BOARD OF SUPERVISORS AGENDA LETTER

Agenda Number:

Clerk of the Board of Supervisors
105 E. Anapamu Street, Suite 407
Santa Barbara, CA 93101
(805) 568-2240

Department Name:	CEO/Auditor-Controller
Department No.:	012/061
For Agenda Of:	03/01/2016
Placement:	Departmental
Estimated Time:	30 Minutes
Continued Item:	No
If Yes, date from:	
Vote Required:	Majority

TO:	Board of Supervisors	
FROM:	Department Director(s)	Mona Miyasato, CEO
	Contact Info:	Gregory Levin, SBCERS CEO 568-2940 Tom Alvarez, Budget Director 568-3432

SUBJECT: **OPEB Funding Policy**

County Counsel Concurrence
As to form: Yes

Auditor-Controller Concurrence
As to form: Yes

Other Concurrence:
As to form: NA

Recommended Actions:

That the Board of Supervisors:

a) Adopt the Resolution in Attachment A that updates and approves a County of Santa Barbara Other Post-Employment Benefits (401(h) Account) Funding Policy.

b) Determine that the above action is not a project under the California Environmental Quality Act (CEQA) pursuant to CEQA Guidelines section 15378(b)(2) because it consists of general policy and procedure making that will not result in changes in the environment.

Summary Text:

This resolution will place into formal policy a funding plan for the County's Other Post-Employment Benefit Plan. The policy provides a minimum baseline of funding equal to 4% of total pensionable payroll, an amount equal to the County's existing budget goal for the Fiscal Year ending June 30, 2017 Budget. By formalizing the County's funding commitment and demonstrating adherence to that policy, the SBCERS actuary projects that the 4% contribution rate over a 19 year period should be sufficient to fully fund the plan by approximately 2034, assuming that investment objectives and other plan assumptions are met.

Background:

History of Establishing the 401(h) Trust and Identification of Plan Participants -
On September 16, 2008 the County of Santa Barbara adopted regulations to create a trust pursuant to sections 401(h) of the U.S. Internal Revenue Code and entered into an agreement with the Santa Barbara County Employees' Retirement System (SBCERS) to administer the trust on the County's behalf. SBCERS therefore serves as the administrator of the County's retiree health plan. The purpose of the 401(h) trust (the "Plan") was to provide for Other Post-Employment Benefits (OPEB) to retired employees of the County and other participating plan sponsors. The following other sponsors have elected to join the Plan:

- Carpinteria-Summerland-FPD
- Santa Maria Cemetery District
- Goleta Cemetery District
- Santa Barbara County Association of Governments
- Summerland Sanitary District
- Carpinteria Cemetery District
- Santa Barbara Air Pollution Control District
- Superior Court of California, County of Santa Barbara

Calculation, Eligibility, and Description of OPEB Benefits -
The Retiree Health Plan provides benefits to employees based upon their years of service and whether or not the employee elects to use a County selected health insurance provider ($15 per month per year of service) or acquires health insurance through another provider ($4 per month per year of service). For example, an employee who retires after 10 years of service and elects to use the County negotiated health insurance will receive $150 per month (10 years x $15 per month) as a subsidy towards their health benefits. An employee who retires after 10 years of service and elects to use their own insurance provider will receive $40 per month (10 years x $4 per month) into a Health Savings Account. All contributions to the Plan on behalf of employees are pre-tax and all benefits disbursed are not taxable if they are used for qualifying medical expenses. *On June 26, 2012 the County closed the Plan to new general members.*

Current Funding Methodology -
Pursuant to the regulations establishing the Plan, individual plan sponsors retain the authority to determine the amount and timing of contributions made. It is in this manner that the Plan is different than the County's core 401(a) pension plan. Since 2008 the County has funded these obligations largely using a modified pay-as-you-go methodology. During the fiscal year ending June 30, 2014, the County implemented a budget policy that increases existing pay as you go funding from 3% of pensionable payroll by 25 basis points each year. For the current year (FY 2015-16), the County is budgeted to provide contributions at 3.75% of payroll.

OPEB Trust & Liability Balances -
As of the June 30, 2014 valuation date, the County has an accumulated asset balance of approximately $3,155,000. The Actuarial Accrued Liability for the period ending June 30, 2014 was $178,461,554. The funded percentage of the Plan was at 1.8% for the fiscal year ending June 30, 2014.

Accounting and Actuarial Standards Supporting a Formally Adopted Policy -
In June 2015, the Governmental Accounting Standards Board (GASB) released Statement Number 75 (GASB 75) which is effective for the fiscal year ending June 30, 2018 and provides accounting and

disclosure requirements that the County is required to implement with respect to OPEB. The requirements are consistent with GASB Statement Number 68 (GASB 68) which applies to financial reporting for core pension plans. The County implemented GASB 68 in its June 30, 2015 financial statements.

GASB 75 implements accounting changes for OPEB plan sponsors that seek to improve disclosures and valuation information provided to the users of the County's financial information. Among the many changes promulgated, the standards require that the County record the amount of the entire unfunded OPEB obligation on the face of its government-wide financial statements and recognize the expense related to the Plan in the current year as opposed to recognizing it over the life of the Plan. There is currently a net OPEB obligation recorded in the County's government-wide financial statements, which under current accounting standards has gradually increased to approximately $91.0 million of the total outstanding net obligation of approximately $175.3 million (as of June 30, 2014, the last valuation date).

The changes in accounting standards, along with generally accepted fiduciary best practices, create conditions that encourage the County to reconcile its current funding practices with a long-term vision for the provision of retiree healthcare benefits, through adoption of this funding policy.

<u>Analysis:</u>

A. Funding Policy

As noted in the Background discussion above, since inception the County has funded the Plan at the current cost of benefits with incremental additional contributions. The Plan has now accumulated a total balance of over $3 million. The accumulated balance constitutes a small percentage of the Plan's liabilities, approximately 1.8%. The accumulated funds are currently invested in a blend of equities (60%) and bonds (40%). Annual contributions to the Plan have approximated 3% of the pension plan payroll, although such contributions have recently been increased, and are budgeted to increase further towards 4% of covered payroll for the fiscal year ending June 30, 2017.

Although favorable investment returns have been obtained, the $3 million accumulated balance is small relative to the size of the OPEB liability. Existing accounting and actuarial standards led to the use of a 4.3% assumed rate of return for the County's OPEB Liability in the most recent OPEB actuarial valuation because of the County's prior funding policy of only paying slightly more than pay-go. This current low assumed rate of return results in a much larger reported Net OPEB liability (generally the difference between plan assets and the actuarially determined liability) than would otherwise be reported by the County if it had a long term funding policy in place.

Effective for the fiscal year ending June 30, 2018, GASB 75 requires that the County recognize a liability equal to the net OPEB liability on its financial statements. However, GASB 75 also includes guidance that allows consideration of a higher discount rate when calculating the total actuarially determined liability. GASB 75 permits the consideration of future contributions from the County when evaluating whether or not there will be accumulated investments and contributions sufficient to meet the benefit payments in a future period. Specifically, GASB 75 recognizes a professional actuarial judgment regarding the likelihood of future funding can be based on either a "statute or contract" mandating contributions or a "formal written policy" specifying future contributions.

The County's contributions are not established by statute or contract; therefore, if the County wishes to enable consideration of a higher assumed rate of return and as a result lower the total actuarially determined liability of the Plan, it can only accomplish this objective if it has a formal, written funding policy supported by a demonstrated history of adherence to that policy. Nothing in the policy is intended to create vested rights to Plan benefits or to modify or limit the authority of the Board of Supervisors pursuant to the Plan Regulations.

B. The County's historic funding practice

As a matter of budget policy, the County has increased contributions to the 401(h) plan by 0.25 percent of covered payroll over a number of years. This policy is projected to reach a rate of contribution of 4% of covered payroll by next fiscal year ending June 30, 2017.

C. Evaluation of future contribution needs

The SBCERS actuary was requested to analyze the County's current funding practices and determine the rate of funding that would be required to reduce the liability over the long term. The actuary developed 8 different funding scenarios for analysis. These scenarios used investment return assumptions that ranged from 6.5% to 7.5%, contribution assumptions that ranged from 3% to 7.5% of payroll. The table below summarizes the analysis scenarios, the scenarios that contain contributions equal to the recommended funding policy are highlighted in bold:

	Scenarios							
	1	2	3	4	5	6	7	8
Assumptions:	3% of Payroll	**4% of Payroll**	5% of Payroll	10-Year Pay-Down	**20-Year Pay-down**	30 Year Pay-Down	**Moderate Investment Risk**	**Conservative Investment Risk**
Estimated Payroll Contribution Percentage	3%	**4%**	5%	7.50%	**4%**	3%	**4%**	**4%**
Investment Return Assumption	7.50%	**7.50%**	7.50%	7.50%	**7.50%**	7.50%	**7.00%**	**6.50%**
Year of Full Funding	2044	**2034**	2030	2024	**2034**	2044	**2035**	**2035**
Total 30-Year Contribution Est. ($ Millions)	$403	**$287**	$248	$212	**$288**	$403	**$301**	**$315**

- Scenarios one through three compare the effect of various contribution rates on the amount of time necessary to pay down the liability.
- Scenarios four through six were developed to assess the contribution rates necessary to achieve full funding over a set period of time (10, 20 and 30 years).
- Scenarios seven and eight evaluate the effect that more conservative investment assumptions and approaches would have on the amount of time necessary to pay down the liability.

The projections of the SBCERS actuary is that a sustained contribution rate of 4% of payroll over a 19 year period should be sufficient to fully fund the 401(h) plan by approximately 2034, assuming that current investment objectives and other plan assumptions are met. The actuarial rate of 4% is in line with the previously approved Board Budget Policies and is a current assumption in the budget development for FY 2016-17. This analysis relies on a funding policy being in place and an assumed rate of return on the assets of 7.5%, as determined by the SBCERS actuary. Having a written policy or plan in place, allows the Board of Retirement to consider modification of the current discount rate, consistent with actuarial standards.

Provided that assumptions are met, implementing this plan will allow, over the long term, for investment returns to have a greater role in funding benefits under the Plan, and will reduce the proportion of contributions required from the annual budget to pay those benefits. In addition, the higher assumed rate of return, discount rate, and the incremental increases in funding, will greatly decrease the County's liabilities associated with the Plan and reduce the impact of changing accounting standards. As an example, utilization of Scenario #7 assumptions (4% contribution rate and a 7% assumed rate of return) will allow the Plan to value its liabilities in a manner that is projected to reduce the Plans total liability by approximately 22% or approximately, $40,000,000 in nominal dollars.

Fiscal and Facilities Impacts:

It is expected that the funding policy will establish a stable platform for the provision of retiree health benefits into the foreseeable future. The minimum contribution rate of 4% of total 401(a) plan pensionable payroll has no fiscal impact relative to the County's current targeted contribution for the fiscal year ending June 30, 2017. The minimum contribution rate is also projected to be sufficient to cover the expected future benefit payments and thus permits using a higher assumed rate of return to value Plan liabilities; thereby reducing the liability. This reduction of liability will dramatically reduce the impact of the changing accounting standards which require the County's financial statements to reflect the full unfunded liability of the Plan.

Fiscal Analysis: Fiscal impacts are stated above in this Board Letter.

Staffing Impacts:

NA

Special Instructions:

None

Attachments:

Attachment A: Resolution