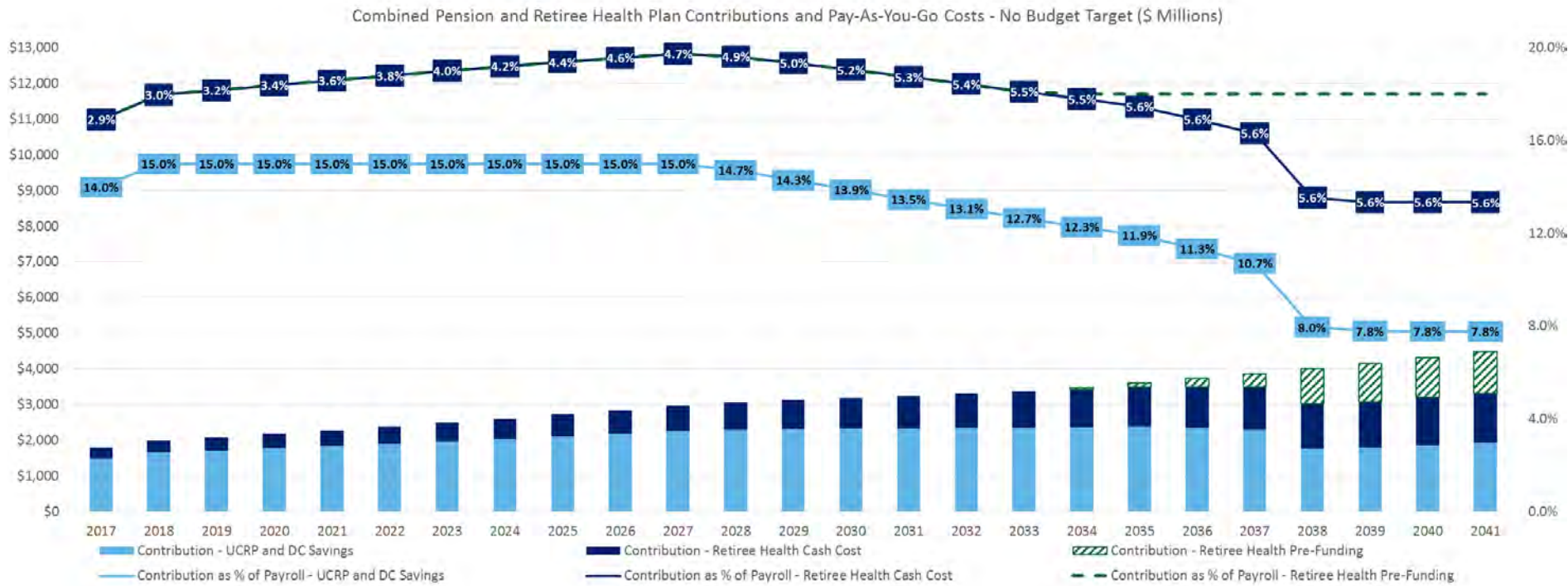
Retiree Health Benefit Program TFIR Modeling Request

September 2017

Please note that these projections are based on a set of assumptions that are subject to change

Funding Retiree Health with Future Pension Contribution Reductions

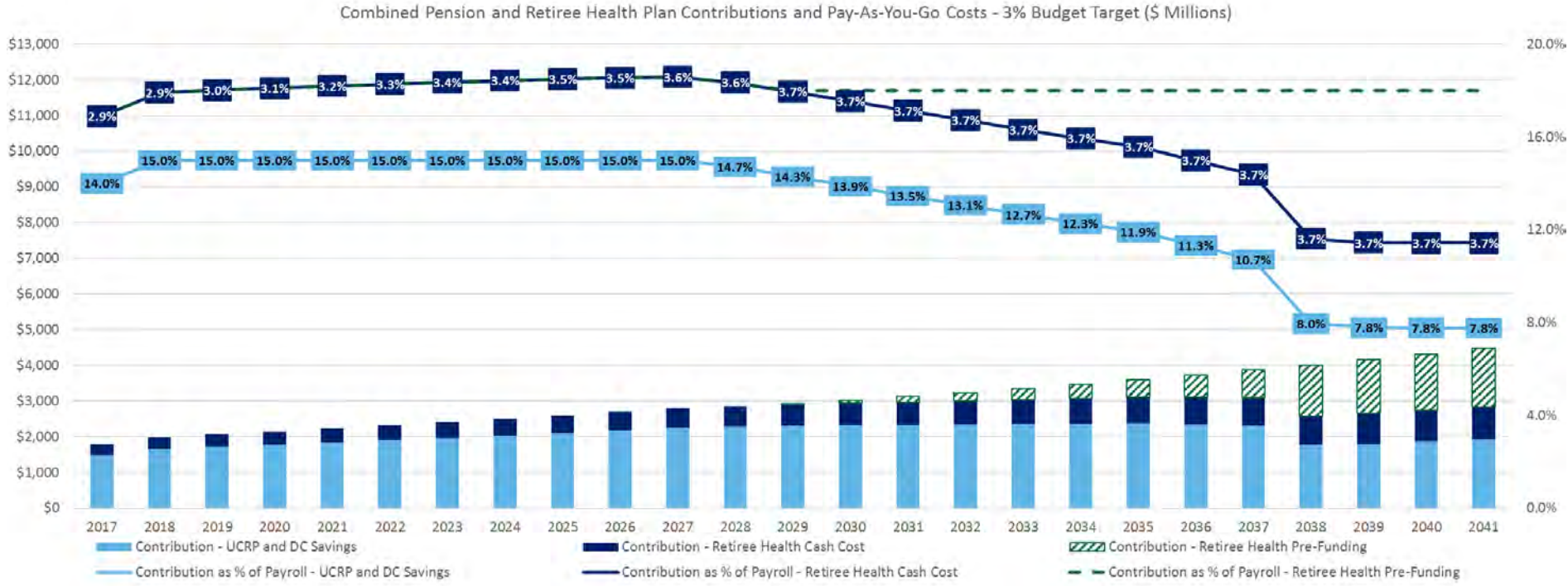
- Retirement plan required contributions for both UCRP and DC Savings are expected to decrease beginning in year 2028
- The table projects total retirement program contributions (pension and retiree health) assuming a minimum of 18% of payroll in future years
 - Total contributions are projected to peak at 19.7% in 2027 before the pension contributions begin to decline
 - 18% of payroll is projected to exceed pension contributions and pay-as-you-go retiree health costs beginning in 2034; this excess could be used to begin prefunding the retiree health program



Based on total payroll projections provided by Segal (includes 0.7% employee headcount growth)

Funding Retiree Health with Future Pension Contribution Reductions – 3% Budget Target

- Retirement plan required contributions for both UCRP and DC Savings are expected to decrease beginning in year 2028
- The table projects total retirement program contributions (pension and retiree health) assuming a minimum of 18% of payroll in future years
 - With a 3% budget target, total contributions are projected to peak at 18.6% in 2027 before the pension contributions begin to decline
 - With a 3% budget target, 18% of payroll is projected to exceed pension contributions and pay-as-you-go retiree health costs beginning in 2030; this excess could be used to begin prefunding the retiree health program

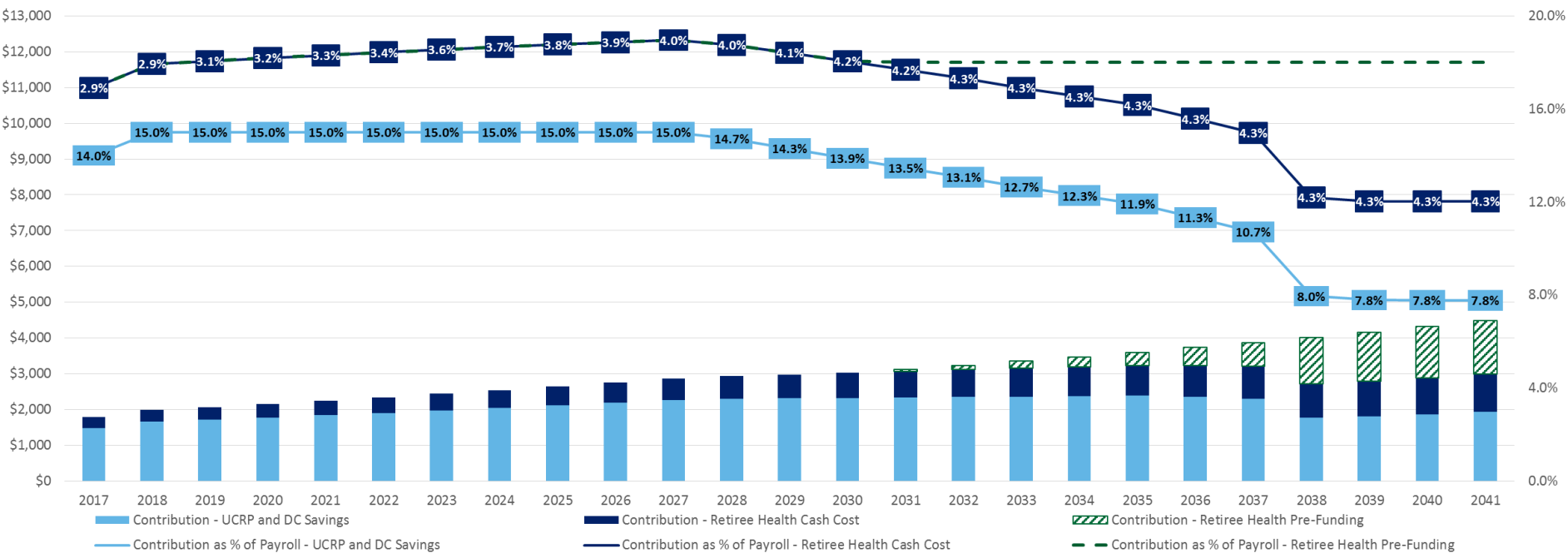


Based on total payroll projections provided by Segal (includes 0.7% employee headcount growth)

Funding Retiree Health with Future Pension Contribution Reductions – 4% Budget Target

- Retirement plan required contributions for both UCRP and DC Savings are expected to decrease beginning in year 2028
- The table projects total retirement program contributions (pension and retiree health) assuming a minimum of 18% of payroll in future years
 - With a 4% budget target, total contributions are projected to peak at 19.0% in 2027 before the pension contributions begin to decline
 - With a 4% budget target, 18% of payroll is projected to exceed pension contributions and pay-as-you-go retiree health costs beginning in 2031; this excess could be used to begin prefunding the retiree health program

Combined Pension and Retiree Health Plan Contributions and Pay-As-You-Go Costs - 4% Budget Target (\$ Millions)



Based on total payroll projections provided by Segal (includes 0.7% employee headcount growth)