To: Board of Supervisors
From: David Twa
Date: March 25, 2014

Contra Costa County

Subject: Other Post Employment Benefits 2014 Valuation Assumptions

RECOMMENDATION(S):
ADOPT recommended assumptions and methods for use in Contra Costa County Other Post Employment Benefit Plan GASB 45 Actuarial Valuation as of January 1, 2014.

FISCAL IMPACT:
This report is for informational purposes and has no specific impact; however, the result of the recommendations herein, if implemented, may have impact on the County's calculated Other Post Employment Benefit Liability.

BACKGROUND:
An Other Post Employment Benefit Plan (OPEB) Valuation Report is required per Governmental Accounting Standards Board (GASB) Statements 43 and 45 to be completed, by a County the size of

☑ APPROVE ☐ OTHER

☑ RECOMMENDATION OF CNTY ADMINISTRATOR ☐ RECOMMENDATION OF BOARD COMMITTEE

Action of Board On: **03/25/2014** ☑ APPROVED AS RECOMMENDED ☐ OTHER

Clerks Notes:

VOTE OF SUPERVISORS

AYES 4 NOES ____
ABSENT 1 ABSTAIN ____
RECUSE ____

I hereby certify that this is a true and correct copy of an action taken and entered on the minutes of the Board of Supervisors on the date shown.

ATTESTED: March 25, 2014
David J. Twa, County Administrator and Clerk of the Board of Supervisors

Contact: Lisa Driscoll, County Finance Director
(925) 335-1023

By: June McHuen, Deputy

cc: Robert Campbell, Auditor-Controller, Christine Penkala, County Benefits Manager

BACKGROUND: (CONT'D)

Contra Costa, every two years. The report presents a calculation of liability and has no specific fiscal impact on its own.

In 2004, due to growing concern over the potential magnitude of government employer obligations for post-employment benefits, the Government Accounting Standards Board enacted Statement 45. The main reason for the Statement was to establish uniform accrual accounting and reporting of these governmental liabilities much like under the Financial Accounting Standards Board (FASB) rules that already applied to the private sector for OPEBs (and GASB 25 and 27 statements that already applied to governmental pension liabilities). Accrual accounting was needed to report the cost of providing government services over the working lifetime of employees providing the services, rather than just the "pay-as-you-go" (paygo) cost that was not realized until after those employees retired.

Additionally, an intended audience for these GASB 45 results was the bond markets so that they could better assess levels of government solvency in issuing debt. Although plan solvency was not the main impetus behind Statement 45, GASB 45 is considered 'funding friendly' because it adds some security for those receiving the benefits, if those benefits are actually pre-funded. Because Statement 45 requires the public sector to account for total long term OPEB costs over the active service life of benefit-earning employees, rather than reporting current year OPEB costs only for existing retirees, it is thought that shining the light on these long term liabilities would force the public sector to address, and hopefully avoid, the collapses in benefit plans that have occurred in the private sector.

Pursuant to GASB 45 requirements, Contra Costa County ordered its initial actuarial report in 2006. The 2006 report valued the County's unfunded liability for retiree medical costs at $2.6 billion based upon a cash discount rate. This outstanding liability, if fully amortized over the following 30 years, would have necessitated an Annual Required Contribution (ARC) of $216 million. At that point in time, $216 million would have been six times the amount that the County was paying toward retiree health care costs on a paygo basis.

The County has received three actuarial reports since that time, which describe the significant actions the County has taken to reduce its OPEB liability since 2006. Interim valuation results have also been presented to the Board of Supervisors, pursuant to California Government Code 7507, since the 2008 report. Interim reports are required prior to the adoption of changes to these benefits. The County's ability to reduce the liability has had significant impact on the County's overall fiscal stability and ability to deliver services.

The majority of the elements of the valuation report are directed by GASB, however, some are not. In 2013, the County issued an RFP and selected Milliman, Inc. to be the County's OPEB actuary. Milliman reviewed the County's actuarial cost method and assumptions, confirmed some and recommended that the County change others. Staff has reviewed these methods with the actuary and the Auditor and recommends that the Board adopt the changes shown below for the 2014 valuation. It is believed that the proposed changes will lead to a more accurate valuation of the County's OPEB liability.

Actuarial Cost Method We recommend that the actuarial cost method used for determining the benefit obligations be changed from the Entry Age Normal cost method to the Projected Unit Credit cost method. The Entry Age Normal cost method is typically used to value pension benefits related to salary. Since health benefits are not based on salary, the Projected Unit Credit cost method is commonly used for OPEB valuations, as it allocates the present value of future benefits based on an employee's expected service with the County at retirement. The Actuarial Accrued Liability (AAL) is equal to the present value of future benefits prorated by service to the valuation date over service at the expected retirement age. The Normal Cost is equal to the portion of the present value of future benefits attributed to one year of service. This equals the present value of benefits divided by the expected years of service at retirement. Note that the actuarial cost method does not change the present value of the County's expected future OPEB payments. It only defines the method by which the present value of OPEB payments are allocated to each fiscal year for accounting purposes.

The County previously used the Entry Age Normal method because the California Employers' Retiree Benefit Trust (CERBT) initially required the Entry Age Normal method as a condition of participation in the CERBT and the County wished to have the option of joining that Trust. There are several reasons to move to the new cost method: 1) the CERBT no longer requires the Entry Age Normal method and the Projected Unit Credit method is an acceptable CERBT method; 2) the allocation of benefit costs will be more understandable and less complex with the Projected Unit Credit cost method; 3) it aligns the method with FASB standards which prescribe only the projected unit credit cost method for OPEB accounting; and 4) we have tested our 2012 valuation using both methods and found the impact to be neutral (future impact may be higher or lower).

Demographic Assumptions The demographic assumptions (rates of termination, retirement, disability, and mortality) used in the prior actuarial valuation were consistent with those used in the December 31, 2008 CCCERA actuarial valuation. CCCERA has since updated its demographic assumptions based on more recent experience. In order to get the most accurate valuation possible to reflect our current employee/retiree demographics, we recommend the demographic assumptions for this OPEB valuation be updated to be consistent with the assumptions used in the December 31, 2012 CCCERA actuarial valuation. This change may increase liability results.

Coverage Election Assumptions

In the prior valuation, an assumption of marital status was included; however, assumed coverage elections for spouses and dependent children were not specified. We are recommending use of assumed coverage elections based on County experience and detailed in the attached list of assumptions. This change may yield a lower liability result than previous assumptions.

Health Cost Inflation Assumption

The medical cost inflation trend used in the prior actuarial valuation was applied to both non-Medicare and Medicare premiums. We developed the medical cost trend based on the "Getzen" model published by the Society of Actuaries for purposes of evaluating long term medical trend. Under the Patient Protection and Affordable Care Act of 2010, a Federal excise tax will apply for high cost health plans beginning in 2018. A margin to reflect the impact of the excise tax in future years is reflected in the assumed trend, which differs for non-Medicare and Medicare health costs. We have assumed dental premiums will increase 4% per year. These assumptions appear to better reflect Contra Costa's experience.

The recommended changes to methods and assumptions and those current assumptions that we are recommending not be changed are included in an attachment for reference.

CONSEQUENCE OF NEGATIVE ACTION:

There will be a delay in the required issuance of the Contra Costa County Other Post Employment Benefit Plan GASB 45 Actuarial Valuation.

CHILDREN'S IMPACT STATEMENT:

Not applicable.

Actuarial Cost Method and Assumptions Recommended for 2014 Valuation

The actuarial cost method used for determining the benefit obligations is the Projected Unit Credit Cost Method. Under this method, the actuarial present value of projected benefits is the value of benefits expected to be paid for current actives and retirees and is calculated based on the assumptions and census data described this report.

The Actuarial Accrued Liability (AAL) is the actuarial present value of benefits attributed to employee service rendered prior to the valuation date. The AAL equals the present value of benefits multiplied by a fraction equal to service to date over service at expected retirement. The Normal Cost is the actuarial present value of benefits attributed to one year of service. This equals the present value of benefits divided by service at expected retirement. Since retirees are not accruing any more service, their normal cost is zero.

In determining the Annual Required Contribution, the Unfunded AAL is amortized as a level dollar amount over 30 years on a “closed” basis. There are 24 years remaining in the amortization period as of January 1, 2014. The actuarial assumptions are summarized below.

Economic Assumptions

Discount Rate (Liabilities) 5.70%

We have used a discount rate of 5.70% in this valuation to reflect the County’s current policy of partially funding its OPEB liabilities. This rate is derived based on the fund’s investment policy, level of partial funding, and includes a 2.50% long-term inflation assumption. County OPEB Irrevocable Trust assets are invested in the Public Agency Retirement Services’ Highmark Portfolio. Based on the portfolio’s target allocation (shown below), the average return of Trust assets over the next 30 years is expected to be 6.25%, which would be an appropriate discount rate if the County’s annual contribution is equal to the ARC. If the County were to elect not to fund any amount to a Trust, the discount rate would be based on the expected return of the County’s general fund (we have assumed a long term return of 3.50% for the County’s general fund). Since the County is partially funding the Trust with a contribution of $20 million per year, we used a blended discount rate of 5.70%.

Asset Class	Expected 1-Year Nominal Return	Targeted Asset Allocation
Domestic Equity Large Cap	8.14%	17.0%
Domestic Equity Mid Cap	8.92%	6.0%
Domestic Equity Small Cap	9.90%	8.0%
U.S. Fixed Income	4.69%	38.0%
International / Global Equity (Developed)	8.56%	16.0%
Real Estate	8.12%	4.0%
Cash	3.01%	1.0%
Alternatives	5.71%	10.0%
Expected Geometric Median Annual Return (30 years)		6.25%

Demographic Assumptions

Below is a summary of the assumed rates for mortality, retirement, disability and withdrawal, which are consistent with assumptions used in the December 31, 2012 CCCERA Actuarial Valuation.

Pre / Post Retirement Mortality

Healthy: For General Members: RP-2000 Combined Healthy Mortality Table projected to 2030 with Scale AA, set back one year.

For Safety Member: RP-2000 Combined Healthy Mortality Table projected to 2030 with Scale AA, set back two years.

Disabled: For General Members: RP-2000 Combined Healthy Mortality Table projected to 2030 with Scale AA, set forward six years for males and set forward seven years for females.

For Safety Member: RP-2000 Combined Healthy Mortality Table projected to 2030 with Scale AA, set forward three years.

Beneficiaries: Beneficiaries are assumed to have the same mortality as a General Member of the opposite sex who had taken a service (non-disability) retirement.

Disability

Age	General Tier 3	Safety (All Tiers)
20	0.01%	0.02%
25	0.02%	0.22%
30	0.03%	0.42%
35	0.05%	0.56%
40	0.08%	0.66%
45	0.13%	0.94%
50	0.17%	2.54%

Withdrawal – Sample probabilities of terminating employment with the County are shown below for selected years of County service.

Years of Service	General	Safety
Less than 1	13.50%	11.50%
1	9.00%	6.50%
2	9.00%	5.00%
3	6.00%	4.00%
4	4.50%	3.50%
5	4.00%	3.00%
10	2.75%	1.90%
15	2.10%	1.40%
20 or more	2.00%	1.00%

Retirement – For this valuation, we have applied the Tier 3 rates for all General employees and Tier A rates for all Safety employees since nearly all current employees are in these two pension tiers.

Age	General Tier 3	Safety Tier A	Age	General Tier 3	Safety Tier A
45	0%	2%	60	15%	40%
46	0%	2%	61	20%	40%
47	0%	7%	62	27%	40%
48	0%	7%	63	27%	40%
49	0%	20%	64	30%	40%
50	4%	25%	65	40%	100%
51	3%	25%	66	40%	100%
52	3%	25%	67	40%	100%
53	5%	25%	68	40%	100%
54	5%	25%	69	40%	100%
55	10%	30%	70	40%	100%
56	10%	25%	72	40%	100%
57	10%	25%	73	40%	100%
58	12%	35%	74	40%	100%
59	12%	35%	75	100%	100%

Coverage Election Assumptions

Retiree Coverage – We have assumed 90% of new retirees will elect medical and dental coverage at retirement.

Spouse Coverage – We have assumed 50% of new retirees electing coverage will elect spouse medical and dental coverage at retirement.

Spouse Age – Female spouses are assumed to be three years younger than male spouses.

Dependent Coverage – We have assumed 30% of retirees with no spouse coverage will elect coverage for a dependent child until age 65, and 50% of retirees with spouse coverage will elect coverage for a dependent child until age 65.

Health Plan Election – We have assumed that new retirees will remain enrolled in the same plan they were enrolled in as actives. For actives who waived coverage, we have assumed that they will elect Kaiser plan coverage.

Valuation of Retiree Premium Subsidy Due to Active Health Costs

The County health plans (Contra Costa Health Plans, Health Net, Kaiser) charge the same premiums for retirees who are not yet eligible for Medicare as for active employees. Therefore, the retiree premium rates are being subsidized by the inclusion of active lives in setting rates. (Premiums calculated only based on retiree health claims experience would have resulted in higher retiree premiums.) GASB 45 requires that the value of this subsidy be recognized as a liability in valuations of OPEB costs. To account for the fact that per member health costs vary depending on age (higher health costs at older ages), we calculated equivalent per member per month (PMPM) costs that vary by age based on the age distribution of covered members, and based on relative cost factors by age. The relative cost factors were developed from the Milliman Health Cost Guidelines™. Based on the carrier premium rates and relative age cost factors assumptions, we developed age adjusted monthly PMPM health costs for 2014 to be used in valuing the implicit rate subsidy.

Since retirees eligible for Medicare (age 65 and beyond) are enrolled in Medicare supplemental plans, the premiums for retirees with Medicare are determined without regard to active employee claims experience and no such subsidy exists for this group for medical cost.

The California PERS health plans are community rated plans. This means that the premium rates are the same for each participating employer in a region regardless of the employer group's demographic composition (age, gender, and number of dependents), claims experience, or health status. For this reason, we value no subsidy for the retirees enrolled in California PERS (PEMHCA) health plans.

Medical Cost Inflation Assumption

We assumed future increases to the health costs and premiums are based on the "Getzen" model published by the Society of Actuaries for purposes of evaluating long term medical trend. Under the Patient Protection and Affordable Care Act of 2010, a Federal excise tax will apply for high cost health plans beginning in 2018. A margin to reflect the impact of the excise tax in future years is reflected in the assumed trend. The following table shows the assumed rate increases in future years for Medical premiums.

Calendar Year	County Plans Pre 65	Calendar Year	PEMHCA Plans Pre 65	Calendar Year	All Plans Post 65
2014	6.50%	2014	7.00%	2014	7.25%
2015	5.25%	2015	5.75%	2015	6.00%
2016	5.75%	2016	6.25%	2016	6.50%
2017	6.50%	2017 – 2018	6.75%	2017 – 2025	6.00%
2018 – 2020	5.75%	2019	7.00%	2026 – 2032	5.75%
2021 – 2023	6.50%	2020 – 2022	7.25%	2033	6.00%
2024 – 2028	6.25%	2023 – 2024	7.00%	2034	6.75%
2029	6.50%	2025 – 2029	6.75%	2035	6.50%
2030 – 2035	6.25%	2030 – 2033	6.50%	2036 – 2042	6.25%
2036	6.00%	2034 – 2036	6.25%	2043 – 2045	6.00%
2037 – 2040	5.75%	2037 – 2038	6.00%	2046 – 2051	5.75%
2041 – 2048	5.50%	2039 – 2043	5.75%	2052 – 2059	5.50%
2049 – 2063	5.25%	2044 – 2050	5.50%	2060 – 2070	5.25%
2064 – 2074	5.00%	2051 – 2061	5.25%	2071 – 2076	5.00%
2075 – 2079	4.75%	2062 – 2074	5.00%	2077 – 2081	4.75%
2080 +	4.50%	2075 – 2079	4.75%	2082 +	4.50%
		2080 +	4.50%		

Dental Cost We assumed Dental costs will increase 4.0% annually.