Retiree Health Benefit Program

Consultation

Retiree Associations

September 8, 2017
Executive Summary

• The University currently spends approximately $300 million per year on retiree health benefits for 43,000 UC retirees and survivors. The Retiree Health Benefit Program has a $21.2 billion unfunded liability as of July 1, 2016.

• For 2018, the UC contribution will increase by 7.2%, or $19.6 million in dollars.

• A budget target for University contributions to the Retiree Health Benefit Program will provide cost predictability for the University’s operating budget. There is currently a budget target for the active health and welfare program for the active health and welfare program.

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• The Regents implemented in 2010 helped slow anticipated growth of University pay-as-you-go costs, which have been held nearly flat for the past five years. However, a new policy is needed to address future UC cost growth.

• The current and projected cost increases are greater than inflation and are growing faster than the University’s budget for 2018.

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• The current and projected cost increases are greater than inflation and are growing faster than the University’s budget for 2018.
The University “Pay-As-You-Go” cash contributions are expected to increase as a percent of payroll.

- University “Pay-As-You-Go” cash contribution requirements are expected to escalate more quickly than price inflation.
- Increase is driven by UC’s retiree health costs, which are projected to grow at the medical trend rate (currently at ~7%).
- Increase is also driven by our growing retiree population.
- Combining impact of these two drivers could cause a greater portion of annual budget growth to be diverted to fund retiree health costs rather than to fulfill the mission of the University.

Projected Pay-As-You-Go Costs ($ Millions)*

<table>
<thead>
<tr>
<th>Year</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
<th>2026</th>
<th>2027</th>
<th>2028</th>
<th>2029</th>
<th>2030</th>
<th>2031</th>
<th>2032</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$308</td>
<td>$329</td>
<td>$363</td>
<td>$401</td>
<td>$440</td>
<td>$481</td>
<td>$525</td>
<td>$570</td>
<td>$616</td>
<td>$665</td>
<td>$714</td>
<td>$764</td>
<td>$814</td>
<td>$864</td>
<td>$914</td>
<td>$964</td>
</tr>
</tbody>
</table>

Based on total payroll projections provided by Segal (includes 0.7% employee headcount growth).
Medical trend is expected to be notably higher than price inflation.

Plan costs are expected to increase over time due to growing retiree health population costs.

Since medical trend is higher than the anticipated growth of revenue, the retiree health program could divert monies from other operational needs if additional efforts are not made to manage costs.

The chart below illustrates the current assumption for medical trend compared to price inflation.

- Medical trend is expected to be notably higher than price inflation.
- Medical trend is a significant driver of future pay-as-you-go costs.
- Future medical inflation (trend)
New accounting standards have highlighted the long-term costs of retiree health benefits. Changes in how Retiree Healthcare (OPEB) liabilities need to be reported on financial statements has highlighted the size of the unfunded obligation.

**GASB Changes – Reporting Benefit Liabilities**

- GASB changes have no impact on the University’s “Pay-As-You-Go” cash contribution requirements.
- The liability is highly sensitive to the index rate; as noted in the table below, the index has increased 73 basis points as of 6/30/2017.
- The decrease in discount rate increased the GASB liability by $5.0B.
- The index rate at 6/30/2016 was 165 basis points lower than the assumed return on the University’s assets, which was the basis for discounting liabilities under the prior accounting standard.
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- The decrease in discount rate increased the GASB liability by $5.0B.
- Similar to recent accounting changes for pensions, under GASB 75 the entire net OPEB liability must be reported on the face of the financial statements rather than in the footnotes.
- Effective FYE June 30, 2017, the University will report Retiree Health Care (OPEB) liabilities on the face of the financial statements rather than in the footnotes.

<table>
<thead>
<tr>
<th>Discount Rate</th>
<th>Basis</th>
<th>Liability 6/30/16</th>
<th>Liability 6/30/17</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.85%</td>
<td>2.85%</td>
<td>$21.2B</td>
<td>$18.8B</td>
</tr>
<tr>
<td>3%</td>
<td>3%</td>
<td>$21.2B</td>
<td>$18.8B</td>
</tr>
<tr>
<td>4.5%</td>
<td>4.5%</td>
<td>$16.0B</td>
<td>$14.0B</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>STIP/TRIP Return</th>
<th>Index Rate – 6/30/16</th>
<th>Index Rate – 6/30/17</th>
</tr>
</thead>
</table>
| 1% increase in discount rate decreases liability by $3.3B.
Regents policy implemented in 2010 and recent program changes have slowed growth in costs.

Despite recent changes, there is still a long tail for the future cash requirements of the program driven primarily by the Medicare-eligible population.

**Key Changes**

- Per Regents policy, beginning in 2010 maximum University contributions decreased 3 percentage points per year to a floor of 70% of total premiums (pre-Medicare floor reached in 2015; Medicare floor reached in 2018); changes to graduated eligibility for retirees who leave prior to age 65 for the 2013 tier of University hires.
- Beginning in 2014, Medicare retirees outside of California enrolled in Medicare Exchange/Coordinator with a $250 per month HRA subsidy.
- Implemented Employer Group Waiver Plans for Medicare retirees.
- Implemented custom network HMO (Blue & Gold) and removed certain high cost plan options for pre-Medicare retirees.
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**Impact on University “Pay-As-You-Go” Cash Costs**

- Despite recent changes, there is still a long tail for the future cash requirements of the program driven primarily by the Medicare-eligible population.
Implementing a 3% budget target is consistent with the University’s long-term price inflation assumption.

- Baseline University “Pay-As-You-Go” cash contribution is expected to grow more quickly than payroll.
- Medical trend and retiree headcount growth is expected to outpace wage and employee headcount growth.
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In 2032, cash contributions are projected to be 5.4% of projected payroll (~85% higher than current % of payroll).

- In 2032, cash contributions are projected to be 3.7% of projected payroll (~30% higher than current % of payroll).

- Baseline University “Pay-As-You-Go” cash contribution is expected to grow more quickly than payroll.

Medical trend and retiree headcount growth is expected to outpace wage and employee headcount growth.

Based on total payroll projections provided by Segal (includes 0.7% employee headcount growth).
Projected University "Pay-As-You-Go" Contributions – Impact of 4% Budget Target

- Baseline University "Pay-As-You-Go" cash contributions are expected to grow more quickly than payroll growth.
- Medical trend and retiree headecount growth is expected to outpace wage and employee headecount growth.

In 2032, cash contributions are projected to be 4.3% of projected payroll (50% higher than current % of payroll).

Implementing a 4% budget target is projected to steadily increase University cash contributions as a percent of payroll.

In 2032, cash contributions are projected to be 5.4% of projected payroll (85% higher than current % of payroll).

Based on total payroll projections provided by Segal (includes 0.7% employee headecount growth).
A budget target will provide cost predictability for UC and shift costs above the target to retirees. A 3% or 4% annual budget target of per capita University contributions is a means of controlling cash contributions and obligations by directly addressing the rising costs associated with medical trend. Requirements and obligations by directly addressing the rising costs associated with medical trend.

How a 3% or 4% Budget Target Would Work

- The University will share in the payment of rate increases up to the 3% or 4% budget target. Rate increases above the budget target will be borne by the retirees.
- HR would be responsible for implementing plan changes designed to achieve the budget target while mitigating the adverse impact on plan costs.
- The University would need to determine if there would be any exceptions to those impacted by the budget target (e.g., retirees over 65 not eligible for Medicare).
- In years where medical trend is greater than the budget target, and barring other plan changes, retirees would pay an increasing portion of plan costs.
- The University will bear in the payment of rate increases up to the 3%/4% budget target.

The graph below provides an illustrative projection of the share of Medicare premiums paid by UC and retirees assuming a 3% budget target is implemented in 2018 without any plan changes and medical trend grows at the rate previously noted.
The following assumptions were made in projecting costs for this illustration:

- Premiums applicable for Calendar Year 2017
- Participant has single coverage
- Eligible for 100% of the maximum University contribution
- Medical trend is projected at a low (3.5%), medium (6.0%) and high (8.5%) annual increase levels

<table>
<thead>
<tr>
<th></th>
<th>Kaiser Pre-Medicare</th>
<th>UC Care Pre-Medicare</th>
</tr>
</thead>
<tbody>
<tr>
<td>Membership</td>
<td>Premiums</td>
<td>Contributions</td>
</tr>
<tr>
<td>University</td>
<td>$604</td>
<td>$476</td>
</tr>
<tr>
<td>Member High - 8.5%</td>
<td>$551</td>
<td>$419</td>
</tr>
<tr>
<td>Member Medium - 6.0%</td>
<td>$579</td>
<td>$430</td>
</tr>
<tr>
<td>Member Low - 3.5%</td>
<td>$1,009</td>
<td>$638</td>
</tr>
</tbody>
</table>

Active v. Pre-Medicare Retiree (Monthly Rates - Single Coverage)

- Medical trend is projected at a low (3.5%), medium (6.0%) and high (8.5%) annual increase levels
- Eligible for 100% of the maximum University contribution
- Participant has single coverage
- Premiums applicable for Calendar Year 2017

The table illustrates how a 3% or 4% budget target could impact Pre-Medicare retirees five years after pre-Medicare retirement.
The following assumptions were made in projecting costs for this illustration:

- Premiums applicable for Calendar Year 2017 with standard Part B premium ($121.80)
- Participant has single coverage
- Eligible for 100% of the maximum University contribution
- Medical trend is projected at a low (3.5%), medium (6.0%) and high (8.5%) annual increase levels

The table illustrates how a 3% or 4% budget target could impact Medicare retirees five years after implementation.

### Medicare Retiree Contributions with 3% or 4% Budget Target

<table>
<thead>
<tr>
<th>Medical Plan (Monthly Rates - Single Coverage)</th>
<th>Active vs. Medicare Retiree</th>
<th>Key Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kaiser High Option</td>
<td>2017</td>
<td>Medical trend is projected at a low (3.5%), medium (6.0%) and high (8.5%) annual increase levels</td>
</tr>
<tr>
<td>No Budget Target</td>
<td>374</td>
<td>Eligible for 100% of the maximum University contribution</td>
</tr>
<tr>
<td>3% Budget Target</td>
<td>339</td>
<td>Participant has single coverage</td>
</tr>
<tr>
<td>4% Budget Target</td>
<td>374</td>
<td>Premiums applicable for Calendar Year 2017 with standard Part B premium ($121.80)</td>
</tr>
</tbody>
</table>

The following assumptions were made in projecting costs for this illustration:
Program Design Options
<table>
<thead>
<tr>
<th>Description</th>
<th>Potential University Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase contributions for non-Medicare retirees over 65 to the same level of average Medicare eligible retiree.</td>
<td>2. Increased contributions for non-Medicare retirees over 65 to the same level of average Medicare eligible retiree.</td>
</tr>
<tr>
<td>Implement 70% cost sharing for retiree dental benefits</td>
<td>2%</td>
</tr>
<tr>
<td>Group Medicare Advantage PPO replacement for Medicare PPO and High Option</td>
<td>2%</td>
</tr>
<tr>
<td>Include Health Net Medicare retirees in Group Medicare Advantage PPO plan</td>
<td>2-5%</td>
</tr>
<tr>
<td>Eliminate 50% of benefits for spouses and dependents</td>
<td>9%-14%</td>
</tr>
</tbody>
</table>

2. These figures are rough estimates; actual savings will require additional actuarial analysis and will depend on final plan design. Unless otherwise noted, all information presented in this document are based on the census, assumptions, methods and plan provisions used in the 6/30/2016 GASB 75 actuarial valuation.
**Overview**

- Non-Medicare retirees over age 65 represent $3.1B of liability ($2.7B attributed to current retirees)
- Non-Medicare retirees pay less for coverage than Medicare retirees
- Non-Medicare retirees have not contributed towards Medicare in the past and they also saved UC from having to contribute to Medicare during their careers

**Potential University Impact**

- Each $1,000 increase in retiree contributions for non-Medicare retirees over 65 will reduce the liability by $0.2B (less than 1%)
- Availability of coverage outside of group plan for those who choose to pay on a public exchange versus paying a higher contribution who choose coverage on a public exchange versus availability of coverage outside of group plan for those who choose to pay on a public exchange versus

### Retiree Considerations

- **Non-Medicare over 65**
  - **Medicare (California)**
  - **Retiree Contribution (Including Part B)**
    - **Non-Medicare over 65**
      - **Medicare (California)**
      - **Average Age**
        - 75
        - 73
        - **Average Plan Costs**
          - $7,587
          - N/A
          - $1,786
        - **Explicit Subsidy**
          - $12,380
        - **Implicit Subsidy**
          - $1,786
        - **Non-Medicare Retirees have not contributed towards Medicare in the past and they also saved UC from having to pay less for coverage than Medicare retirees**
        - **Non-Medicare Retirees over age 65 represent $3.1B of liability (less than 1%)**

### Cost Sharing

- Increase Contributions for Non-Medicare Retirees over 65
The University currently contributes 100% towards dental, subject to graduated eligibility.

The table below illustrates retiree contributions assuming UC contributes 70% towards dental in 2017, assuming 100% graduated eligibility.

### Abstract
- Dental accounts for $1.8B in liability. Reducing liability by paying retirees 30% of dental costs would reduce liability by $0.5B (2%)
- The majority of retirees are enrolled in Dental PPO and would have had to contribute $12.82 per month in 2017 towards dental costs.

#### Monthly Single Rates

<table>
<thead>
<tr>
<th></th>
<th>DPPO</th>
<th>DHMO</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017 Premium</td>
<td>$42.75</td>
<td>$20.03</td>
</tr>
<tr>
<td>UC Share</td>
<td>70%</td>
<td>70%</td>
</tr>
<tr>
<td>Maximum University Contribution</td>
<td>(a) * (b)</td>
<td>(c)</td>
</tr>
<tr>
<td>(a)</td>
<td>$29.93</td>
<td>$14.02</td>
</tr>
<tr>
<td>(b)</td>
<td>$42.75</td>
<td>$20.03</td>
</tr>
<tr>
<td>Retiree Contribution</td>
<td>(c)</td>
<td>(d)</td>
</tr>
<tr>
<td>(e) – (c)</td>
<td>$12.82</td>
<td>$6.01</td>
</tr>
<tr>
<td>(e) + (c)</td>
<td>$42.75</td>
<td>$20.03</td>
</tr>
</tbody>
</table>

- Maximum University Contribution: (a) * (b)
- UC Share: (b)
- Retiree Contribution: (c)
- Minimum Premium: (a) + (c)

#### Implementation
- The table below illustrates retiree contributions assuming UC contributes 70% towards dental in 2017, assuming 100% graduated eligibility.

The University currently contributes 100% towards dental benefits.
Overview

• Transition retirees from the Medicare PPO and High Option plans to a fully insured group Medicare Advantage plan structure; actions for the network Medicare Advantage HMO plan (currently Health Net) may depend on the outcome of the current HMO bid process
• Plan sponsors may replicate the current plan design

Medicare Advantage PPO plans typically reduce costs through two principal mechanisms:

- Introduction of medical management
- Capture of incremental CMS revenues

Plan sponsors may replicate the current plan design

Potential University Impact

- Current retirees can default into coverage
- Products fully insured
- No change to administrative process
- Cost and reduce liability by $0.5B (2%) (2%)
- Could deliver meaningful reduction to „pay as you go“

Retiree Considerations

• May not accept Medicare
• Limited potential for disruption as a few providers (>5%) particularly by older members
• Medical management may be viewed as disruptive, Plan designs may not be exact match

With current contribution approach, lowering plan cost in one plan impacts what retirees pay in all plans

Replace Medicare PPO and High Option Plans with Group Medicare Advantage (MA) PPO

Plan Structure and Delivery
Overview

Plan Structure and Delivery

Re-bid / Re-design Health Net Seniority Plus Plan

Retirees may be subject to plan designs changes

• Retirees in other plans would pay more

• Savings would be shared with Health Net retirees, while

• Pre-needly this would not be done alone, and would be

• Reduce liability by $0.5B (2%)

15 percent reduction in costs of Health Net alone would

Potential University Impact

15 percent reduction in costs of Health Net alone would

High Option plans to Group Medicare Advantage $1.0B

combined with the transition of the Medicare PPO and

high Option members

Although this may not align with the active Health Net plan, it may be preferable to transition Seniority Plus members to

Multiple carriers in California offer similar products, current competitive bid process could lower rates

Health Net plan represents the highest liability and cash expense of all Medicare plans due to high enrollment and cost

Health Net Plan is a Group Medicare/Advantage Advantage product, but has relatively high costs (higher than Medicare PPO)