

Cost of Retiree Health Benefits (OPEB)

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Cost of Retiree Health Benefits (OPEB)

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OLO REPORT 2019-11: COST OF RETIREE HEALTH BENEFITS (OPEB)

EXECUTIVE SUMMARY

This Office of Legislative Oversight report responds to the County Council's request for a comprehensive understanding of current and projected Other Post-Employment Benefit (OPEB) costs, and identification of possible strategies to control the growth of these costs.

What is OPEB?

Other Post-Employment Benefits (OPEB) are non-pension benefits offered by an employer to qualified retirees (e.g., retiree health insurance). Each agency sets OPEB benefit levels, eligibility criteria, and cost share structure for their own retirees. OPEB includes two funding components:

- **Pay-as-you-go funding** refers to the annual cost of group insurance benefits for current retirees. Under this funding method, agencies annually budget resources to pay the current year's cost of health care claims for retired employees and their dependents. Once a retiree turns 65, Medicare becomes the primary coverage and the agency plan becomes secondary.
- **Pre-funding** sets aside assets at the time employees earn a benefit to cover cost obligations that will be paid in the future (the same as how all agencies pre-fund pension benefits). Annual pre-funding amounts are determined by actuarial valuation, and pre-funding payments are deposited into a designated Trust Fund. County agencies began pre-funding in FY08.

Summary of Key Findings

1. **Pre-funding OPEB benefits provides several long-term financial advantages compared to covering retiree health care costs solely on a pay-as-you-go basis.** These include: lowering long-term costs by 25-40%; helping Montgomery County maintain its AAA bond rating; and protecting the benefit by ensuring long-term sustainability.
2. **Retiree health benefits are a significant cost factor for Montgomery County agencies, and in FY20 account for 4.1% of the total approved tax supported operating budget.** Approved retiree health funding of \$227.9 million in FY20 consists of \$205.3 million in tax supported funding and \$22.6 million in non-tax supported funding.
3. **In FY18 and FY19, faced with unanticipated revenue shortfalls, the County did not meet its annual OPEB pre-funding obligations. County agencies have also drawn down on OPEB Trust assets to fund pay-as-you-go costs on a limited basis since FY15.** These actions have reduced the annual operating budget impact but not the overall cost of providing retiree health benefits.
4. **At the end of FY18, the combined OPEB liability across the four County agencies was \$4.9 billion. The agencies have set aside \$1.0 billion in Trust assets since FY08, or 21% of the total liability.** In other words, County agencies have set aside about 21 cents for every dollar of their current combined retiree health care liability.
5. **Since FY08, the \$755.4 million pre-funding contributions deposited in the County's Consolidated OPEB Trust for County Government, MCPS, and Montgomery College have accrued investment gains of \$261.3 million (as of March 2019).** These investment gains represent 26% of the total Trust assets, confirming that pre-funding produces long-term cost savings.
6. **Compared to several other local public sector employers, the County agencies have OPEB funded ratios that measure up favorably with Maryland jurisdictions but are below that of some Northern Virginia jurisdictions.** There is significant variation in OPEB funded ratios regionally, notably ranging from 3% for the State of Maryland to 77% for Fairfax County Government.

7. **Among 16 other local jurisdictions reviewed, the County Government has a relatively high calculation of total OPEB liability per member when normalizing for plan members and discount rate.** This calculation indicates that plan design, eligibility, and/or demographics are generating higher employer costs per member than those incurred by many other local public sector employers.
8. **For County Government, pre-Medicare (under age 65) retirees appear to be a significant cost driver for health benefits.** Pre-Medicare retirees represent 34% of medical plan enrollment but 52% of projected claims costs in 2019.
9. **Retiree health is a fast-disappearing benefit in the private sector and has decreased in the public sector as well.** Many large firms and governments have implemented cost reduction strategies including increased retiree premium contributions, increasing patient cost sharing, and eliminating coverage all together.
10. **Several state and local governments have replaced traditional defined retiree health benefits with a Health Retirement Account and Private Exchange model.** This model has gained support from some labor organizations (in the Pacific Northwest) and has resulted in significant reductions in total OPEB liability of 33% (Ohio Public Employees Retirement System) and 45% (State of Nevada).

Summary of Recommendations

Recommendation #1. The County should align the cost of retiree health benefits with the County's ability to pay these costs.

Recommendation #2. The Council should review and update fiscal policies related to OPEB to ensure appropriate planning and funding. Specifically, consider whether to:

- a. establish OPEB pre-funding policy goals and milestones.
- b. consider requirements for depositing appropriated OPEB pre-funding into the Consolidated Trust.
- c. review other fiscal practices that could provide additional pre-funding.

Recommendation #3. The Council should request an actuarial assessment of a variety of changes to the County Government's retiree health benefit package to determine how such changes would affect both retirees and County finances. Potential changes include:

- a. Reduce the minimum and maximum cost share arrangement by years of service to match MCPS.
- b. Cap the County's cost share contribution at the amount for Self+1 coverage.
- c. Reduce the County's cost share for under age 65 retirees.
- d. Require non-Medicare eligible retirees who are employed in jobs that offer health insurance to enroll in their current employer's health insurance plan.
- e. Revise eligibility criteria such that a retiree only receives health benefits as a Medicare supplement.
- f. Establish a minimum age of 55 to be eligible to receive retiree health benefits.
- g. Revise eligibility criteria such that health benefits for retirees are no longer available to a retiree's dependents.
- h. Exclude retirees from adding to their health insurance new dependents who were not eligible for coverage at the time of retirement.
- i. Adjust plan design features that affect the costs paid by retirees and the County.

Recommendation #4. Examine the feasibility of adopting a Retiree Healthcare Account/Private Exchange approach for Medicare-eligible retirees.

CHAPTER 1. AUTHORITY, SCOPE, ORGANIZATION AND ACKNOWLEDGEMENTS

A. Authority

Council Resolution 18-882, Fiscal Year 2018 Work Program of the Office of Legislative Oversight, adopted July 25, 2017.

B. Scope, Purpose, Organization and Methodology

This report responds to the County Council's request that the Office of Legislative Oversight (OLO) team with Council Central Staff to prepare a report that provides a comprehensive and up-to-date understanding of current and projected future retiree health benefit costs. As directed by the County Council, the report includes:

- An explanation of the cost of retiree health benefits in the context of the aggregate operating budget and individual agency operating budgets;
- An analysis of funded ratios for the Consolidated Retiree Health Benefits Trust Fund;
- An analysis of similarities and differences among agency retiree health plan designs, eligibility, and cost share structures; and
- A projection of long-term retiree health benefit costs and identification of possible strategies to control the growth of these costs.

This report is organized as follows:

Chapter 2. Overview of Retiree Health Benefits in County Agencies summarizes the retiree health benefits offered by Montgomery County Government, Montgomery County Public Schools (MCPS), Montgomery College, and the Maryland-National Capital Park and Planning Commission (M-NCPPC).

Chapter 3. OPEB Budget and Fiscal Considerations provides an overview of the budgeting, financial reporting, and fiscal considerations facing employers that provide a defined retiree health benefit.

Chapter 4. OPEB in Montgomery County describes Montgomery County OPEB policies, funding levels, and current costs.

Chapter 5. OPEB Liability and Funding: Montgomery County and Other Jurisdictions reviews OPEB liabilities and funding status for Montgomery County agencies, reviews projected funded ratios under alternative funding scenarios, and compares OPEB liabilities incurred by Montgomery County agencies with other local public sector employers.

Chapter 6. OPEB Cost Control Measures presents information on the prevalence of retiree health benefits among large public and private employers, and how public sector employers in Maryland and across the country have initiated reforms to control the cost of retiree health benefits.

Chapter 7. Summary Findings and Staff Recommendations summarizes the key findings from the joint OLO/Council staff review of OPEB and provides recommendations for Council consideration.

This project was conducted by Craig Howard, Senior Legislative Analyst, County Council Central Staff and Aron Trombka, Senior Legislative Analyst, Office of Legislative Oversight. Staff gathered information for the report through document reviews, budget and data analysis, and interviews with County agency staff.

C. Acknowledgements

The report authors recognize and appreciate cooperation and assistance of staff in the County Office of Human Resources, Montgomery County Employee Retirement Plans, Department of Finance, and Office of Management and Budget. In addition, OLO thanks representatives from MCPS, Montgomery College, and M-NCPPC who provided information for this report.

CHAPTER 2. OVERVIEW OF RETIREE HEALTH BENEFITS IN COUNTY AGENCIES

Other Post-Employment Benefits (OPEB) are non-pension benefits offered by an employer to qualified retirees (e.g., retiree health insurance).¹ In Montgomery County, each agency sets OPEB benefit levels and eligibility criteria for its own retirees. This chapter summarizes the retiree health benefits offered by Montgomery County Government, Montgomery County Public Schools (MCPS), Montgomery College, and the Maryland-National Capital Park and Planning Commission (M-NCPPC).

A. Retiree Health Benefits Offered by County Agencies

Currently, each agency sponsors an array of health plans with varying structures. Key structural components of retiree health plans that impact the overall cost include:

Plan Design and Administration. Each agency offers multiple health plan choices for retirees, and contracts with different insurance carriers for plan administration. Based on the design and administrator, each plan has its own structures such as co-pays, deductibles, out-of-pocket maximums, and network of health care providers.

Coordination with Medicare. For all agency retirees, the structure of agency-provided health benefits changes once a retiree becomes eligible for Medicare. Between retirement and age 65, the medical plan offered by each agency is the retiree's primary plan. Once a retiree turns 65, Medicare becomes the primary coverage and the agency plan becomes secondary coverage. Each agency requires Medicare-eligible retirees to participate in Medicare Parts A, B, and D in coordination with their agency-provided benefits. A description of each Medicare Part is included below, adapted from the Montgomery County Government's Office of Human Resources *Health Insurance: Options When You Retire* document.²

Medicare Part A (Hospital Insurance) covers most medically necessary hospital, skilled nursing facility, home health and hospice care services. Retirees do not pay for Part A if they have worked and paid Social Security taxes for at least 40 calendar quarters (10 years); retirees pay a monthly premium if they have worked and paid taxes for less time. Part A is effective the month in which the retiree turns 65.

Medicare Part B (Medical Insurance) covers 80% of most medically necessary doctors' services, preventive care, durable medical equipment, hospital outpatient services, laboratory tests, x-rays, mental health care, and some home health and ambulance services. The retiree pays a monthly premium for this coverage and it is required if you want to receive benefits from the County medical plan.

Medicare Part D (Prescription Drug Insurance) The County's prescription plan works together with Medicare Part D to maintain your current coverage level; this process is administered through SilverScript.

¹ For the purposes of this report, "retiree" is defined as any employee who leaves County service and is eligible for post-employment benefits.

² <https://www.montgomerycountymd.gov/HR/Resources/Files/Benefits/1-22-2018New%20Grp%20Ins%20Retirement%20Monthly.pdf>

Eligibility for Retiree Health Benefits. Each agency establishes its own eligibility criteria for retiree health benefits (see table below). The current criteria are based on different combinations of an employee’s years of credited service and/or age. Most recently, the County Government, MCPS, and Montgomery College made changes to eligibility criteria that took effect in FY12.

Level of Coverage and Dependents. Retirees generally choose among three different levels of insurance coverage: self (covers only the employee); self+1 (covers the employee and one eligible dependent); and family (covers the employee and all eligible dependents). MCPS and M-NCPPC do not allow the addition of any new dependents once an employee has retired.

Table 1. 2019 Retiree Health Plan Options by Agency

Agency	Eligibility	Medical Plans	Prescription Drug Plans
County Government	<u>ERS (Pension Plan) Participants:</u> <ul style="list-style-type: none"> • Hired before 7/1/11: all employees eligible for retirement • Hired on or after 7/1/11: all employees eligible for retirement with at least 10 years of service <u>RSP (Defined Contribution) Participants:</u> varies based on years of service, age, and hire date.	<ul style="list-style-type: none"> • Carefirst BlueChoice POS – High Option • Carefirst BlueChoice POS – Standard Option • Kaiser Permanente HMO • United Healthcare Select HMO • Carefirst Indemnity (closed plan) 	<ul style="list-style-type: none"> • Caremark (< 65 only) • SilverScript (65+ only) • Kaiser Permanente*
MCPS	Employees eligible for retirement and: <ul style="list-style-type: none"> • At least 5 years of service if retired on or before 7/1/11; • At least 10 years of service if retired after 7/1/11.** 	<ul style="list-style-type: none"> • CareFirst BlueChoice Advantage POS • Carefirst BlueChoice HMO • Carefirst EPO • Kaiser Permanente HMO • CareFirst BlueChoice Advantage Indemnity (65+ only) 	<ul style="list-style-type: none"> • Caremark (< 65 only) • SilverScript (65+ only) • Kaiser Permanente*
Montgomery College	Employees eligible for retirement and: <ul style="list-style-type: none"> • At least 5 years of service if hired before 7/1/11; • At least 15 years of service if hired on or after 7/1/11. 	<ul style="list-style-type: none"> • CIGNA POS • CIGNA PPO Medicare Supplement • Kaiser Permanente HMO 	<ul style="list-style-type: none"> • Caremark (< 65 only) • SilverScript (65+ only) • Kaiser Permanente*
M-NCPPC	Employees eligible for retirement and: <ul style="list-style-type: none"> • At least 5 years of service if hired before 1/1/13; • At least 10 years of service if hired on or after 1/1/13. 	<ul style="list-style-type: none"> • United Healthcare POS • United Healthcare EPO • Kaiser Permanente HMO 	<ul style="list-style-type: none"> • Caremark (< 65 only) • SilverScript (65+ only) • Kaiser Permanente*

*Kaiser prescription plans are included within Kaiser medical plans, and only available to enrollees of the medical plan. MCPS allows Kaiser medical enrollees to opt out of the Kaiser prescription coverage.

**Employees who retire after July 1, 2011 are eligible with five years of service if they meet one of the following conditions: hired prior to July 1, 2011 and was at least 55 years old as of July 1, 2011; hired prior to July 1, 2006; hired prior to July 1, 2011 and with at least 30 years of eligible service in the state core plan.

Premium Cost Share. Each year, based on the structure of each plan and projected total agency health care costs, agency actuaries calculate recommended premium amounts. Within each agency, the annual insurance premium varies by plan and level of coverage. The cost of the annual premium is shared between the agency and the enrolled retirees. A “cost share” ratio determines how much of the annual premium is paid by the agency and how much is paid by the retiree. Table 2 lists the current premium cost share arrangement for each agency. Retiree cost shares vary by hire date, years of credited service, and/or retirement date.

Table 2. 2019 Premium Cost Share for Retiree Health Benefits by Agency

Employee Status or Plan Type	Years of Service	Health Premium Cost Share	
		Agency Pays	Retiree Pays
Montgomery County Government			
Hired before Jan. 1, 1987*		80% or 70%	20% or 30%
Hired between Jan. 1, 1987 and June 30, 2011	5 years	50%	50%
	6-14 years	52-68%	48-32%
	15+ years	70%	30%
County share increases by 2% for each year of additional service between 5 and 15			
Hired or rehired on or after July 1, 2011	10 years	50%	50%
	11-24 years	51.3-68.7%	31.3-48.7%
	25+ years	70%	30%
County share increases by 1.33% for each year of additional service between 10 and 25			
MCPS			
Retired on or before July 1, 2011	5+ years	64%	36%
Retired after July 1, 2011**	10-14 years	40%	60%
	15-19 years	50%	50%
	20+ years	64%	36%
Montgomery College			
Employees hired prior to July 1, 2011 (regardless of age)	5-10 years	40%	60%
	10+ years	60%	40%
Employees hired after July 1, 2011 and at least age 55	15-19 years	40%	60%
	20+ years	60%	40%
M-NCPPC			
Hired before January,1 2013	5 years	80%	20%
Hired or rehired on or after January 1, 2013	10 years	50%	50%
	11-24 years	51.5-72%	48.5%-28%
	25+ years	75%	25%
	Agency share increases by 1.5% for each year of additional service between 10 and 24, and an additional 3% between 24 and 25		

*Employees hired before Jan. 1, 1987 are only eligible for retiree health insurance for the same number of years they were eligible for insurance as an active employee. In 1986 and 2002, these employees were given the option to switch to the same lifetime cost sharing arrangement as those hired after Jan. 1, 1987.

**Employees who retire after July 1, 2011 are grandfathered into the 64/36 cost share arrangement if they have five years of cumulative service and meet one of the following conditions: hired prior to July 1, 2011 and was at least 55 years old as of July 1, 2011; hired prior to July 1, 2006; hired prior to July 1, 2011 and with at least 30 years of eligible service in the state core plan.

Retiree Subsidy. One factor that impacts costs for County Government retirees is that retirees and active employees are included in a single pool for calculating health premiums. As a result, active employees in County Government pay a higher premium than they would if they were in a separate pool – in effect subsidizing part of the premium cost for retirees. The County’s health care consultant estimates the subsidy amount at \$2,153 in 2019. In other words, if active employees and retirees were in separate pools for premium rate setting purposes, active employee premiums would cost around \$2,000 less and retiree premiums would cost \$2,000 more on average. This is not the case for all agencies. For example, MPCS does not have the same type of retiree subsidy because it separates retirees and actives into separate pools for premium rate setting.

B. Legal Structure for Retiree Health Benefits

The structure of employee health benefits is not established in County or State law; rather it is a policy established by each agency. The authority to change the structure of retiree health benefits lies with the governing body for each agency. For a discussion of general legal issues surrounding modification to health benefits, see a 2010 memo in the appendix (©1) from the County Attorney on the Council’s authority to modify employee pay and benefits. In general, the County Attorney has concluded (on several occasions) that the Council has the authority to change County Government retiree health benefits.

The most recent change to County Government retiree health benefits in 2011, which increased the years of service required to qualify for benefits and to receive the maximum health premium subsidy, was accomplished via Council Resolution 17-163, *County Policy on Group Insurance Benefits for Retired County Employees* (attached ©15).

Since 1994, the County’s *Group Insurance Summary Description* document has included a provision reserving the right to amend retiree health benefit plan terms. The most recent *Summary Description* document from 2018 states:³

The County expects to continue the group insurance benefits, but it is the County’s position that there is no implied contract between retired employees and the County to do so. The County reserves the right at any time and for any lawful reason to amend or terminate its group insurance benefits and policies for retired employees.

³<https://www.montgomerycountymd.gov/HR/Resources/Files/Benefits/October%202018%20mid%20year%20Group%20Insurance%20Summary%20Description2018asm.pdf>, pg. 16.

CHAPTER 3. OPEB BUDGET AND FISCAL CONSIDERATIONS

As with many public sector employers, County agencies provide a defined retiree health insurance benefit. In a defined benefit plan, the retiree receives a specified benefit (a particular health insurance plan). The employer, particularly those who are self-insured, bears most or all the risk associated with health care utilization and inflation. This chapter provides an overview of the fiscal consideration facing employers that provide a defined retiree health benefit.

A. How Employers Pay for OPEB

Employers fund retiree health insurance benefits using one (or both) of the following methods:

Pay-As-You-Go refers to budgeting resources to pay the employer's share of current year health care claims for retired employees. The employer incurred the liability to pay these claims when retirees had been active employees in past years. Nonetheless, the pay-as-you-go approach treats these costs as an expense in the year the benefit comes due rather than as a benefit that was earned and an obligation that had accrued during the period of active employment.

Pre-funding is a practice of setting aside assets at the time employees earn the benefit to cover health care claims that will be paid in the future. As an employee earns the benefit, an actuarially determined dollar amount is deposited in an OPEB reserve or trust fund. Resources in the reserve or trust fund are available to pay future health care claims when they become due.

The other major type of defined post-employment benefit is a pension plan. Pre-funding is the accepted standard for financing pension plans. Indeed, the County pre-funds its pension with the goal of achieving a 100 percent funded ratio. As stated in the Comprehensive Annual Financial Report for the County's pension fund, "the funding objective ... is to collect employer and employee contributions sufficient to pay the benefits of the Montgomery County Employees' Retirement System when due and to achieve a funded ratio of 100 percent at the end of the amortization period."⁴

B. Budgeting for Pay-As-You-Go Costs

Under the pay-as-you-go funding method, an employer annually budgets resources to pay for the cost of retiree health care claims incurred in that year. The amount budgeted for pay-as-you-go reflects the employer's portion of the annual premium cost. Typically, the employer and retiree portions of the premium are accounted for in a group insurance fund and annual health care claims costs are paid from that fund. The employer may maintain a fund balance in the group insurance fund to cover years in which actual claims exceed the budgeted contribution.

⁴ *Montgomery County Employee Retirement Plans Comprehensive Annual Financial Report for Fiscal Year 2018*, page 60, [https://www.montgomerycountymd.gov/mcerp/Resources/Files/FY18%20CAFR%20-%20Updated%20Board%20of%20Trustees%20Term\(1\).pdf](https://www.montgomerycountymd.gov/mcerp/Resources/Files/FY18%20CAFR%20-%20Updated%20Board%20of%20Trustees%20Term(1).pdf)

C. Long-Term OPEB Liabilities and Assets

An employer's OPEB liability refers to the present value of benefits earned to date for employees' past service. In other words, OPEB liability is the value in current year dollars of future health care benefits already earned by employees.

The Governmental Accounting Standards Board (GASB) is an independent organization that establishes accounting and financial reporting standards for state and local governments. In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (known as "GASB 75"). GASB 75, among other things, set the current standard for public sector measurement and reporting of OPEB liabilities:

The total OPEB liability generally is required to be determined through an actuarial valuation....Unless otherwise specified by this Statement, all assumptions underlying the determination of the total OPEB liability and related measures set forth by this Statement are required to be made in conformity with Actuarial Standards of Practice issued by the Actuarial Standards Board.⁵

An employer's OPEB assets are the cash or investments placed into a fund to pay future liabilities. The value of assets is measured in current year dollars. The term "funded ratio" refers to a calculation of OPEB current assets as a percentage of current liabilities. In other words, the funded ratio measures the extent to which the employer has set aside funds to pay for the cost of retiree health benefits already earned by current and past employees. See Chapter 5 of this report for information on the County's OPEB funded ratio.

D. OPEB Reporting Requirements

In June 2004, GASB issued Statement #45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (known as "GASB 45"). GASB 45 first established the requirement that governments measure and report OPEB liabilities:

Net OPEB obligations...should be displayed as liabilities (or assets) in government-wide financial statements. Similarly, net OPEB obligations associated with proprietary or fiduciary funds from which contributions are made should be displayed as liabilities (or assets) in the financial statements of those funds.

Employers are required to disclose descriptive information about each defined benefit OPEB plan in which they participate, including the funding policy followed. In addition, sole and agent employers are required to disclose information about contributions made in comparison to annual OPEB cost, changes in the net OPEB obligation, the funded status of each plan as of the most recent actuarial valuation

⁵ Governmental Accounting Standards Board, Summary of Statement No. 75 *Accounting and Financial Reporting For Postemployment Benefits Other Than Pensions*, June 2015, https://www.gasb.org/cs/ContentServer?c=Pronouncement_C&cid=1176166370763&d=&pagename=GASB%2FPronouncement_C%2FGASBSummaryPage

date, and the nature of the actuarial valuation process and significant methods and assumptions used.⁶

In sum, GASB 45 requires governments that offer defined retiree health benefits to disclose the actuarially determined liability for OPEB benefits and the assets that offset the liability. In addition, GASB 45 requires public reporting of the actuarial methods and assumptions used to calculate the liability.

In June 2015, GASB 75 replaced GASB 45. Beginning with financial statements for FY18, GASB 75 requires the following standard for measurement and reporting of OPEB liabilities:

This Statement requires the liability of employers...to employees for defined benefit OPEB (net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position.⁷

GASB 75 expands the previous OPEB liability measurement and reporting requirements. GASB 75 requires that the balance sheet in the employer's Comprehensive Annual Financial Report (CAFR) include OPEB net liability as a long-term liability similar to outstanding general obligation debt. Moreover, accumulated assets will not reduce the OPEB liability on the balance sheet unless those assets are invested in an irrevocable trust. Previously, OPEB net liability could have been relegated to the notes section of the CAFR.

E. Reporting Standards versus Pre-Funding Amount

The new GASB 75 standards affect accounting and reporting of OPEB liabilities and assets; these standards do not mandate the amount an employer must contribute annually to OPEB pre-funding. As noted in an appendix to the GASB 75 Statement, the intent of the standards is not to "establish a specific method of financing OPEB (that being a policy decision for government officials or other responsible authorities to make) or to regulate a government's compliance with the financing policy or method it adopts." Rather, GASB established standards "within the context of accounting and financial reporting, not within the context of the funding of OPEB."⁸

The GASB standards will affect how employers report OPEB net liability in annual financial statements. Most notably, the new GASB rules modify the method for assigning a discount rate for investment returns on fund assets. The term "discount rate" refers to the assumed investment yield used to calculate the present-day value of future fund assets. In revising their standards, GASB concluded that the previous method for assigning a discount rate to OPEB assets

⁶ Governmental Accounting Standards Board, Summary of Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, June 2004, https://www.gasb.org/jsp/GASB/Pronouncement_C/GASBSummaryPage&cid=1176156700943

⁷ Ibid., Governmental Accounting Standards Board, Summary of Statement No. 75.

⁸ Governmental Accounting Standards Board, *Statement No. 75: Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, Appendix B, Paragraph B10, June 2015, https://www.gasb.org/jsp/GASB/Document_C/DocumentPage?cid=1176166144750&acceptedDisclaimer=true

artificially inflated the returns for unfunded liabilities. As such, GASB adopted new standards that require most public sector employers to establish a blended discount rate based, in part, on the current yield for tax-exempt municipal general obligation bonds.⁹ The yield for tax-exempt bonds is often two to four percentage points below the discount rate assumed by employers to calculate the present value of their OPEB assets. The new discount rate methodology takes effect this fiscal year and will reduce the present value of their OPEB assets for many public sector employers (including Montgomery County agencies).

GASB 75 further introduces a new term, “actuarially determined contribution,” or ADC. The ADC is an employer’s targeted annual pre-funding contribution that is consistent with the new OPEB accounting standards. As mentioned, GASB does not mandate how much an employer must contribute to OPEB pre-funding. Rather, the ADC is a recommended contribution amount that is based on the calculation of liabilities and assets in financial reports.

F. Calculating Pre-Funding Amount

GASB rules only affect reporting but do not directly influence the public sector employer’s OPEB budget decision-making. Rather, each employer determines on its own how much to contribute to its OPEB trust fund or reserve. The amount of an employer’s annual OPEB pre-funding contribution is primarily a function of three factors:

1. Normal costs;
2. Size of the employer’s unfunded liability; and
3. Actuarial and accounting assumptions.

OPEB **normal costs** refer to the actuarial present value of future health insurance benefits earned by active employees for work performed during the current year. In other words, this portion of OPEB pre-funding represents the current year amount needed to be set aside to cover the anticipated future health care claims by current employees when they retire. The calculation of this cost is an actuarial exercise with an outcome that is dependent on multiple assumptions.

For many employers, an additional factor in calculating their annual OPEB pre-funding contribution calculation is the size of the **unfunded liability**. The unfunded liability equals the difference between the actuarially determined liability and the value of assets accumulated to finance that obligation. Employers must contribute over and above the normal cost to meet obligations earned by employees in past years that had not been fully funded.

The amount of the pre-funding contribution is also shaped by **actuarial and accounting assumptions**. Some of the key assumptions used in ADC calculations include: (a) the expected return on fund investments; (b) the projected life expectancy of retirees; (c) the number of future year retirees and dependents receiving employer-sponsored health benefits; (d) projected health care inflation rates; (e) the method of measuring assets and liabilities; and (f) the amortization method, that is, the period of time assumed to eliminate unfunded liability.

⁹ The new OPEB fund discount rate standard is nearly identical to the discount rate standard for pension fund.

See Chapter 4 of this report for information about past and projected future OPEB pre-funding contributions for County agencies.

G. Pre-Funding Versus Pay-As-You-Go Funding

This section discusses the budgetary and fiscal considerations of pre-funding versus pay-as-you-go, specifically, the budgetary opportunity cost as well as the fiscal advantages of pre-funding OPEB obligations.

1. Opportunity Cost of Pre-Funding

In the annual operating budget process, pre-funding OPEB carries a significant opportunity cost. OPEB pre-funding contributions capture substantial dollars that could be used for other pressing immediate service needs. The competition for finite public resources often makes pre-funding difficult, particularly in years when resources are scarce and demand for public services is high. For example, budget decision-makers may have to choose between an increment of OPEB pre-funding versus using those dollars to pay for current or new public services.¹⁰ Decision-makers may deem immediate service demands to have higher priority than funding a benefit that, although earned in the current year, will not be paid until many years in the future. Nonetheless, while OPEB pre-funding clearly involves a significant opportunity cost, any shortfall in pre-funding adds to the employer's long-term liabilities.

2. Advantages of Pre-Funding

Pre-funding refers to the practice of setting aside resources to cover retiree health insurance benefits in the year in which the benefits were earned. Pre-funding retiree health benefit costs has several advantages over paying solely on a pay-as-you-go basis:

- **Lower Costs.** Pre-funding OPEB obligations requires fewer tax dollars over the long-term than the pay-as-you-go method because the investment of trust fund assets earns income that later can be used to pay for retiree health costs. According to analysis presented at the 2014 conference of the Government Finance Officers Association (GFOA), the long-term cost of pre-funding is “commonly about 25-40% lower” than funding the same OPEB obligations through the pay-as you go method.¹¹ The County's experience supports the GFOA finding. As detailed in Chapter 4, investment income since FY08 has contributed nearly 26% of the total assets in the County's OPEB trust. Additionally, once the OPEB Trust becomes fully-funded, it will free up significant resources currently dedicated to annual pay-as-you-go costs that can be used on other programs and services.

¹⁰ To place this trade-off in context, \$1.0 million that otherwise might go toward OPEB pre-funding could be spent to pay one year's salary and benefits for about 11 to 12 entry-level firefighters (based on current County Government salary and benefit costs).

¹¹ Government Finance Officers Association, 108th Annual Conference, “*OPEB: What Now?*” presentation by Bill Reynolds, Jill Urdahl, Brian Whitworth, and Marcus Wu, May 2014, <http://gfoa.org/sites/default/files/FINAL%20-%20OPEB%20What%20Now.pdf>

- **Higher Investment Returns.** Investment managers that expect continual growth of assets and consistent annual employer contributions (without a concern that assets will be withdrawn early for pay-as-you-go purposes) are able to invest in high yield long-term instruments that are unavailable to fund managers that must maintain liquidity for large portions of fund assets.
- **Bond Ratings.** Bond rating agencies track whether governments meet their OPEB pre-funding obligations and manage the retiree health pay-as-you-go costs. Growth of pay-as-you-go costs is considered a risk factor in a jurisdiction credit worthiness (discussed in greater detail below).
- **Taxpayer Equity.** By pre-funding, an employer pays the projected costs for retiree health benefits as they are earned instead of deferring the costs for future taxpayers. Although the benefit is paid out in future years, retiree health is a form of compensation earned in the year when the employee provides the service. Current year taxpayers gain from the operating expense of compensating the employee in that year; future year taxpayers do not. The pay-as-you-go approach is the equivalent of issuing long-term debt to pay for an operating expense. For this reason, public sector employers (including the County) contribute annually to their pension funds to pay for the pension benefits earned by employees in that year.
- **Protection of the Benefit.** Setting aside resources at the time employees accrue the benefit helps ensure that sufficient resources will be available to pay future year retiree health care claims.

GFOA identifies policies and procedures that are “best practices” to improve government management. GFOA has declared OPEB pre-funding as a best practice to ensure OPEB sustainability:

Financing other postemployment benefits as they are earned (prefunding) rather than as they come due (pay-as-you-go funding) offers significant advantages in terms of equity and sustainability and should be formalized through a specific funding policy for postemployment benefits.¹²

H. OPEB Pre-Funding and Bond Ratings

When evaluating the credit-worthiness of governments, bond rating agencies consider multiple fiscal factors including the jurisdiction’s tax base, reserves, debt load, pension obligations, and OPEB liability. Rating agencies regard on-going annual OPEB obligations (both pay-as-you-go expenditures and pre-funding) as a fixed cost similar to pension payments or long-term debt. As with pensions and long-term debt, OPEB obligations reduce the amount of future government resources that are available for programs and services.

¹² Government Finance Officers Association, “Ensuring Other Postemployment Benefits (OPEB) Sustainability,” January 2016, <http://www.gfoa.org/ensuring-other-postemployment-benefits-opeb-sustainability-0>

1. Risk Assessment

There is no single standard to inform a government what level of OPEB net liability would endanger its bond rating. Nonetheless, rating agencies have guidelines describing how they assess OPEB risk. For example, Standard & Poor's assesses State government OPEB risk on a scale from one (low risk) to four (high risk) as shown in Table 3 below.

Table 3. Standard & Poor's OPEB Risk Levels

Risk Level	OPEB Risk Assessment
Low (1)	Limited benefits provided or benefit consists of allowing some participation in the health plan (cost paid entirely by the retiree, implicit subsidy recorded), high level of discretion to change benefits, pay-go costs are not significantly different from the actuarial required contribution.
Moderate (2)	Moderate/average liability relative to other states, proactive management of the liability in our view, some flexibility to adjust benefit levels, contributions in excess of the annual pay-go amount have been made in order to accumulate assets to address the liability.
Elevated (3)	Above-average liability relative to other states, options to address the liability are being considered but plans are not well-developed in our view, there may be some flexibility to adjust benefits but changes have been limited.
High (4)	High liability relative to other states, high level of benefits that are viewed as inflexible based on statute/constitution/contract terms, a lack of management action to address the liability in our view which will lead to accelerating pay-go contributions.
Standard & Poor's Ratings Direct on the Global Credit Portal, "U.S. State Ratings Methodology," January 3, 2011. Reproduced with permission of Standard & Poor's Financial Services LLC. See disclaimer on ©19.	

As evident in the Standard & Poor's risk assessment guidelines, rating agencies consider OPEB management decisions and pay-as-you-go cost trends when evaluating a government's credit-worthiness. Bond rating agencies assign the lowest risk to governments that take management action to control the growth of retiree health pay-as-you-go costs. On the other hand, accelerating annual pay-as-you-go payments are viewed as an indication of high risk. This assessment of relationship between OPEB pre-funding and bond ratings is emphasized on the County Department of Finance website:

Among other things, the rating agencies consider unfunded pension and OPEB liabilities in the rating analysis and quantify them similarly to debt. They are interested in how the County is managing all of its long term obligations ... Commitments to payout benefits to retirees compete with commitments to pay debt service on bonds, so the rating agencies have an obligation to report to the County's investors how well prepared the County is to meet all of its future commitments... Montgomery County currently has a AAA Bond rating, which is the highest rating given to public entities. But if the County is not found to be satisfactorily addressing its liabilities, this could impact the County's rating.¹³

¹³ Montgomery County Department of Finance, *Retiree Health Benefits - Frequently Asked Questions*, <https://www.montgomerycountymd.gov/finance/opeb/faqs.html>

2. OPEB's Effect on Bond Ratings

Growth in unfunded OPEB liability can contribute to a bond rating downgrade. When a downgrade occurs, OPEB may be one of several factors that combine to create a more negative outlook toward a jurisdiction's financial standing. In July 2017, for example, Moody's Investors Service downgraded the bond rating for the City of Fort Worth. Moody's attributed the downgrade to "the city's large and growing unfunded pension liability and growing fixed cost burden, which includes annual pension, OPEB, and debt service requirements."¹⁴ Similar justification was offered by rating agencies for recent downgrades or negative outlook for general obligation bonds issued by the states of Connecticut, Massachusetts, and New Jersey as well as the cities of Milwaukee and New Haven.

As detailed above, the Government Accounting Standards Board recently modified the requirements for measuring and reporting OPEB liabilities and assets. In light of these changes, Standard and Poor's issued a notice on the OPEB liabilities of state governments.¹⁵ The report warns that OPEB liabilities "are a growing concern for certain states' credit quality and require attention to control higher future costs." The report further notes that "plans that do not address OPEB costs in a timely manner may be exposed to large future swings in contributions and an increased likelihood that rapidly increasing benefits become unaffordable if no other action is taken to reduce costs." The rating agency notes that it assesses a state's "proactive liability management and flexibility to adjust benefits and plan offerings" as important factors in determining credit quality.

3. Recent Rating Agency Comment Regarding Montgomery County

At least one of the credit rating agencies has taken note of the recent County budget savings plan adjustments to OPEB contributions. In an Issuer Comment published in May 2019, Moody's noted that:

Montgomery County lowered its contributions toward pre-funding employee retiree health benefits in order to maintain progress toward its fiscal 2020 reserve target, the second consecutive year it has done so. The reduction in pre-funding is credit negative [emphasis added] because the County will accumulate assets more slowly and thus carry higher unfunded liabilities.¹⁶

¹⁴ Moody's Investor Services, "Moody's Downgrades Fort Worth, TX's GOLTs to Aa3; Outlook Revised to Negative," https://www.moodys.com/research/Moodys-Downgrades-Fort-Worth-TXs-GOLTs-to-Aa3-Outlook-Revised--PR_904123758#, July 13, 2017.

¹⁵ S&P Global, *Rising U.S. States' OPEB Liabilities Signal Higher Costs Ahead*, https://www.capitaliq.com/CIQDotNet/CreditResearch/RenderArticle.aspx?articleId=2135706&SctArtId=463709&form=CM&nsl_code=LIME&sourceObjectId=10777284&sourceRevId=2&fee_ind=N&exp_date=20281128-15:58:27, Nov 28, 2018.

¹⁶ Moody's Investor Service, Issuer Comment, *Montgomery County Maryland Reduction in Retiree Healthcare Pre-Funding is Credit Negative*, May 22, 2019.

Moody's further notes that past year OPEB contributions have put the County in a better position than many other local governments and that current OPEB Trust Fund assets provide the County short-term budget flexibility:

While its contributions relative to pre-funding targets have been scaled back in each of the past two fiscal years, and its unfunded liabilities for retirement benefits are material, the OPEB assets that Montgomery County has built up to date provide it with an extra source of near-term budgetary flexibility. Many US local governments have few or no OPEB assets, pay-as-you-go funding is widely prevalent, and the costs associated with pay-as-you-go funding often rise rapidly.¹⁷

¹⁷ Ibid.

CHAPTER 4. OPEB IN MONTGOMERY COUNTY

This chapter describes Montgomery County OPEB policies, funding levels, and current costs.

A. County OPEB Policies

OPEB funding in Montgomery County is addressed in two County policy statements:

Charter Mandated Fiscal Policy. Section 302 of County Charter states that “the County Executive shall submit to the Council, not later than March 15 of each year, comprehensive six-year programs for public services and fiscal policy” (emphasis added). The Executive’s recommended operating budget annually includes a fiscal policy chapter, and the FY20 budget includes the following statement regarding pre-funding of retiree health benefits:

The County phased-in full pre-funding of its Actuarially Determined Contribution (ADC), from the previous pay-as-you-go approach, beginning with contributions to one or more trust funds established for that purpose, over an eight-year period beginning with FY08.

Council Reserve and Fiscal Policies Resolution. In FY11 and FY12, the Council approved a “Reserve and Selected Fiscal Policies” resolution. These resolutions included a policy statement that identified payment of OPEB unfunded liabilities as a priority use for one-time revenues.

If the County determines that reserves have been fully funded, then one-time revenues should be applied to nonrecurring expenditures which are one-time in nature, pay-as-you-go for the CIP in excess of the County's targeted goal, or to unfunded liabilities. Priority consideration should be given to unfunded liabilities for Retiree Health Benefits (OPEB) and Pension Benefits Prefunding (*Council Resolution 17-312*).

B. County OPEB History

In 2003, after the GASB released preliminary drafts of the OPEB reporting rules, the Council’s Management and Fiscal Policy Committee began working with County agencies to address the new requirements. A timeline of key OPEB-related legislative, governance, and funding events that followed is summarized below.

- **OPEB workgroup.** In 2006, a multi-agency OPEB workgroup was formed with County Government, MCPS, Montgomery College, M-NCPPC, and WSSC representatives.
- **Adoption of a five-year pre-funding phase-in policy.** In April 2007, the Council adopted Resolution 16-87 stating the Council’s policy intent to reach 100% of the annual required pre-funding contribution over a five-year period beginning with FY08 for the tax supported agencies.

- **Establishment of OPEB Trusts.** Each agency established an OPEB Trust prior to or during FY08 and began depositing OPEB pre-funding appropriations into their respective trusts. For County Government, the Council adopted Expedited Bill 28-07 to formally establish a Retiree Health Benefit Trust in the County Code.
- **Adoption of a revised eight-year pre-funding phase-in schedule.** The County Executive's FY09 Recommended Operating Budget proposed switching from the five-year OPEB pre-funding phase-in schedule to an eight-year schedule due to the County's fiscal situation. In May 2008, the Council adopted Resolution 16-555 that amended the prior OPEB pre-funding resolution and established an eight-year funding schedule and appropriated OPEB pre-funding dollars in FY09 based on the new schedule.
- **Fiscal constraints eliminate OPEB pre-funding for FY10 and FY11.** Due to fiscal constraints, the Council did not appropriate any tax supported OPEB pre-funding dollars to any agency in FY10 or FY11.¹⁸
- **Creation of Consolidated OPEB Trust, resumption of pre-funding, and agency changes to benefit structure in FY12.** In June 2011, the Council adopted Bill 17-11 to amend the Retiree Health Benefit Trust to allow the Trust to receive OPEB pre-funding for MCPS and Montgomery College in addition to County Government. Pre-funding resumed based on the eight-year phase-in schedule. The County Government, MCPS, and Montgomery College each took actions to reduce overall long-term OPEB liability through changes to eligibility and cost share (M-NCPPC made similar changes in 2013).
- **Agencies adopt Medicare Part D Employee Group Waiver Program (EGWP) Plan for prescription drug coverage in FY15.** The four tax supported agencies implemented Medicare Part D EGWP plans in FY15. Because of this change and other factors, the required FY15 tax supported OPEB pre-funding across the agencies was \$81.8 million less than projected a year prior in the fiscal plan. This reduction in required pre-funding meant that the approved pre-funding was at 100% of the actuarially required level (ahead of the planned phase-in schedule).
- **Use of Trust to help fund retiree pay-as-you-go costs on a limited basis for MCPS and County Government.** Each year beginning in FY15, the Council has authorized MCPS use \$27.2 million in OPEB Trust assets to pay current year retiree health claims. In FY18 and FY19, \$9.0 million was authorized from the Consolidated OPEB Trust to fund current year claims for County Government (this amount was increased in FY18 as part of the savings plan). These actions are described in more detail below.
- **OPEB funding reduced in FY18 and FY19 as part of savings plans.** The Executive recommended and the Council approved savings plans in FY18 (\$62.4 million) and FY19 (\$89.6 million) that reduced OPEB funding in order to ensure reserves at the level assumed in the approved operating budget.

¹⁸ In FY10, the Council approved \$12 million in OPEB pre-funding for MCPS. With the mutual consent of the Council and the Board of Education, MCPS expended the \$12 million for other budget priorities.

C. Retiree Health Funding Summary

For FY20, the Council approved \$227.9 million in funding for retiree health benefits for County Government, MCPS, Montgomery College, and M-NCPPC – \$205.3 million in total tax supported funding and \$22.6 million in non-tax supported funding. **The tax supported portion represents 4.1% of the total approved FY20 tax supported operating budget of \$4.996 billion across all four agencies.**¹⁹ For comparison, the FY20 tax supported funding for the Montgomery County Fire and Rescue Service totals \$223.3 million and represents 4.5% of total tax supported funding.

As shown in Table 4, OPEB funding has ranged from 4.0% and 4.3% of total tax supported spending in five of the past six years, excluding FY16 when a larger proportion of pay-as-you-go funding came from non-tax supported sources. More detail on annual pay-as-you-go funding and pre-funding is available in sections D and E below, including the impact of the FY18 and FY19 savings plans on retiree health funding.

Table 4. Approved Retiree Health Budget for All Agencies, FY15-FY20

	FY15	FY16	FY17	FY18	FY19	FY20
Retiree Health Tax Supported Funding						
Pay-as-you-go	\$48.4	\$48.3	\$88.6	\$79.9	\$83.4	\$83.9
Pre-funding	\$127.8	\$108.5	\$109.9	\$122.2	\$128.7	\$121.4
Total	\$176.2	\$156.8	\$198.5	\$202.1	\$212.1	\$205.3
Retiree Health as % of Total Tax Supported Operating Budget	4.0%	3.5%	4.3%	4.2%	4.3%	4.1%
Retiree Health Non-Tax Supported Funding						
Pay-as-you-go (net from Trust)	--	\$51.2	\$27.2	\$36.2	\$36.2	\$18.2
Pre-funding ²⁰	\$4.4	\$5.3	\$5.3	\$5.6	\$5.6	\$4.4
Total	\$4.4	\$56.5	\$32.5	\$41.8	\$41.8	\$22.6
Combined Retiree Health Funding (all sources)	\$180.6	\$213.3	\$231.0	\$243.9	\$253.9	\$227.9

D. Retiree Health Pay-As-You-Go Funding

As discussed in Chapter 3, pay-as-you-go funding refers to the annual cost of group insurance benefits for current retirees and these costs represent the employer share of annual group insurance premiums.

Pay-as-you-go funding for each agency primarily comes from the tax supported operating budget. However, in each year since FY15, a portion of pay-as-you-go costs for MCPS and

¹⁹ Retiree health funding in FY20 represents 4.5% of the total tax supported funding if debt service is excluded.

²⁰ The County uses non-tax supported funds to pay for the pre-funding of retiree health benefits for employees that work in non-tax supported activities such as Solid Waste Services, Permitting Services, and Liquor Control.

County Government has been funded with OPEB Trust assets (i.e., dollars appropriated to the Trust as pre-funding in prior years). These actions have reduced the annual tax supported operating budget impact but have not reduced the overall cost of retiree health benefits.

Table 5 shows total approved retiree health pay-as-you-go funding by agency and funding source from FY15-FY20. The data show that:

- Total combined pay-as-you-go costs for all agencies increased each year from FY15 to FY19, before decreasing by \$8.5 million or 7% in FY20. This reduction is primarily due to reduced claims trends and the use of fund balance in MCPS and County Government.
- While the FY18 savings plan for County Government shifted the funding source for pay-as-you-go costs, it did not reduce the overall dollar amount of funding.
- For MCPS and County Government, a total of \$246.6 million has been used since FY15 from the Trust to cover a portion of pay-as-you-go costs with an additional \$36.2 million provided in pre-funding to partially offset these uses (discussed in Section E). As a result, the net “draw down” of Trust assets for pay-as-you-go funding is \$210.4 million.

**Table 5. Approved Retiree Health Pay-As-You-Go Funding by Agency
FY15-FY20 (\$ in millions)**

Agency and Funding Source	FY15	FY16	FY17	FY18			FY19	FY20
				Initial	Savings Plan	Change		
County Government								
Tax Supported	\$32.5	\$36.7	\$52.3	\$43.3	\$1.9	(\$41.4)	\$41.6	\$46.1
OPEB Trust	--	--	--	\$9.0	\$50.4	\$41.4	\$9.0	--
Total	\$32.5	\$36.7	\$52.3	\$52.3	\$52.3	--	\$50.6	\$46.1
MCPS								
Tax supported	\$8.4	\$3.4	\$28.1	\$28.6	\$28.6	--	\$33.1	\$29.1
MCPS Trust	\$27.2	\$24.0	--	--	--	--	--	--
OPEB Trust	--	\$27.2	\$27.2	\$27.2	\$27.2	--	\$27.2	\$27.2
Total	\$35.6	\$54.6	\$55.3	\$55.8	\$55.8	--	\$60.3	\$56.3
Montgomery College								
Tax supported	\$3.2	\$3.5	\$3.5	\$3.6	\$3.6	--	\$3.6	\$3.8
M-NCPPC								
Tax supported	\$4.4	\$4.7	\$4.6	\$4.3	\$4.3	--	\$5.0	\$4.9
All Agencies								
Tax supported	\$48.4	\$48.3	\$88.6	\$79.9	\$38.5	(\$41.4)	\$83.4	\$83.9
OPEB/MCPS Trust	\$27.2	\$51.2	\$27.2	\$36.2	\$77.6	\$41.4	\$36.2	\$27.2
Total	\$75.6	\$99.5	\$115.8	\$116.1	\$116.1	--	\$119.6	\$111.1

Use of OPEB/MCPS Trust Funding. Funds set aside in an OPEB Trust are intended (and allowed) to be used for annual pay-as-you-go funding – which typically occurs once the Trust reaches a certain funding level. In FY15, the Council reduced MCPS’ tax supported retiree health pay-as-you go funding by \$27.2 million, MCPS used its internal Trust (now closed out) to fund that portion of pay-as-you-go expenditures, and the Council added \$27.2 million in MCPS pre-funding to hold MCPS OPEB spending harmless. In FY16-FY19, approved budgets drew down the remaining \$24.0 million balance in the MCPS Trust and continued to provide MCPS with \$27.2 million from the Consolidated OPEB Trust for retiree health pay-as-you-go funding. Unlike the Council’s actions in FY15, however, pre-funding was not added to hold MCPS total OPEB funding harmless during these years.

The approved FY20 operating budget once again authorizes \$27.2 million from the OPEB Trust for MCPS pay-as-you-go funding but also includes \$9.0 million in additional pre-funding to partially offset the impact on the Trust. As a result, the net draw down for FY20 is \$18.2 million. The Executive’s fiscal plan assumes continued increases in the offset in future years.

In FY18 and FY19, \$9.0 million was authorized from the Consolidated OPEB Trust to fund pay-as-you-go costs for County Government. As noted above, the FY18 savings plan increased this amount to \$50.4 million as a one-time action. The FY19 savings plan did not impact pay-as-you-go funding. The approved FY20 budget eliminates use of the OPEB Trust to help fund County Government pay-as-you-go costs.

E. OPEB Pre-Funding

In alignment with fiscal policies, the Executive has recommended, and the Council has approved, over \$1.1 billion in OPEB pre-funding contributions for the tax supported agencies since FY08. However, the approved pre-funding amounts were reduced by about 10% due to savings plans, and the actual contribution still represent only a portion of the total long-term OPEB liability (discussed in Chapter 5). Table 6 (on the next page) shows the total approved OPEB pre-funding by agency since FY08. The data show:

- Savings plans in FY18 and FY19 reduced the pre-funding contributions by a total of \$110.6 million (\$21.0 million in FY18 and \$89.6 million in FY19).
- A total of \$36.2 million (\$27.2 million in FY15, \$9.0 million in FY20) in additional tax supported pre-funding (i.e., amounts above the actuarially determined contribution) have been approved for MCPS to help offset the use of Trust assets for pay-as-you-go costs.

Table 6. Approved OPEB Pre-Funding by Agency, FY08-FY20 (\$ in millions)

	FY08-				FY18			FY19			FY20
	FY14	FY15	FY16	FY17	Initial	Plan	Change	Initial	Plan	Change	
County Government											
Tax supported	\$144.8	\$38.6	\$43.5	\$43.5	\$43.4	\$43.4	---	\$43.6	\$9.0	(\$34.6)	\$34.7
Non-tax supported	\$38.0	\$4.4	\$5.3	\$5.3	\$5.6	\$5.6	--	\$5.6	\$5.6	--	\$4.4
Total	\$182.8	\$43.0	\$48.8	\$48.8	\$49.0	\$49.0	--	\$40.2	\$14.6	(\$34.6)	\$39.1
MCPS											
Tax supported	\$162.6	\$58.3	\$61.7	\$63.1	\$74.2	\$55.2	(\$19.0)	\$79.4	\$27.2	(\$52.2)	\$69.5
Tax supported offset	--	\$27.2	--	--	--	--	--	--	--	--	\$9.0
Total	\$162.6	\$85.5	\$61.7	\$63.1	\$74.2	\$55.2	(\$19.0)	\$79.4	\$27.2	(\$52.2)	\$78.5
Montgomery College											
Tax supported	\$5.2	\$2.0	\$1.4	\$1.5	\$2.6	\$0.6	(\$2.0)	\$2.8	\$0.0	(\$2.8)	\$5.4
Total	\$5.2	\$2.0	\$1.4	\$1.5	\$2.6	\$0.6	(\$2.0)	\$2.8	\$0.0	(\$2.8)	\$5.4
M-NCPPC											
Tax supported	\$8.4	\$1.8	\$1.8	\$1.8	\$2.1	\$2.1	--	\$2.8	\$2.8	--	\$2.8
Total	\$8.4	\$1.8	\$1.8	\$1.8	\$2.1	\$2.1	\$2.1	\$2.8	\$2.8	--	\$2.8
All Agencies											
Tax supported	\$321.0	\$127.9	\$108.4	\$109.9	\$122.3	\$101.3	(\$21.0)	\$128.6	\$39.0	(\$89.6)	\$121.4
Non-tax supported	\$38.0	\$4.4	\$5.3	\$5.3	\$5.6	\$5.6	--	\$5.6	\$5.6	--	\$4.4
Total	\$359.0	\$132.3	\$113.7	\$115.2	\$127.9	\$106.9	(\$21.0)	\$134.2	\$44.6	(\$89.6)	\$125.8

Additional pre-funding. As part of participating in the Medicare Part D program, the agencies receive rebates from prescription drug manufactures that can vary from year to year based on actual prescription use. In County Government, the Executive Branch has deposited these funds directly into the Consolidated OPEB Trust as additional pre-funding dollars in FY17 (\$11.2 million) and FY18 (\$13.4 million).

Future pre-funding in the fiscal plan. The FY20-25 tax supported fiscal plan summary that was approved by the Council on June 25 assumes continued OPEB pre-funding that meets the actuarially determined contributions. Tax supported pre-funding is anticipated to increase through FY22 before declining slightly through FY25.

Table 7. FY20-25 Tax Supported OPEB Pre-Funding in Approved Fiscal Plan (All Agencies)

FY20	FY21	FY22	FY23	FY24	FY25
\$121.4 million	\$127.7 million	\$131.6 million	\$128.0 million	\$125.5 million	\$117.4 million

Staff notes that these required contribution amounts may change based on updated actuarial valuations. The County Government revises pre-funding requirements based on updated valuations every two years, with the next update scheduled to be available for the FY22 budget. The valuations can either increase or decrease funding requirements based on updated factors such as mortality assumptions, claims trends, demographics and experience, and projected investment gains. For example, compared to what was assumed in the prior approved fiscal plan, in FY18 the updated valuations led to a \$15.5 million increase in required pre-funding while in FY20 the updates led to a \$20.2 million decrease in required pre-funding.

F. Consolidated OPEB Trust

The Consolidated Retire Health Benefit Trust is managed by a Board of Trustees and includes OPEB funding set asides for Montgomery County Government, Montgomery County Public Schools, Montgomery College, and several participating agencies.²¹ M-NCPPC maintains its own separate trust for both Montgomery and Prince George’s County.

Table 8 shows OPEB pre-funding contributions made to the Consolidated Trust since its creation in FY08, the investment gains on those contributions, and the balance held in the Trust as of March 2019 for each agency. Three-quarters of the way through FY19, the Trust had assets of just over \$1 billion – consisting of \$755.4 million from County contributions and \$261.3 million from investment gains since FY08.

While the OPEB Trust has substantial assets at \$1 billion, this amount currently represents only one-fifth of the County’s total retiree health care liability (as detailed in the next chapter).

Table 8. Consolidated OPEB Trust Net Contributions and Investment Gains by Agency as of March 31, 2019

	Net		Ending
	Contributions	Gain/(Loss)	Balance
County Government	\$350,268,890	\$139,659,241	\$489,928,131
MCPS	\$346,992,576	\$100,207,359	\$447,199,935
Montgomery College	\$41,465,016	\$14,336,392	\$55,801,408
Participating Agencies	\$16,707,653	\$7,080,110	\$23,787,763
Total	\$755,434,135	\$261,283,102	\$1,016,717,237

²¹ Participating agencies include the Montgomery County Revenue Authority, Strathmore Hall Foundation, Montgomery County Employee Credit Union, State Department of Assessment and Taxation, District Court of Maryland, Housing Opportunities Commission, Washington Suburban Transit Commission, and the Village of Friendship Heights. These participating agencies pay 100% of their OPEB contribution and the Consolidated Trust Board of Trustees manages and invests these funds as part of the Trust. These agencies also participate in the County’s active employee and retiree group insurance programs.

The \$261.3 million in investment gains since FY08 represents the long-term savings from pre-funding as it reduces the need for future tax supported revenues that would otherwise be spent on retiree health. The total investment gains to date comprise more than one quarter of total assets and are equivalent to more than two years of OPEB pay-as-you-go funding for County Government, MCPS, and Montgomery College combined.

Investment returns are subject to many economic and market factors often outside the County’s control and can vary from year to year. As of February 2019, the annualized rate of return achieved for the OPEB Trust by different timeframes were: 10-year, 11.38%; 5-year, 5.92%; 3-year, 10.70%; and 1-year, 4.20%.

Due to both the pre-funding reductions in the savings plans and use of Trust assets for pay-as-you-go funding since FY15, the net increase in each agency’s portion of the Consolidated Trust has been lower than the approved pre-funding amounts. As shown below, total net contributions to the Trust for County Government, MCPS, and Montgomery College are \$321.0 million lower than they would have been absent those actions. As discussed by the Council during its deliberations on the FY19 savings plan, the “opportunity cost” of not depositing OPEB pre-funding into the Trust is the potential lost investment income.

Table 9. Summary of OPEB Reductions

Type of Reduction	FY15-FY20
Net draw down of Trust assets for pay-as-you-go funding	\$210.4 million
Pre-funding reductions from savings plans	\$110.6 million
Total Reductions	\$321.0 million

G. Analysis of County Government Retiree Enrollment and Costs

To gain a better understanding of County Government retiree enrollment and potential factors impacting cost, staff reviewed data and information provided by the Office of Human Resources and the County’s health care consultant.

1. Retiree/Survivor Enrollment by Age Range and Coverage Type

As of November 2018, Montgomery County Government has 5,456 retirees/survivors enrolled in a retiree medical plan (excluding retirees from participating agencies). Many of the retirees also have associated dependents (a spouse and/or eligible children) covered on their plan. Table 10 shows the number of enrollees by age and coverage type. The data show:

- 34% of enrolled retirees/survivors are under the age of 65. Overall, premium costs are lower for retirees once they reach age 65 since Medicare becomes their primary coverage.
- 89% of retirees/survivors are enrolled in Self (retiree only) coverage or Self+1 (retiree plus one dependent).

- 11% of retirees/survivors are enrolled in Family coverage (retiree plus two or more dependents). However, among the 599 enrollees with Family coverage, 489 or 82% are under age 65.

Table 10. MCG Enrolled Retirees/Survivors by Age and Coverage Type

Age Range	Self		Self+1		Family		Total	
	#	%	#	%	#	%	#	%
Pre-Age 65	659	26%	706	30%	489	82%	1,854	34%
Age 65+	1,872	74%	1,620	70%	110	18%	3,602	66%
Total	2,531	100%	2,326	100%	599	100%	5,456	100%
% all Enrollees by Coverage Type	46%		43%		11%		100%	

Source: MCG Office of Human Resources and AON Consulting

2. Comparison of Retiree Health Costs – Pre-Age 65 vs. Age 65+

To assess the cost differential between pre-age 65 and age 65+ retirees, staff analyzed data on the projected claims cost per enrollee for 2019. The cost of health care claims refers to how much is paid out to cover the health care services used by retirees in a given year. Since the County is largely self-insured (Kaiser is the only full-insured plan offered), the claims costs are a primary factor in determining the premiums for each plan.

Using 2019 claims projections and retiree enrollment data, staff calculated the projected claims cost per retiree broken down by plan vendor and age (pre-age 65 vs. age 65+) as shown in Table 11.²² For age 65+ retiree prescription costs, the table shows the estimated claims both with and without Employee Group Waiver Program (EGWP) subsidies.²³ The data show:

- For medical plans, the average claims per enrollee is 2.3 times higher for pre-age 65 retirees than for Medicare-eligible retirees in the CareFirst plans. Within the United Healthcare plan the claims per enrollee is 4.4 times higher for under 65 retirees.
- For prescription plans, the average claims cost per enrollee is 1.6 times higher for under age 65 retirees after accounting for EGWP subsidies.
- On average, the combined medical and prescription claims costs per enrollee is approximately 2.3 times higher for pre-age 65 retirees than for Medicare-eligible retirees when EGWP subsidies are included (and 1.8 times higher if EGWP subsidies are not included).

²² Data on costs for non-Medicare retirees enrolled in Kaiser was not available and is excluded from this analysis.

²³ As described earlier in this chapter, the County participates in the Medicare Part D prescription drug program for age 65+ retirees. As part of that program, the County receives EGWP subsidies each year to offset prescription drug costs. For 2019, the County projects a total of \$21.2 million in prescription claims for age 65+ retirees and \$8.8 million in EGWP subsidies. As a result, the net 2019 cost of age 65+ prescription claims after accounting for the subsidy is estimated at \$12.4 million.

- Overall, while pre-age 65 retirees account for 34% of enrollment, they account for up to 52% of total claims costs when including EGWP subsidies.

Table 11. 2019 Projected Claims Cost Per Enrolled Retiree

Plan and Age	2019 Claims Projection	Enrolled Retirees	Claims per Enrollee
Medical			
CareFirst Pre-65	\$18,600,000	1,260	\$14,762
CareFirst 65+	\$18,900,000	2,935	\$6,440
United Healthcare Pre-65	\$6,700,000	460	\$14,565
United Healthcare 65+	\$1,500,000	454	\$3,304
Kaiser 65+	\$1,400,000	213	\$6,573
Prescription			
All Rx Pre-65	\$11,800,000	1,685	\$7,003
All Rx 65+ (w/ EGWP subsidy)	\$12,400,000	2,758	\$4,496
All Rx 65+ (no EGWP subsidy)	\$21,200,000	2,758	\$7,687
Medical and Prescription			
All Pre-65	\$37,100,000	1,720	\$21,570
All 65+ (w/EGWP subsidy)	\$34,200,000	3,602	\$9,945
All 65+ (no EGWP subsidy)	\$43,000,000	3,602	\$11,938

CHAPTER 5. OPEB LIABILITY AND FUNDING: MONTGOMERY COUNTY AND OTHER JURISDICTIONS

This chapter reviews OPEB liabilities and funding status for Montgomery County agencies, reviews projected funded ratios under alternative funding scenarios, and compares OPEB liabilities incurred by Montgomery County agencies with other local public sector employers.

A. Montgomery County Agency OPEB Liabilities, Assets, and Funded Ratio

An agency’s total OPEB liability refers to the present value of benefits earned to date for employees’ past service. The net position in trust refers to the current value of OPEB assets (cash or investments) placed into a fund to pay future liabilities. The funded ratio is calculated by dividing the net position in the trust by the total OPEB liability. Table 12 below shows these values for each agency based on the FY18 Comprehensive Annual Financial Statements. In sum:

- The total estimated OPEB liability for County Government, MCPS, Montgomery College, and M-NCPPC is about \$4.9 billion.
- The actuarial value of OPEB assets in the agency trust funds is just over \$1.0 billion.
- The value of OPEB assets equal 21% of the total OPEB liability. In other words, County agencies have set aside about 21 cents for every dollar of their current combined retiree health care liability.

Table 12. Agency OPEB Liabilities, Assets, and Funded Ratio (as of 7/1/18)

Agency	Total OPEB Liability	Net Position in Trust	Funded Ratio
County Government	\$1,823,142,490	\$492,078,607	27%
MCPS	\$2,838,086,716	\$455,655,062	16%
Montgomery College ²⁴	\$113,438,041	\$49,068,188	43%
M-NCPPC ²⁵	\$151,350,028	\$32,712,550	22%
Total	\$4,926,017,275	\$1,029,514,407	21%

Sources: FY18 Agency Comprehensive Annual Financial Reports

Annual Contributions and Funded Ratios. As detailed in Chapter 3, public sector employers that offer a defined retiree health benefit must make an annual budget decision on the amount of OPEB pre-funding. The amount contributed to the Consolidated Retiree Health Benefits Trust (also known as the “OPEB Trust”) has a direct influence on the funded ratio. As stipulated in the County Code, the Board of Trustees manages Trust assets and selects investment strategies for

²⁴ For several years prior to FY08 the College had set aside funds for accrued retiree health liabilities. In FY14 the College transferred these resources (\$30.8 million) to the Consolidated Retiree Health Benefits Trust, accounting for their comparatively high funded ratio.

²⁵ M-NCPPC’s OPEB data includes Montgomery County and Prince George’s County employees/costs. Montgomery County’s OPEB funding schedule assumes that the Montgomery County portion is 45% of the total plan.

OPEB Trust assets.²⁶ For the purpose of estimating future year assets levels, the Board directed its actuary to assume a 7.50% annual return on investments. However, the Board has an interest in understanding how Trust assets would fare under market scenarios that vary from the actuarial assumption. To that end, the Board of Trustees recently commissioned an analysis of the effect of varying investment returns and County contribution levels on future Trust funded ratios.

Table 13 presents a summary of the analysis provided to the Board of Trustees. The table shows the expected and likely range of Consolidated OPEB Trust funded ratios in five years and ten years under three funding scenarios: (1) net OPEB contributions of \$100 million per year; (2) net contributions of \$200 million per year; and (3) no future year OPEB contributions while using the Trust assets for annual pay-as-you-go costs. For this analysis, the annual net contribution equals the annual pre-funding amount minus any fund withdrawals used for current year pay-as-you-go expenses.

Table 13. OPEB Trust Alternative Scenario Future Funded Ratios²⁷

Scenario	Annual Net Contribution	Year 5 Funded Ratio	Year 10 Funded Ratio
1	\$100 Million	Expected: 37.4% (Likely Range: 31.0% - 45.0%)	Expected: 44.1% (Likely Range: 33.1% - 55.7%)
2	\$200 Million	Expected: 71.0% (Likely Range: 63.0% - 79.1%)	Expected: 105.6% (Likely Range: 89.7% - 124.2%)
3	\$0 (and use assets for pay-as-you-go)	Expected: 6.4% (Likely Range: 4.2% - 9.2%)	Expected: 0.0% (Likely Range: 0.0% - 0.0%)

Scenario 1, a \$100 million annual net contribution, is similar to the net contribution budgeted for Montgomery County Government, MCPS, and Montgomery College in FY19 (before the budget savings plan) and FY20. Recurring annual net contributions at this level along with expected investment returns likely would raise the OPEB Trust’s funded ratio to 37.4% after five years. Similarly, the \$100 million annual net contribution scenario would result in an expected 44.1% funded ratio after ten years.

Scenarios 2 and 3 show the effect on the funded ratio of an extreme increase and an extreme decrease, respectively, from the FY20 net contribution level. In Scenario 2, the County would make annual net contributions of \$200 million, approximately double the FY20 funding level. Under this scenario, the OPEB trust could be expected to attain 71.0% funding after five years and likely would exceed 100% funding after ten years.

²⁶ Montgomery County Code, Chapter 33, Section 163.

²⁷ The OPEB funding analysis received by BIT presents outcomes based on alternative investment strategies and simulations of investment returns. The “expected” outcomes reflect current investment practices and the 50th percentile of simulated returns. The “likely range” of outcomes reflect current investment practices and the 25th through 75th percentile of simulated returns.

In Scenario 3, the County would cease making annual contributions to the OPEB trust and would use the existing Trust assets for annual pay-as-you go costs. Without the additional pre-funding, the trust would be expected to fall to a 6.4% funding level after five years and would be completely depleted within ten years.

B. Comparison with Other Jurisdictions

This section compares the total OPEB liability and funded ratios for County agencies with other local public sector employers and reviews the factors that impact the relative cost of retiree health benefits. Under the new GASB rules (see Chapter 3 of this report), plans are required to include standardized OPEB data and information in the Comprehensive Annual Financial Report (CAFR). This section compiles similar FY18 CAFR information across several jurisdictions or agencies in the region to compare total OPEB liability and to identify some of the factors that may lead to differences.

1. Factors that Affect OPEB Liability

Total OPEB liability measures the relative cost or expense of a jurisdiction's promised retiree health benefits. There are multiple factors that affect the total OPEB liability owed by a jurisdiction, including:

- **Total number of members in the plans.** The number of members in an OPEB plan refers to current count of participating retirees plus the current count of active employees who will have the option to participate in the retiree health plans in the future. A greater number of plan members leads to higher total liabilities.
- **Discount rate.** The discount rate is the assumed long-term expected rate of return on OPEB trust investments. A higher discount rate leads to lower total OPEB liability (since a greater share of the total cost is assumed to be paid from investment returns) and vice versa. The new GASB rules require that jurisdictions with lower funded ratios use a lower discount rate than those with higher funded ratios. Additionally, each jurisdiction's CAFR includes a discount rate sensitivity calculation that shows how much the total OPEB liability would change from a 1% decrease and 1% increase in the discount rate.
- **Demographics and actuarial assumptions.** Total OPEB liability is also impacted by the demographics of a jurisdiction's workforce (e.g., proportion of pre-65 vs. 65+ retirees, etc.), as well as other actuarial assumptions such as mortality rates, health care use, and health care inflation.
- **Benefit plan design and structure.** Plan design and structure include the overall level of coverage provided by a retiree health plan, benefit eligibility criteria, and the cost share formula between the employer and the retiree.

2. OPEB Liability in Other Jurisdictions

Table 14 on the next page presents the total OPEB liability, funded ratio, plan members, and discount rate for 17 local jurisdictions and/or agencies. Since liabilities would be expected to vary based on the number of members, staff also calculated the total liability per member to help

normalize for different sized populations and allow for a better comparison of liability across jurisdictions. The data show:

- There is significant variation in funded ratios across the selected jurisdictions and agencies, ranging from lows of 0% in Anne Arundel Public Schools and 3% for the State of Maryland and Prince George’s County Government to a high of 77% for Fairfax County Government.
- Montgomery County Government’s total liability per member (\$99,014) is higher than many surrounding jurisdictions or agencies. Despite having a much higher funded ratio, the County Government’s liability is more than 40% higher on a per member basis than the State of Maryland’s liability.
- The nearby Virginia jurisdictions and agencies examined (Fairfax County Public Schools and Government, Arlington County Public Schools and Government) have a total liability per member that is lower than most of the Maryland jurisdictions and agencies. A key factor in the lower liability is likely the use of a fixed-dollar cost sharing structure (described in detail below).

Table 14. FY18 OPEB Liability for Nearby Local Governments and Agencies

Employer	Total OPEB Liability	Funded Ratio	Plan Members	Total Liability per Member	Discount Rate
Fairfax County Government	\$400,568,000	77%	18,339	\$21,842	7.00%
Fairfax County Public Schools*	\$747,831,131	38%	30,346	\$24,643	7.00%
Montgomery College	\$113,438,041	43%	2,429	\$46,702	6.51%
Arlington County Public Schools*	\$277,905,812	32%	5,865	\$47,384	6.75%
Arlington County Government*	\$322,992,685	40%	5,525	\$58,460	6.75%
State of Maryland	\$10,900,551,000	3%	155,898	\$69,921	3.87%
Montgomery County Public Schools	\$2,838,086,716	16%	32,503	\$87,318	5.87%
Prince George's County Public Schools	\$2,189,883,501	5%	24,990	\$87,630	5.64%
Baltimore Co. (Gov't, Schools, College)	\$2,910,073,000	13%	32,664	\$89,091	4.01%
Howard Co. (Gov't, Schools, College)	\$1,302,161,438	10%	13,538	\$96,186	3.98%
Montgomery County Government	\$1,823,142,490	27%	18,413	\$99,014	6.26%
Frederick County Government	\$244,035,044	62%	2,366	\$103,142	7.00%
Anne Arundel County Government	\$696,318,000	20%	6,599	\$105,519	6.38%
Frederick County Public Schools	\$756,342,000	14%	7,090	\$106,677	4.28%
M-NCPPC (All)**	\$336,333,395	22%	2,883	\$116,661	6.95%
Anne Arundel County Public Schools	\$2,208,059,000	0%	15,543	\$142,061	3.58%
Prince George’s County Government	\$1,660,593,000	3%	9,658	\$171,940	3.87%

* Fairfax Public Schools, Arlington County, and Arlington County Schools each participate in and have liability for OPEB plans managed by the State of Virginia in addition to their local plan. For each agency, this data sums the liability for each OPEB plan as shown in the financial statements.

**Data for M-NCPPC includes both Montgomery and Prince George’s County.

Source: FY18 Comprehensive Annual Financial Report for each jurisdiction/agency

3. Discount Rate Adjusted OPEB Liability in Other Jurisdictions

Since the discount rate also impacts total liability, staff used the discount rate sensitivity data published in each CAFR to estimate total OPEB liability and liability per member for a common discount rate of 6.26% (the discount rate used for Montgomery County Government) as detailed in Table 15. The data show:

- The impact of changes in the discount rate can be substantial. For example, adjusting the State of Maryland’s discount rate from 3.87% to 6.26% decreases their total liability per member from \$69,921 to an estimated \$53,823. After controlling for discount rate, the County Government’s per member liability is more than 80% higher than that of the State.
- When normalizing for discount rate, the Montgomery County Government’s retiree health package incurs a greater liability per member than all but four of the employers listed. The relatively high liability indicates that plan design, eligibility, and/or demographics are generating higher employer costs per member than those incurred by many other local public sector employers.

**Table 15. FY18 OPEB Liability for Nearby Local Governments and Agencies
Adjusted to a Common Discount Rate (6.26%)**

Employer	Estimated Total OPEB Liability with 6.26% Discount Rate	Plan Members	Estimated Total Liability per Member
Fairfax County Government	\$450,931,660	18,339	\$24,589
Fairfax County Public Schools*	\$813,939,057	30,346	\$26,822
Montgomery College	\$117,691,656	2,429	\$48,453
Arlington County Public Schools*	\$299,695,707	5,865	\$51,099
State of Maryland	\$8,390,893,260	155,898	\$53,823
Arlington County Government*	\$335,858,827	5,525	\$60,789
Howard Co. (Gov't, Schools, College)	\$834,768,948	13,538	\$61,661
Baltimore Co. (Gov't, Schools, College)	\$2,051,383,000	32,664	\$62,803
Anne Arundel County Public Schools	\$1,137,608,040	15,543	\$73,191
Frederick County Public Schools	\$521,768,349	7,090	\$73,592
Prince George's County Public Schools	\$2,003,644,801	24,990	\$80,178
Montgomery County Public Schools	\$2,690,500,202	32,503	\$82,777
Montgomery County Government	\$1,823,142,490	18,413	\$99,014
Prince George's County Government	\$990,028,000	9,658	\$102,509
Anne Arundel County Government	\$705,263,620	6,599	\$106,874
Frederick County Government	\$273,864,197	2,366	\$115,750
MNCPPC (All)**	\$370,633,952	2,883	\$128,558

*Fairfax Public Schools, Arlington County, and Arlington County Schools each participate in and have liability for OPEB plans managed by the State of Virginia in addition to their local plan. For each agency, this data sums the liability for each OPEB plan as shown in the financial statements.

**Data for M-NCPPC includes both Montgomery and Prince George’s County.

Source: FY18 Comprehensive Annual Financial Report for each jurisdiction/agency

4. Benefit Structure and Eligibility in Other Jurisdictions

Similar to discount rate, benefit plan design and structure affect the overall cost of retiree health benefits. Staff identified structural factors in seven different local jurisdictions or agencies that likely contribute to the cost differential described in the previous section.

- **Fairfax County and Fairfax County Public Schools**

Both Fairfax County Government and Public Schools offer a fixed-dollar subsidy retiree health benefit. This means that instead of paying a percentage of the monthly premium, these agencies contribute a fixed dollar amount and the retiree pays the rest. The retiree receives this fixed subsidy regardless of which plan type (HMO, POS, etc.) or coverage level (Self, Self+1, Family) they select.

Based on years of service, the annual subsidy in 2019 for Fairfax County Government retirees ranges from a low of \$480 per year to a high of \$2,760 per year. For Fairfax Public Schools retirees, the annual subsidy ranges from a low of \$180 to a high of \$2,100 per year. School system employees may also be eligible for a subsidy from the State, which increases the maximum subsidy to a combined \$3,780.

The two Fairfax agencies offer a benefit with a substantially lower cost than the benefit offered Montgomery County Government retirees. For example, for a plan with an \$18,000 premium, the amount the Montgomery County Government would pay for a retiree with a 70/30 cost share would be \$12,600 – substantially higher than the maximum employer share in either Fairfax agency.

- **Arlington County Government**

Similar to the Fairfax agencies, Arlington County Government offers a fixed-dollar subsidy retiree health benefit. This means that instead of paying a percentage of the monthly premium, these agencies contribute a fixed dollar amount and the retiree pays the rest. Based on years of service, the annual subsidy in 2019 for Arlington County Government retirees ranges from a low of \$720 per year to a high of \$3,600 per year. Retirees receive this fixed subsidy regardless of which plan type (HMO, POS, etc.) or coverage level (Self, Self+1, Family) they select.

- **Howard County Government and Howard County Public Schools**

Howard County Government and Public Schools each pay 50%, 75%, or 90% of retiree health premiums depending on years of service. However, those cost share amounts are fixed to Individual (i.e., Self) coverage for a specified plan. If a retiree chooses a different plan or a different coverage level, they are responsible for covering the difference in cost.

For example, in 2019, the cost share rates for Howard County Government retirees are tied to the Aetna Open Access Plan. For an under-age 65 retiree that qualifies for a 75/25 cost share and chooses Individual coverage in that plan, the County pays 75% of the annual premium. If a

retiree chooses more expensive Family coverage within that same plan, the amount of the premium covered by the County is reduced to approximately 35%.

- **Baltimore County Government and Baltimore County Public Schools**

Similar to Montgomery County Government, both Baltimore agencies provide a cost share structure where a retiree must have at least 10 years of service to be eligible for health benefits and the employer cost share increases by a set amount for each additional year of service. The Baltimore agencies differ in that the minimum amount covered by the agency is 20% compared to 50% in Montgomery County.

In Baltimore County Government, in 2019 the employer share begins at 20% for eligible retirees with 10 years of service and increases to a maximum of between 70-85% for employees with 30+ years of service (the maximum varies based on plan type and Medicare-eligibility status). In Baltimore County Public Schools, the employer share begins at 25% and increases to a maximum of 80-85% at 30+ years for under age 65 retirees. For Medicare-eligible retirees, the cost share differs by plan type. In the CIGNA plan, the school system pays 36% for 10-19 years of service, 66% for 20-29 years of service, and 84% for 30+ years of service. In the Kaiser plan, the school system pays 68% for 10-19 years of service, and 100% for 20-29 years of service.

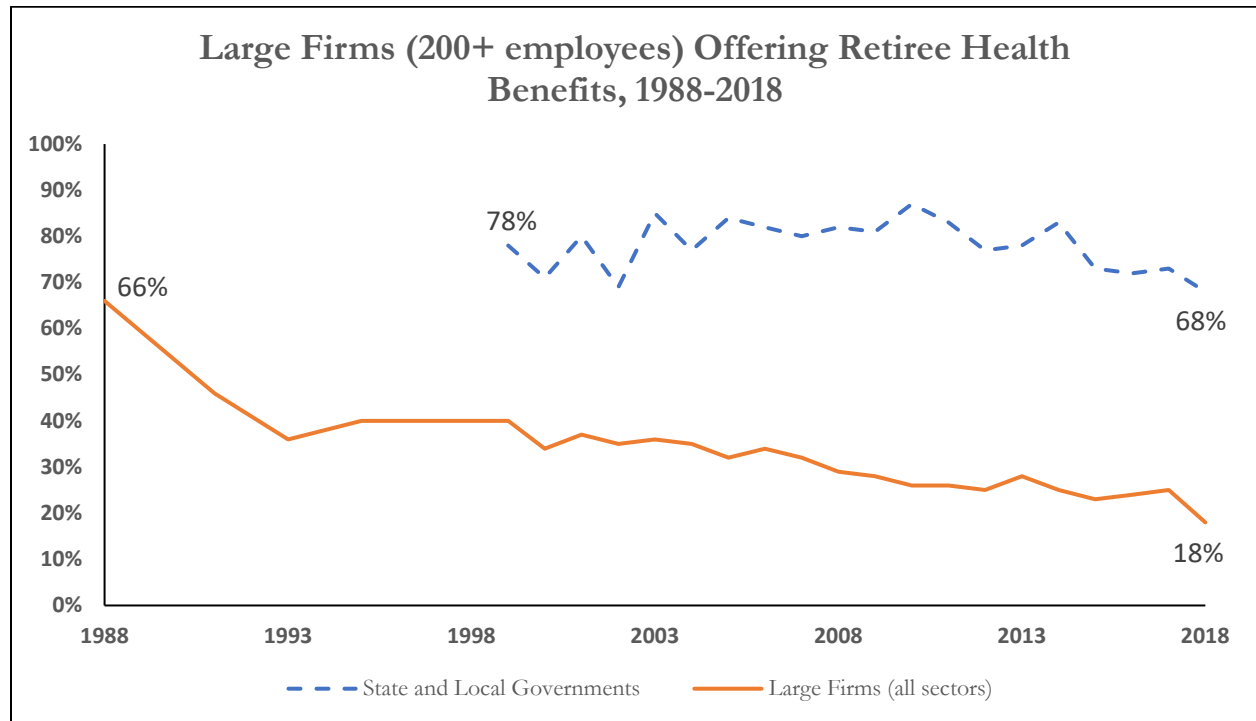
Chapter 6. OPEB Cost Control Measures

This chapter presents information on the prevalence of retiree health benefits among large public and private employers across the country, and provides examples of how some public sector employers have initiated reforms to control the cost of retiree health benefits.

A. Retiree Health Benefits Offered by Large Employers

Each year since 1988, the Kaiser Family Foundation (KFF) has conducted a survey of private and non-federal public employers on employer sponsored health-benefits.²⁸ For large public and private firms, defined as those with 200 or more employees, the survey collects data on retiree health benefits. The chart below shows that the number of large employers across all sectors that offer retiree health insurance has declined substantially over the past 30 years, from 66% in 1988 to 18% in 2018.

The chart also shows that the proportion of large state and local governments offering retiree health benefits is much higher than for all sectors combined, although it also has declined over the past 20 years overall by ten percentage points. The state and local data show greater year-to-year fluctuation, which could be a function of who responds to the survey each year, but also a downward trend for the last five years that is similar to the trend for all large firms.



²⁸ KFF survey archive: <https://www.kff.org/health-costs/report/employer-health-benefits-annual-survey-archives/>
2018 survey: <http://files.kff.org/attachment/Report-Employer-Health-Benefits-Annual-Survey-2018>

Among the large firms that continue to offer retiree health benefits, several responded to the 2018 KFF survey that they have implemented cost reduction strategies within the past two years. Specifically:

- 29% have increased retiree premium contributions;
- 20% have increase patient cost sharing;
- 8% have started offering benefits through a Medicare Advantage Plan for Medicare-eligible retirees;
- 3% have eliminated coverage for early (pre-Medicare) retirees;
- 3% have eliminated coverage for Medicare-eligible retirees; and
- 2% have started using a defined contribution approach to permit retirees to purchase benefits on a public or private exchange.

B. Cost Control – Maintain Full Pre-Funding

As discussed in Chapter 3, the Government Finance Officers Association has found that pre-funding retiree health obligations costs 25% to 40% less than the pay-as-you-go method over the long-term. Nonetheless, given annual budgetary constraints and immediate service demands, most public sector employers do not annually meet their full actuarially determined OPEB contribution. Those employers that annually make their full OPEB contribution expend less over time than employers that do otherwise.

As an example, the State of Arizona has made its full actuarially determined OPEB contribution every year since FY08. As of June 30, 2018, the Arizona OPEB trust had a funded ratio of 102.2%.²⁹ In other words, the value of the accumulated assets in the fund exceeded the value of current OPEB liabilities. With no unfunded liability, the State only needs to contribute an annual amount equal to the future cost of benefits earned each year discounted to reflect projected investment returns.

One county in Maryland, Caroline County, has made annual actuarially determined OPEB contributions and achieved an OPEB funded ratio above 100%. According to the County Administrator, Caroline County’s strong OPEB position is a product of two factors. “First, the County offers only a modest Medicare supplement plan and does not subsidize health insurance for employees under age 65. Second, the County set aside money for the OPEB fund before the Great Recession.”³⁰

²⁹ Arizona State Retirement System, *Comprehensive Annual Financial Report for Fiscal Year Ended June 30, 2017*, pages 46-49, https://www.azasrs.gov/sites/default/files/ASRS_CAFR_FY18.pdf

³⁰ County Commissioners of Caroline County, Maryland *Comprehensive Annual Financial Report Year Ended June 30, 2018*, page 21, <https://www.carolinemd.org/DocumentCenter/View/3851/Caroline-County-FY18-CAFR-Sum>

C. Cost Control – Modification of Group Insurance Benefit

In recent years, the most common OPEB cost control approach has been to modify the design of the retiree group insurance benefit to reduce the employer’s short- and long-term obligations. Public sector employers have modified retiree health benefits in multiple ways including:

- Reducing the percentage of the premium cost paid by the employer;
- Capping the amount of the employer contribution; and
- Raising the minimum age and service requirements needed to qualify for the benefit.

Research by the Pew Charitable Trusts and the MacArthur Foundation found that between 2000 and 2015, more than a dozen states increased the minimum age or years of service required to become eligible for health benefits. In addition, more than a dozen states modified the eligibility requirements to receive the maximum state premium contribution. During that same time period, at least 10 states instituted or modified the prorating formulas that varied their levels of premium contribution based on years of service. Finally, at least five states eliminated employer contributions to retiree health insurance premiums for certain retirees.³¹

County agencies have also modified retiree health benefits within the last decade to control the rate of growth for OPEB costs. Effective the beginning of FY12, the County Government, MCPS, and Montgomery College each increased the minimum number of years an employee must work before: (a) becoming eligible for retiree health benefits; and (b) receiving the maximum cost employer cost share.

The case study below describes a proposed major change in the Maryland State retiree prescription benefit.

OPEB Cost Control Case Study #1

State of Maryland

Elimination of Prescription Drug Benefit for Medicare-Eligible Retirees

Maryland’s OPEB Problem: As was the case for most state and local governments, the State of Maryland had funded retiree health benefits on a pay-as-you-go basis until GASB first established OPEB reporting requirements in 2004. In 2006, the State made its first OPEB pre-funding contribution.

A 2010 valuation found that the State of Maryland had set aside assets that equaled only 1.2% of the total OPEB liability. The value of the State’s unfunded liability alone totaled nearly \$16 billion. Actuaries determined that the State would have to contribute \$1.2 billion

³¹ The Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation, *State Retiree Health Plan Spending*, May 2016, page 22, https://www.pewtrusts.org/-/media/assets/2016/09/state_retiree_health_plan_spending.pdf

in FY11 (and likely more in future years) to meet OPEB pre-funding requirements consistent with the then-current plan design, actuarial assumptions, and State policies.

The Public Employees' and Retirees' Benefit Sustainability Commission: State elected officials raised concerns about the effect of outstanding OPEB (as well as pension) obligations on both the State's operating budget and on its bond rating. In April 2010, the Maryland General Assembly established the Public Employees' and Retirees' Benefit Sustainability Commission to study and make recommendations regarding health care and pension benefits provided to State and public education employees and retirees. After a series of briefings and deliberations, the Commission found that "employee benefits, including employee and retiree health insurance, State employee pensions, and State costs for pensions for local employees, are growing at unsustainable rates" and that "the cost of those benefits is growing much faster than the State's general fund revenues."³² The Commission concluded that:

These trends cannot continue without imposing very significant cuts in other vital State programs and employee compensation. The Commission, therefore, recommends a series of changes to the structure and funding of these benefits to secure retention of pension and health benefits at sustainable cost levels. In recommending these changes, the Commission's goal is to maintain meaningful and viable benefit packages for public employees that assist in the recruitment and retention of a talented workforce and provide income security during retirement. At the same time, the commission recognizes that the cost of employee benefits must remain within the State's ability to adequately fund them without impinging on other critical State functions.³³

The Commission offered a series of recommendations and suggested that "failure to act may endanger the State's AAA bond rating."³⁴ Regarding OPEB, the Commission recommended that the State establish a goal of reducing its unfunded liability by 50% and commit to fully funding its annual required contribution within ten years. In support of these outcomes, the Commission recommended shifting Medicare-eligible State retirees from the State's prescription drug plan to Medicare Part D drug coverage beginning in 2020 and eliminating any State coverage.³⁵ Eligible State retirees already were (and remain) required to enroll in Medicare for medical benefits. The Commission established the transition date for 2020 to coincide with the implementation of the portion of the Affordable Care Act that would eliminate the Part D coverage gap³⁶ in 2020.

³² Public Employees' and Retirees' Benefit Sustainability Commission, 2010 Interim Report, January 2011, page ix, <http://dls.maryland.gov/pubs/prod/TaxFiscalPlan/2011-Sustainability-Commission-2010-Interim-Report.pdf>

³³ Ibid., page ix.

³⁴ Ibid., page 25.

³⁵ Medicare Part D is described in Chapter 2. While the Montgomery County agencies implemented Medicare Part D for retirees in FY15, they still provide supplemental prescription coverage.

³⁶ The interval in which a Medicare Part D participant must pay the full cost of prescription drugs is known as the "coverage gap" or the "donut hole."

Action to Eliminate Retiree Prescription Drug Coverage: In January 2011, then-Governor O’Malley released a “path to sustainability” to reform retiree health and pension benefits and funding. One of the stated goals of the reform was to reduce unfunded OPEB liability by about \$7 billion.³⁷ Noting that nearly half of the State’s OPEB unfunded liability was attributable to the prescription drug benefit, the Governor proposed shifting retirees to Medicare Part D as recommended by the Public Employees’ and Retirees’ Benefit Sustainability Commission. In April 2011, the General Assembly passed the Budget Reconciliation and Financing Act of 2011 that amended State law to discontinue prescription drug benefits for Medicare-eligible retirees in Fiscal Year 2020.³⁸ The Governor approved the bill in May 2011.

Adjustment of the Start Date: In February 2018, Congress approved the Bipartisan Budget Act of 2018. This bill adjusted the implementation date for elimination of the Medicare Part D coverage gap to January 1, 2019. Maryland law previously had set the termination of State prescription drug coverage for Medicare-eligible retirees for the start of Fiscal Year 2020, July 1, 2019. In response to the Federal Government action to shift the elimination of the Medicare Part D coverage gap to January 1, 2019, the General Assembly included a provision in the Budget Reconciliation and Financing Act of 2018 to terminate State prescription drug coverage for Medicare-eligible retirees on January 1, 2019.³⁹ Governor Hogan signed the bill in April 2018.

Temporary Assistance to Retirees: In July 2018, Governor Hogan, Senate President Miller, and then-Speaker of the House Busch announced that the State would provide temporary assistance to State retirees who transition to Medicare Part D prescription drug coverage on January 1, 2019. For one year, the State would reimburse retirees’ out-of-pocket prescription drug expenses above \$1,500 (the out-of-pocket copayment maximum under the soon-to-be-discontinued State plan).⁴⁰

Court Order: In September 2018, a group of State government retirees sued seeking to stop the State from discontinuing the prescription drug benefits for Medicare-eligible retirees. In their lawsuit, the retirees’ argued that they are entitled to retention of the existing drug coverage because it was promised as part of their employment and that the State is breaking a contract by denying the benefits.⁴¹ The retirees further asked the court to issue a temporary

³⁷ Governor Martin O’Malley, *Reforming Maryland’s Pension System: A Path to Sustainability*, January 21, 2011, <http://www.sra.state.md.us/News/2011/RetirementReform.pdf>

³⁸ House Bill 72, Budget Reconciliation and Financing Act of 2011, Page 64, http://mgaleg.maryland.gov/2011rs/chapters_noln/Ch_397_hb0072E.pdf

³⁹ Senate Bill 187, Budget Reconciliation and Financing Act of 2018, Page 29, http://mgaleg.maryland.gov/2018RS/chapters_noln/Ch_10_sb0187E.pdf

⁴⁰ Maryland Department of Budget and Management, News & Updates, *Governor Larry Hogan, General Assembly Provide Assistance to State Retirees Transitioning to Medicare Part D*, July 13, 2018, <https://dbm.maryland.gov/benefits/pages/newsdisplay.aspx?DID=44>

⁴¹ Capital Gazette, *Maryland Extends Drug Coverage After Judge Rules State Retirees Don't Have to Switch Plans*, October 11, 2018, <https://www.capitalgazette.com/lifestyle/health/bs-hs-retiree-prescriptions-court-win-20181011-story.html>

restraining order prohibiting the State from requiring retirees to enroll in Medicare Part D during open enrollment. In October, the court issued the injunction precluding the State from implementing the change in retiree drug coverage until after a decision on the lawsuit. In response to the court order, Governor Hogan announced that the State would extend current retiree drug coverage through December 2019.

FY20 Budget Action: In April 2019, the Maryland General Assembly approved a bill that would require State retirees to sign up for Medicare Part D. However, the legislation requires the State to reimburse eligible retirees for out-of-pocket expenses that exceed \$1,500 annually for an individual and \$2,000 annually for a family. In addition, the legislation established programs to: (a) reimburse out-of-pocket costs after the retiree enters catastrophic coverage under the Medicare drug benefit plan; and (b) reimburse eligible retirees for out-of-pocket costs for life-sustaining drugs that are covered under the State plan but not covered under the retiree's Medicare prescription drug plan.⁴²

D. Elimination of Retiree Health Benefit

As mentioned above, most large private sector employers in the United States do not offer retiree health benefits. Several state and local governments have recently eliminated health benefit coverage for future employees.

For example, three years ago, the North Carolina legislature passed a bill that discontinues retiree health coverage for employees hired after January 2021.⁴³ The State of Kansas decided to maintain the benefit but charge retirees the full cost of coverage beginning in 2017.⁴⁴

The case study below details the recent decision by the Garrett County Commissioners to eliminate retiree health benefits for new hires. Garrett County has become the seventh Maryland County that offers no medical benefits to Medicare-eligible retirees.

⁴² Department of Legislative Services, Fiscal and Policy Note for Maryland General Assembly 2019 Session, Revised Senate Bill 946, http://mgaleg.maryland.gov/2019RS/fnotes/bil_0006/SB0946.pdf

⁴³ Raleigh News and Observer, *State retiree health coverage to end for future NC employees*, June 23, 2017, <https://www.newsobserver.com/news/politics-government/politics-columns-blogs/under-the-dome/article157928844.html>

⁴⁴ Wall Street Journal, May 1, 2019, https://www.wsj.com/articles/as-retiree-health-care-bills-mount-some-states-have-a-solution-stop-paying-11556703001?mod=hp_lead_pos3#comments_sector

OPEB Cost Control Case Study #2

Garrett County, Maryland

Elimination of Retiree Health Benefit for New Hires

Garrett County's OPEB Problem: The Garrett County Government provides health care benefits to retirees who had been full-time employees. Eligibility for the benefit is based on the retiree's age and years of service.

In FY09, the County created an OPEB trust. That year, the County contributed \$120,000 to the trust. However, from FY10 to the present, the County has solely funded pay-as-you go costs without any OPEB trust fund contributions to reduce the unfunded liability. The most recent valuation found Garrett County's current OPEB liability at about \$13 million (including the County Government, public school system, and community college).⁴⁵ As of July 2016, the OPEB funded ratio for the Garrett County Government was 1.6%.⁴⁶

Past Changes to Retiree Health Benefit: Garrett County has modified its retiree health benefits several times in recent years. Prior to 2006, County retirees and their dependents were eligible for a group insurance benefit. Beginning in July 2006, the County discontinued paying health benefit costs for dependents of retirees, although the retiree may purchase dependent group insurance coverage at full cost.

Garrett County again modified the retiree health benefit in 2017. Previously, both pre-Medicare and Medicare eligible retirees received a direct group insurance benefit from the County. Beginning in January 2017, the County shifted Medicare-eligible retirees from County group insurance to a Health Reimbursement Account (HRA) benefit. The County contributes an amount to Medicare eligible retirees HRAs based on age and years of service. The retiree may use the HRA to purchase supplemental medical and prescription benefits through a third-party vendor under contract with the County.

Elimination of Health Benefit for New Employees: In July 2018, Garrett County Commissioners approved Resolution 2018-5 that eliminated retiree health benefits for any County employees hired after June 30, 2018. The Garrett County Administrator characterized the elimination of retiree health benefits as necessary to "help to keep the costs at a manageable level."⁴⁷ The Commissioners' action did not affect retiree health benefits for current retirees and active employees.

The County's community college, Garrett College, similarly eliminated retiree health benefits for new hires.

⁴⁵ As a point of reference, the Fiscal Year 2019 operating budget for Garrett County (including the County Government and local contributions to the public school system and community college) was about \$80 million.

⁴⁶ Board of County Commissioners of Garrett County, Maryland *Financial Report June 30, 2017*, page 88, <https://www.garrettcountry.org/resources/finance/pdf/2017-June-30-Garrett-County-Financial-Statements.pdf>

⁴⁷ Garrett County Republican, *County Eliminating Retiree Health Benefits for Future Employees*, July 19, 2018, https://www.wvnews.com/garrettrepublican/news/county-eliminating-retiree-health-benefits-for-future-employees/article_853b441f-8c6c-5972-917c-d98aefd782ba.html

E. Alternative Model – Retiree Healthcare Accounts and Private Exchanges

Traditionally, public employers that provide health benefits to retirees offer a similar type of benefit as provided to active employees. In this model, the employer pays a formula-based portion of health insurance premium costs for the retiree. For most large public employers, retirees participate in a health insurance pool consisting of retirees (and possibly current employees) from a single employer or an alliance of related employers.

This section presents information about an alternative model in which the employer provides dollars for retirees to use for third-party health insurance plans.

Health Reimbursement Account (HRA). An HRA is an employer-funded benefit that provides retirees (or employees) funds for reimbursement of out-of-pocket medical care expenses. An HRA is not a group insurance plan; the beneficiary does not pay a premium for participation in the plan. Rather, an HRA is a type of defined-contribution plan set up by an employer for its employees to cover medical expenses such as insurance medical premiums, co-pays, deductibles, and prescription drugs. For a retiree HRA, the employer makes annual contributions during and/or after the employee's years of service for use after the employee retires. Employer HRA contributions are exempt from any Federal tax. Moreover, reimbursement dollars received by the retiree are not subject to Federal taxes.

Private Exchange/Private Individual Marketplace. A private exchange is a plan that is coupled with an HRA that allows retirees to shop for a customized package of benefits from a large selection of medical, vision, dental, and prescription plans. Employers make tax free contributions to employees' retirement health reimbursement accounts for post-employment use for qualified expenses. Exchange participants have the option to contribute funds in addition to the employer's contribution.

Retirees use dollars in their HRA accounts to pay premiums and other out-of-pocket medical expenses. At retirement and during annual open seasons, retirees may shop among dozens of plans with varying designs, cost-shares, and pricing. Some exchanges offer multiple plans from a single carrier, while others offer plans from several different carriers. Exchange managers frequently provide consultative services to guide retirees to the plans best suited for their needs and budget.

A Medicare marketplace is a private exchange in which Medicare-eligible retirees have access to shop among a large selection of Medicare Advantage, Part D prescription, and Medigap plans. Medicare marketplaces (which are different from the health care exchanges created by the Affordable Care Act) provide retirees with more expanded choice of plan designs than traditional employer-sponsored group insurance plans and allow retirees to adjust their coverage to meet changing needs during the post-employment years. Private Medicare marketplaces offer plans that pool all Medicare beneficiaries purchasing coverage in a county or state and may provide coverage at more competitive rates than traditional group insurance plans comprised of retirees from a single employer.

Voluntary Employees' Beneficiary Association (VEBA). A VEBA is a variation on the HRA approach. A VEBA is a type of trust in which an employer contributes tax-free dollars for use by the employee when he or she retires. The employer contributes a specified percentage of pay annually during the employment period. A VEBA may also allow contribution of unused sick and annual leave payouts to the account when the employee retires.

Under Federal law, employees must be covered by an employer-sponsored health plan to be eligible for VEBA membership. Employees also make mandatory pre-tax payments to their VEBA account. VEBA members may choose how to invest the dollars in the account. VEBA plan managers typically offer a range of investment options involving varying levels of risk. VEBA accounts are portable; an employee may transfer the account to a subsequent employer with a similar plan.

After retirement, money in the account may be used for reimbursement or payment of medical expenses including insurance medical premiums, co-pays, deductibles, and prescription drugs. Dollars withdrawn from a VEBA account are not taxable and account balances roll over from one year to the next.

Cost Considerations. The retiree healthcare account approach may or may not be less costly to the employer than a traditional retiree health insurance coverage. The relative costs of these two approaches is dependent on the comparative plan designs and funding levels for the healthcare account and group insurance options. However, the healthcare account approach does reduce long-term budgetary uncertainty for the employer. As employers contribute to accounts during the years of employment (similar to contributions to a defined contribution retirement plan), they may reasonably budget for these annual costs and do not incur long-term future OPEB obligations.

Retiree Healthcare Accounts in the Public Sector. Public sector employers across the country have offered healthcare accounts as a retiree benefit for decades. The bullets below briefly summarize four examples of public sector retiree healthcare accounts established from 1984 through 2016:

- ***State of Washington School Districts and Education Institutions:*** In 1984, the State of Washington created a VEBA Trust for school districts to provide retirees with a medical reimbursement plan benefit. In 1997, the State expanded the plan eligibility to include employees of community and technical colleges. In 1998, the State further expanded VEBA eligibility to include retirees of general government agencies and higher education institutions. At present, the VEBA Trust provides benefits to 50,000 public employees and retirees from more than 400 school districts, community and technical colleges, State agencies, and higher education institutions.⁴⁸
- ***Pacific Northwest Governments:*** Approximately 18,400 public sector retirees (as well as an additional 44,600 active employees) from more than 500 cities, counties, school districts, public utility districts, fire districts, water and wastewater districts, and other

⁴⁸ VEBA Trust, Background page, <https://www.veba.org/about>

special purpose districts in Washington, Oregon and Idaho participate in a health reimbursement VEBA Trust that was formed in 1990. The public employers fund the health reimbursement accounts through tax-free contributions and retirees may cash out unused sick leave as account contributions. Retirees may make tax-free withdrawals from their HRA for reimbursement of out-of-pocket medical care costs including insurance premiums, co-pays, deductibles, and prescription drugs.⁴⁹ Public sector employers participating in the HRA VEBA Trust include King County, Multnomah County, the Cities of Seattle, Portland, and Spokane, and the University of Washington. In multiple jurisdictions, collective bargaining agreements allow employees to vote whether to participate in the HRA VEBA program. For example, in the most recent contracts, 35 of the 42 bargaining units representing City of Seattle employees voted to participate in a VEBA with a mandatory conversion of sick leave balances.⁵⁰

- **Nevada:** In 2011, the State of Nevada replaced its group health insurance benefit for Medicare-eligible retirees with an HRA private exchange benefit. The amount of the HRA contribution varies depending on an individual's years of service. The State contracted with a private exchange to administer retiree health benefits for its Medicare-eligible retirees. State retirees may choose from 85 participating Medicare Advantage, Medigap, and Part D plan carriers. A State official reported in 2016 that the exchange offers retirees more coverage options and lower premiums than available through the State-run group insurance plan. The transition to the private exchange benefit (coupled with a move to a high-deductible health plan for early retirees) produced a 45% reduction in the State's OPEB liability.⁵¹
- **Ohio:** In 2016, the Ohio Public Employees Retirement System (OPERS) transitioned its retiree health benefit to a private Medicare exchange for its 165,000 Medicare-eligible retirees and spouses. OPERS contracted with a benefits management firm to allow retirees to select and enroll in Medicare Advantage, Medigap, and Part D prescription drug plans through the individual Medicare market. Eligible retirees receive a monthly allowance through an HRA that may be used for paying premiums and other out-of-pocket medical expenses.⁵² The OPERS official who oversaw the transition reported the individual Medicare marketplace approach provided retirees with more choices at more affordable prices while reducing State costs by about 33%.⁵³

Retiree healthcare accounts case studies from two Maryland counties appear below.

⁴⁹ HRA VEBA Trust, Background page, <https://www.hraveba.org/about>

⁵⁰ Seattle Department of Human Resources, <http://www.seattle.gov/personnel/benefits/retirement/veba.asp>

⁵¹ Pew Charitable Trusts, *How States Provide Health Benefits to Retired Workers*, September 7, 2016, <https://www.pewtrusts.org/en/research-and-analysis/articles/2016/09/07/how-states-provide-health-benefits-to-retired-workers>

⁵² Business Wire, *Ohio Public Employees Retirement System Selects a Towers Watson Company to Administer OPERS Medicare Connector*, October 1, 2014, <https://www.businesswire.com/news/home/20141001006082/en/Ohio-Public-Employees-Retirement-System-Selects-Towers>

⁵³ Governing Webinar, *How Private Individual Marketplaces Can Help Reduce GASB Statement 75 OPEB Liabilities*, Presentation by Marianne Steger, Former Director of Health Care Ohio Public Employees Retirement System, January 30, 2018.

OPEB Cost Control Case Study #3

**Charles County, Maryland
Voluntary Employee Beneficiary Account for New Hires**

Charles County's OPEB Problem: As of the end of Fiscal Year 2016, the Charles County OPEB trust had total assets valued at about \$4.1 million and unfunded liabilities estimated at \$171.4 million, representing a funded ratio of only 2.5%.⁵⁴ In Fiscal Year 2017, Charles County contributed \$1.25 million to its OPEB trust, about seven percent of the actuarially determined required contribution for that year.

Voluntary Employee Beneficiary Account: To control future OPEB costs, the Charles County Government modified its retiree health benefit for employees hired after January 1, 2017. The County established a new post-employment health plan (PEHP) in which future retirees will be enrolled in a Voluntary Employee Beneficiary Association (VEBA). For the current year, Charles County Government employees contribute a minimum of \$612 per year while the County contributes \$1,837 per year to each employee's VEBA account. Charles County plans to adjust the employee and employer contribution amounts annually based on the Consumer Price Index. Employees may opt to contribute additional dollars into their VEBA account.

Charles County employees with a VEBA account elect how to invest their account assets. Nationwide, the investment management firm that administers the Charles County VEBA, offers 19 investment options with varying asset allocations and risk tolerances. County employees pay no taxes on VEBA account contributions or investment earnings. Upon retirement (or separation from County employment), retirees become eligible to use the accumulated balance in their VEBA account for qualified medical expenses. Qualified expenses include health insurance premiums, Medicare Part B premiums, Medicare supplemental insurance premiums, long-term care premiums, and out-of-pocket expenses such as prescription drugs, medical appointment co-pays, and eyeglasses.

⁵⁴ Charles County, Maryland *Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2017*, pages 124-125, <https://www.charlescountymd.gov/sites/default/files/fas/accounting/Final%20FY17%20CAFR%20for%20Charles%20County%20MD.pdf>

**OPEB Cost Control Case Study #4
Anne Arundel County, Maryland**

Private Exchange Authorized but not Implemented

Anne Arundel’s OPEB Problem: In 2011, in response to growing employee and retiree benefits cost, the Anne Arundel County Council created the “Benefits Collaborative Study Group” to:

1. review existing employment and post-employment benefits provided by the County;
2. assess the impact of the continued increase in the costs of the benefits on current and projected revenues and expenditures of the County;
3. determine fair and equitable priorities in the reduction of the benefit costs, ensuring that the benefits are fair to employees, retirees, and taxpayers of the County and can be funded on a fiscally sustainable basis; and
4. report to the County Executive and County Council recommendations on fair and equitable reductions of continued benefit costs.

The Study Group found that the County’s practice of paying retiree health benefit costs entirely through a pay-as-you-go method was “of the most concern for the County” and was “an unsound financial practice.” The Study Group concluded that “absent a plan to address this liability, it will continue to spiral upwards and eventually strangle the County’s ability to provide for current services ... and would in all likelihood result in County retirees not receiving the promised retiree benefit as a result of a bankruptcy court determination.”⁵⁵

Recommendation to Transition to Exchange Model: The Study Group’s report included a series of recommendations to control employee and retiree benefits costs. The Study Group suggested that a private exchange (referred in the report as a “Connector”) “offers the prospect of savings to both the County and the post-65 retiree. The ability to utilize consumer driven healthcare whereby individuals are empowered to select the best healthcare plan for their individual circumstances is a significant improvement to the benefit and should be incorporated in the County’s retiree healthcare benefit. It provides a retiree friendly solution that is sustainable and cost effective.”⁵⁶

Legislative Authorization: After receiving the Study Group’s report, the Anne Arundel County Council considered multiple bills to re-design County Government employee and retiree benefits. In 2013, the Council approved legislation that modified plan provisions such as the number of years of service needed to qualify for retiree health benefits and percent of health premium costs paid by active employees. Notably, the legislation amended the “County Employee and Retiree Health Benefits Program” section of the County Code to

⁵⁵ Anne Arundel County, *Report of the Collaborative Benefits Committee*, February 14, 2012, https://www.aacounty.org/departments/personnel/forms-and-publications/CollaborativeBenefitsCommittee_20120214.pdf

⁵⁶ Ibid.

authorize the County Government to provide a cash subsidy or allowance in lieu of a Medicare supplement. The amended Code further authorizes that “the subsidy or allowance may be administered through a Health Reimbursement Account to provide for the reimbursement of out-of-pocket costs.”⁵⁷

Decision Not to Immediately Implement: Despite the legislative authorization to implement a retiree health private exchange benefit, Anne Arundel County has not implemented the provision to date. Instead, the County added a Medicare Advantage Plan as an alternative retiree health cost savings. The authorization allows the County to implement a retiree health private exchange in the future.

⁵⁷ Anne Arundel County Code, Article 6, Title 1, Subtitle 3, Section 6-1-308.

CHAPTER 7. SUMMARY FINDINGS AND STAFF RECOMMENDATIONS

This chapter summarizes key findings from the joint OLO/Council staff review of OPEB and provides recommendations for Council consideration.

A. Summary of Key Findings

This report includes information about OPEB practices, policies, and funding for Montgomery County agencies as well as other public sector employers. This section summarizes the most important findings of the report and serves as the basis for the staff recommendations in the following section.

- Finding #1: Pre-funding OPEB benefits has several advantages compared to covering retiree health care costs solely on a pay-as-you-go basis.** These include: lowering long-term costs by 25-40%; helping Montgomery County maintain its AAA bond rating; and protecting the benefit by ensuring long-term sustainability.
- Finding #2: Retiree health benefits are a significant cost factor for Montgomery County agencies, and in FY20 account for 4.1% of the total approved tax supported operating budget.** For FY20, the approved retiree health funding of \$227.9 million for County Government, MCPS, Montgomery College, and M-NCPPC consists of \$205.3 million in tax supported funding and \$22.6 million in non-tax supported funding.
- Finding #3: Over the last two years, faced with unanticipated revenue shortfalls, the County did not meet its annual OPEB pre-funding obligations. County agencies have also drawn down on OPEB Trust assets to fund pay-as-you-go costs on a limited basis since FY15.** These actions have reduced the annual operating budget impact but have not reduced the overall cost of providing retiree health benefits. Absent these actions, total net OPEB Trust assets for County Government, MCPS, and Montgomery College would be approximately \$321.0 million higher (excluding any potential investment returns).
- Finding #4: At the end of FY18, the combined OPEB liability across the four County agencies was \$4.9 billion. The agencies have set aside \$1.0 billion in Trust assets since FY08, or 21% of the total liability.** In other words, County agencies have set aside about 21 cents for every dollar of their current combined retiree health care liability. If the \$321 million in OPEB reductions had instead accrued to the Trust, the combined funded ratio would be approximately 27%.
- Finding #5: Since FY08, the \$755.4 million pre-funding contributions deposited in the County's Consolidated OPEB Trust for County Government, MCPS, and Montgomery College have accrued investment gains of \$261.3 million (as of March 2019).** These investment gains represent 26% of the total Trust assets, confirming that pre-funding produces long-term cost savings.

- Finding #6:** Compared to several other local jurisdictions or agencies, the County agencies have OPEB funded ratios that compare favorably with Maryland jurisdictions but are below that of some Northern Virginia jurisdictions. There is significant variation in funded ratios across local jurisdictions and agencies, notably ranging from 3% for the State of Maryland to 77% for Fairfax County Government.
- Finding #7:** Among 16 other local jurisdictions reviewed, the County Government has a relatively high calculation of total OPEB liability per member when normalizing for plan members and discount rate. This calculation indicates that plan design, eligibility, and/or demographics are generating higher employer costs per member than those incurred by many other local public sector employers. For example, using a common discount rate, the County Government's per member liability (\$99,014) is 61% higher than Howard County's per member liability (\$61,661).
- Finding #8:** For County Government, pre-Medicare (under age 65) retirees appear to be a significant cost driver for health benefits. Pre-Medicare retirees represent 34% of medical plan enrollment but 52% of projected claims costs in 2019. On average, the projected medical and prescription claims costs per enrollee is up to 2.3 times higher for under age 65 retirees than for Medicare-eligible retirees.
- Finding #9:** Retiree health is a fast-disappearing benefit in the private sector and has decreased in the public sector as well. A 2018 study by the Kaiser Family Foundation found that one-third of large firms and governments that offer retiree health benefits have implemented cost reduction strategies within the past two years. Strategies include increased retiree premium contributions, increasing patient cost sharing, and eliminating coverage altogether.
- Finding #10:** Several state and local governments have replaced traditional defined retiree health benefits with a Health Retirement Account and Private Exchange model. This model has gained support from some labor organizations (in the Pacific Northwest) and has resulted in significant reductions in total OPEB liability of 33% (Ohio Public Employees Retirement System) and 45% (State of Nevada).

B. Staff Recommendations

Based on the findings of this report, staff offers four recommendations to the Council. While the specific recommendations focus on Montgomery County Government, the Council should also encourage each of the other tax supported agencies (MCPS, Montgomery College, and M-NCPPC) to review and consider these recommendations.

As it considers future OPEB policies and practices, the Council should seek input from stakeholders including current retirees, employee bargaining units, and taxpayers.

Recommendation #1: The County should align the cost of retiree health benefits with the County's ability to pay these costs.

There is no standard retiree health benefit package among state and local governments in the United States. Rather, retiree health insurance coverage, eligibility conditions, and cost share formulas vary greatly among public sector employers. In each state and local government, policy-makers decide what health benefits should be offered to retirees who provided years of public service to residents.

Employees earn their retiree health benefit during their active careers, creating a future liability for the employer. Under a defined health benefit such as that offered by the County Government, retiree health care claims do not come due until after the employee leaves public service. Nonetheless, the employer incurs the liability for those future year claims during the employee's years of active service. As such, annually pre-funding of OPEB consistent with the additional liability incurred each year is essential to properly funding the benefit. Failure to set aside resources to meet future obligations will result in ballooning future year pay-as-you-go costs that will crowd out other budget priorities.

Recent history has demonstrated that the County has had difficulty consistently meeting its annual OPEB pre-funding obligations. In the long-term, failure to meet OPEB pre-funding obligations could threaten the County's long-term fiscal stability, put at risk agencies' ability to meet their past commitments to retirees, and/or threaten existing programs and services. The County Executive laid out this dilemma in his FY20 budget submission in reference to his recommended FY19 OPEB pre-funding reductions: "Quite frankly, we do not have the revenues available at this time to satisfy both our OPEB funding policy and our reserves funding policy without making substantial reductions in current services."

To prevent these unwelcome outcomes, the County will need to either pre-fund liabilities incurred under current retiree health packages or adopt less costly benefits. In other words, the County must align the cost of retiree health benefits with the County's ability to pay for these benefits.

Recommendation #2: The Council should review and update fiscal policies related to OPEB to ensure appropriate planning and funding. Specifically, staff recommends that the County:

- a. establish OPEB pre-funding policy goals and milestones;**
- b. consider requirements for depositing appropriated OPEB pre-funding into the Consolidated Trust; and**
- c. review other fiscal practices that could provide additional pre-funding.**

This recommendation includes three related components that collectively are intended to help the Council align the cost of retiree health benefits with the County's ability to pay.

a. Establish OPEB pre-funding policy goals and milestones

At present, County's Fiscal Policy establishes target dates for achieving certain fiscal milestones. For example, the current Fiscal Policy sets a target date for building General Fund reserves to ten percent of revenues by FY20. Adherence to this policy goal has been a tenet of County budgeting since 2010, and the FY20 operating budget approved by the Council realizes this goal.

The Fiscal Policy also includes an important, albeit outdated, OPEB milestone. More than a decade ago, the Council addressed the County's growing OPEB obligations by amending the Fiscal Policy to call for full funding of the annual actuarially determined OPEB pre-funding contribution, phased in over eight years, beginning with Fiscal Year 2008.

Staff recommends that the Council update its Fiscal Policy by establishing target dates for achieving certain OPEB Trust funding milestones. For example, the Council could establish the policy goal of achieving a 50% funded ratio by the end of Fiscal Year 2025, and/or a goal of achieving a 75% funded ratio by Fiscal Year 2030. Ultimately, the Council should establish a plan to achieve a 100 percent funded ratio within a reasonable time frame, no more than 20 years. By way of comparison, it is current County policy to contribute to its pension fund at a rate necessary to achieve and maintain a 100 percent funded ratio. (The County Government's pension fund has a current funded ratio of 96%.) Annual OPEB contributions necessary to comply with the targets should be included as a committed use of resources in the County's Six-Year Fiscal Plan.

As part of this review, the Council should also determine the required Trust funding level for the transition to using Trust assets for pay-as-you-go costs. For example, it may be appropriate to begin using Trust assets to pay the entire pay-as-you-go costs prior to reaching 100% funding (similar to how pension funds pay current retiree pension costs even if the fund is less than 100% funded). The Council should request that the County's actuarial consultant provide a recommendation on the funding level needed for using Trust assets.

b. Consider requirements for depositing appropriated OPEB pre-funding into the Consolidated Trust

In both FY18 and FY19, the County Executive recommended reductions in approved OPEB pre-funding due to lower than anticipated revenues. This was possible because the County Government typically waits until the 3rd or 4th quarter of the fiscal year to deposit appropriated OPEB pre-funding into the Consolidated Trust. Once these funds are deposited in the Trust, they are not available for use as part of a potential savings plan.

When the Executive recommends changes to previously approved OPEB funding to help fund the next year's budget, the Council is left with few options. For example, to reject the Executive's \$89.6 million FY19 OPEB savings plan, the Council would have needed to find an additional \$89.6 million in FY20 revenue or cut funding for services by that same amount.

To ensure that approved pre-funding is not saved until the end of the year for a possible savings plan, the Council could require the deposit of OPEB appropriations into the Trust at specified intervals. For example, the annual budget resolution could require deposits into the Trust in four intervals at the end of each quarter (as is done with non-tax supported appropriations). This type of approach would still leave some flexibility in case of a fiscal emergency by leaving a portion of the funding undeposited until the latter part of the fiscal year. The Council should weigh the advantages of making mid-year OPEB Trust deposits against the disadvantages – cash flow limits and reduced budget savings options – associated with this approach.

c. Review other fiscal practices that could provide additional pre-funding

In reviewing its fiscal policies, the Council should also consider whether to establish any formal structures for providing one-time, ad hoc, or non-recurring increases to the OPEB Trust under specific circumstances

For example, during its review of compensation and benefits in the FY20 operating budget, the Council requested that staff explore options to shift contributions that would otherwise have gone to employee retirement plans to OPEB once the retirement plans are fully funded. In addition, the Council could review whether to formalize the County Government's practice of depositing Medicare Part D rebates into the Trust as additional pre-funding.

Recommendation #3: The Council should request an actuarial assessment of a variety of changes to the County Government’s retiree health benefit package to determine how such changes would affect both retirees and County finances.

If the County fully meets its OPEB pre-funding and pay-as-you-go obligations year-in and year-out, then no change in the retiree health benefit package is necessary. However, full funding has not occurred in recent years, and the County is at a significant crossroads with retiree health funding. Due to fiscal considerations from unanticipated revenue shortfalls, the County Executive has recommended significant mid-year reductions in OPEB funding in each of the last two years. Absent changes to reduce the long-term costs of retiree health benefits or unexpected revenue growth, the County will continue to be challenged to fund its annual OPEB obligations.

Staff recommends that the Council request an actuarial analysis to assess how alternative modifications to the retiree health benefit package would affect both retirees (current and future) and County finances (total OPEB liability and annual pay-as-you-go costs). The goal of this analysis would be to identify a revised benefit package that reasonably serves retirees and is fiscally sustainable for the County. For each option, consideration should be given to:

- Applying changes only to new employees hired after a certain date (holding current employees and retirees harmless);
- Applying changes to employees who retire after a certain date (holding current retirees harmless but potentially impacting current employees); and
- Whether changes would apply to those on disability retirement.

Staff identified a series of potential modifications (listed below) for actuarial analysis based on a review of retiree health benefits currently offered by other public sector employers and current County OPEB cost drivers, most notably the data that show the cost for pre-Medicare retirees is about double that for Medicare-eligible retirees. After receiving more in-depth actuarial analysis on various options, the Council should seek input from interested stakeholders including current retirees, employee organizations, and taxpayers.

Option	Description
Changes to Cost Share	
<p>#3A: Reduce the minimum and maximum cost share arrangement based on years of service to match MCPS</p>	<p>For several years, the Council has encouraged MCPS to align its active employee cost share with County Government. Similar consideration should be given for retiree cost share. This action would reduce the County’s current minimum (50%) and maximum (70%) cost share by establishing the County’s share of the premium cost at:</p> <ul style="list-style-type: none"> • 10-14 years of service: 40% • 15-19 years of service: 50% • 20+ years of service: 64% <p>Alternatively, a reduction could be made to the minimum or maximum while keeping the other elements of the County’s current structure.</p>

Cost of Retiree Health Care Benefits (OPEB)

Option	Description
<p>#3B: Cap the County’s cost share contribution at the amount for Self+1 coverage</p>	<p>Retirees would be able to select Self (covering the retiree only) or Self+1 (covering the retiree and one spouse/dependent) with no change to the cost share arrangement. However, the County’s annual premium contribution would be capped at the Self+1 amount for each plan. Retirees would still be able to select Family coverage; however, they would be responsible for paying 100% of the premium cost difference above the capped amount.</p> <p>This structure is similar to how the County Government requires active employees who select high option prescription coverage to pay the cost difference from the standard option plan.</p>
<p>#3C: Reduce the County’s cost share for under age 65 retirees</p>	<p>The County could establish a different cost share structure for non-Medicare eligible retirees (i.e., those under age-65). For example, the County could reduce its share of the premium cost for otherwise eligible retirees to 20% until the retiree reaches age 55 and/or 30% until the retiree reaches age 60.</p>
<p>Changes to Eligibility</p>	
<p>#3D: Require non-Medicare eligible retirees who are employed in jobs that offer health insurance to enroll in their current employer’s health insurance plan</p>	<p>Retirees who are employed in a new job that offers health insurance after leaving County service would not be eligible for retiree health benefits. These retirees would be allowed to rejoin the County’s plan once they no longer worked at a job that offered health insurance or completely retired from the workforce.</p> <p>Alternatively, the County could allow these retirees to participate in health plans but pay 100% of the premium.</p>
<p>#3E: Revise eligibility criteria such that a retiree only receives health benefits as a Medicare supplement</p>	<p>Retirees would no longer be eligible to receive any health benefits from the agency <u>until</u> they are eligible for Medicare. Under this option, retiree health benefits would serve as supplemental or secondary insurance plans intended to pay health costs Medicare does not.</p> <p>Alternatively, the County could allow pre-Medicare eligible retirees to participate in health plans but pay 100% of the premium.</p>
<p>#3F: Establish a minimum age of 55 to be eligible to receive retiree health benefits</p>	<p>Regardless of years of service or other criteria, the County could establish 55 as the minimum age for retiree health benefits eligibility. Alternatively, retirees below the minimum age could be allowed to participate in the health plans but pay 100% of the premium.</p>
<p>#3G: Revise eligibility criteria such that health benefits for retirees are no longer available to a retiree’s dependents</p>	<p>Eliminate the ability for retirees to cover any dependents under their health plan. As a result, retirees would no longer be able to choose Self+1 or Family coverage levels.</p> <p>Alternatively, the County could continue to offer coverage to retirees’ dependents but require the retiree to pay 100% of the additional cost above single coverage.</p>

Option	Description
#3H: Exclude retirees from adding to their health insurance new dependents who were not eligible for coverage at the time of retirement	Retirees could no longer add new spouses and any children who were not eligible for coverage at the time of retirement. This change would align with the policy of MCPS and M-NCPPC.
Changes to Benefit Structures	
#3I: Adjust plan design features that affect the costs paid by retirees and the County	This option would involve plan design modifications that could reduce the overall cost such as include increasing co-pays, deductibles, and/or out-of-pocket maximums.

Recommendation #4: Examine the feasibility of adopting a Retiree Healthcare Account/Private Exchange approach for Medicare-eligible retirees.

Each of the possible modifications to retiree health benefits listed in Recommendation #3 involves a trade-off through altering the benefits received and/or shifting the cost burden. As detailed in Chapter 6, some jurisdictions have reduced costs while attempting to avoid these trade-offs by implementing a Retiree Healthcare Account/Private Exchange model for Medicare-eligible retirees.

A Retiree Healthcare Account is a type of defined-contribution plan set up by an employer to cover retiree medical expenses. Retirees use dollars in their accounts to pay premiums and other out-of-pocket medical expenses. A Private Exchange offers plans that pool large numbers of Medicare beneficiaries purchasing coverage in a county, state, or across the country. These exchanges, which are different from the exchanges for non-Medicare retirees established by the Affordable Care Act, may provide coverage at more competitive rates than traditional group insurance plans comprised of retirees from a single employer.

The theory behind this model is that it provides an option where employers reduce their OPEB costs while retirees enjoy expanded and more affordable health care choices. Some jurisdictions that have implemented this model report the support of employee labor organizations and a high-level of satisfaction of retiree participants after the switch.

Implementation of a Retiree Healthcare Account/Private Exchange approach would constitute a wholesale change in how the County provides health coverage for its Medicare-eligible retirees. In addition, this approach would not address a large cost to the County Government for coverage of pre-Medicare age retirees. Nonetheless, staff suggests that this approach warrants further study to evaluate whether it could be advantageous to both the County and retirees.



OFFICE OF THE COUNTY ATTORNEY

Isiah Leggett
County Executive

Marc P. Hansen
Acting County Attorney

MEMORANDUM

TO: Karen Orlansky
Office of Legislative Oversight

FROM: Amy Moskowitz *AM/EBJ*
Associate County Attorney

Edward B. Lattner *Edward B. Lattner*
Chief, Division of Human Resources & Appeals

VIA: Marc P. Hansen *Marc P. Hansen*
County Attorney

DATE: October 28, 2010

RE: **Council Authority to Modify Employee Compensation and Benefits**

Due to a structural budget deficit, your office is exploring options to suggest to the County Council on reducing the deficit. Specifically, you asked our office to address whether the County Council may change employees' compensation and benefits, including changes to retirement and health benefits, for both active employees and retirees.

Summary

In general, because retirement benefits are set forth in the County Code, they are contractual obligations protected by the Contract Clause of the United States Constitution. Retirement benefits contained in current collective bargaining agreements may also have Contract Clause protection. The Council may make a retroactive modification that causes a substantial impairment in retirement benefits only if the modification is reasonable and necessary to serve an important public purpose. The Council can avoid any Contract Clause issues by only making prospective changes that do not affect accrued retirement benefits.

In contrast to retirement benefits, the Council has more flexibility in making changes to health benefits because those benefits are not required by County law. The Council resolutions that address retiree health coverage do not create an interest protected by the Contract Clause

because they do not promise any particular level of benefit or subsidy and, unlike the retirement law, they do not state that retirees “vest” or that retiree health benefits are an obligation of the County. While certain health benefits for current employees are provided for in collective bargaining agreements (and for retirees in the FOP agreement), the benefits in those agreements, like the benefits in the Council’s resolutions, are subject to the Council’s decision to annually appropriate sufficient funds to cover the cost of implementing those agreements. The discretionary funding of health benefits stands in marked contrast to the County-mandated funding of retirement benefits, which are held in trust. Thus, even in the face of a multi-year agreement, the Council could decide not to fully fund an agreement in any given fiscal year without violating that agreement or implicating the Contract Clause.

Likewise, the Council enjoys broad discretion in setting salaries for each upcoming fiscal year, unfettered by either the Contract Clause or the applicable collective bargaining agreements. The Council cannot promise salaries beyond the current fiscal year because the Charter restricts Council from appropriating funds beyond the current fiscal year.

I. THE CONTRACT CLAUSE

Article I, § 10, clause 1 of the United States Constitution provides that “No State shall . . . pass any Law impairing the Obligations of Contracts . . .”. It is well settled that, despite the absolutist nature of the Clause, the Constitutional prohibition against impairing the obligation of contracts is not to be read literally. *Keystone Bituminous Coal Ass’n. v. DeBenedictis*, 480 U.S. 470, 502 (1987). The Contract Clause does not prohibit governments from impairing contracts, but limits a government’s right to do so. The courts employ a three-part test for harmonizing the command of the Contract Clause with the necessarily reserved sovereign power of the government to provide for the welfare of its citizens. *Baltimore Teachers Union v. Mayor and City Council*, 6 F.3d 1012, 1015 (4th Cir. 1993).

A. Is There A Contract And Has The Government Impaired That Contract?

First, the court must determine whether there has been impairment of the contract. This inquiry necessarily requires a determination of whether there is a contractual relationship in the first place. *Allstate Ins. Co. v. Kyong*, 376 Md. 276, 299, 829 A.2d 611, 624 (2003). A contractual relationship can arise either from a contract or even a statute “when the language and circumstances [of the statute] evince a legislative intent to create private rights of a contractual nature enforceable against the [government].” *Andrews v. Anne Arundel County*, 931 F. Supp. 1255, 1260 (1996), *aff’d without opinion*, 114 F.3d 1175, *cert. denied* 522 U.S. 1015 (1997) (quoting *United States Trust Co. v. New Jersey*, 431 U.S. 1, 17 n. 14 (1977)). But there is a strong presumption that statutes do not create contractual rights. *Nat’l R. Passenger Corp. v. Atchison, Topeka & Santa Fe R. Co.*, 470 U.S. 451, 465-66 (1985).

1. Contracts and even statutes can create contractual rights protected under the Contract Clause.

The County's retirement plans are set out in Chapter 33 (Articles III and VIII) of the County Code.¹ "[I]n Maryland, as in most states, public employee pension plans embody contractual rights and duties between and employee and the government as employer under the well-settled Contract Clause analytical approach." *Howell v. Anne Arundel County*, 14 F. Supp. 2d 752, 754 (D. Md. 1998); *Frederick v. Quinn*, 35 Md. App. 626, 629-30, 371 A.2d 724, 726 (1977) (statutory pension rights created a contract for purposes of Contract Clause).

Unlike retirement benefits, health benefits and salaries are not set out in law.² But they are addressed in the collective bargaining agreements, along with retirement benefits. Charter Sections 510, 510A, and 511 state that the County Council shall provide for collective bargaining for police officers, firefighters and general government employees. The three collective bargaining laws, set forth in Articles V, VII and X of Chapter 33 of the County Code, provide that salaries, retirement, and benefits are mandatory subjects of collective bargaining. See County Code Sections 33-80, 33-107, and 33-152. All current collective bargaining agreements contain provisions regarding these items.

2. The Contract Clause prohibits only retroactive impairment of contract.

The Contract Clause prohibits only a retroactive impairment of contract, not a prospective impairment.

A very important prerequisite to the applicability of the Contract Clause at all to an asserted impairment of a contract by state legislative action is that the challenged law operate with retrospective, not prospective effect. *Ogden v. Saunders*, 25 U.S. 213, 12 Wheat. 213, 6 L. Ed. 606 (1827). See also *Old Wine in Old Bottles: the Renaissance of the Contract Clause*, (1979) Supreme Court Rev. 95, 99. *United States Trust Co. [v. New Jersey]*, 431 U.S. 1, 52 L. Ed. 2d 92, 97 S. Ct. 1505 (1977)] explicitly restates the existence of statutory retroactivity as a necessary predicate for the applicability of the Contract Clause. *United States Trust Co.*, 431 U.S. at 18 n.15. The opinions in both *United States Trust Co.* and [*Allied Structural Steel Co. v. Spannaus*], 438 U.S. 234, 244, 98 S. Ct. 2716, 2722, 57 L. Ed. 2d 727 (1978)] strongly assert that the challenged legislation involved was retroactive and thus, inferentially, impaired the subject contracts. *United States Trust Co.*, 431 U.S. at 14; *Spannaus*, 438 U.S. at 246, 247, 249. No

¹ Charter Section 401 requires that "[t]he Council shall establish by law a system of retirement pay."

² Salaries for the County Executive and Council members being a notable exception.

Supreme Court decision has been found in this court's research which has invalidated a non-retroactive state statute on the basis of the Contract Clause.

Maryland State Teachers Assoc. v. Hughes, 594 F. Supp. 1353, 1360-1361 (D. Md. 1984). See also *American Nat'l Fire Ins. Co. v. Smith Grading & Paving*, 454 S.E.2d 897, 899 n.2 (S.C. 1995) (internal citations omitted) ("The first inquiry of any Contract Clause analysis is whether the state law has operated as a substantial impairment of a contractual relationship. It is a long-held axiom of Contract Clause analysis that there is no impairment where the statute affects only future contracts between private parties. A non-retroactive statute affecting private contracts is, by definition, a statute that affects only future contracts and does not violate the Contract Clause.")

B. The Contract Clause Prohibits Only A Substantial Impairment Of Contract.

Second, a contract violation occurs only if the government substantially impairs a party's right under the contract. Legitimate expectations of the parties determine whether the impairment was substantial. In *Baltimore Teachers Union v. Mayor and City Council*, 6 F.3d 1012 (4th Cir. 1993) the court noted that the Supreme Court provided little guidance as to what constitutes substantial impairment, but assumes that a substantial impairment occurs "where the right abridged was one that induced the parties to contract in the first place or where the impaired right was on which there had been reasonable and especial reliance."

C. The Government May Substantially And Retroactively Impair A Contract If Reasonable And Necessary To Serve A Legitimate Public Purpose.

Finally, a government may substantially impair a contract if reasonable and necessary to serve a legitimate public purpose. Reasonableness is determined in light of whether the contract had "effects that were unforeseen and unintended by the legislature". Necessity means that the government did not have a less drastic modification available and the government could not achieve its goals without altering the contractual terms. Courts generally defer to the government in determining the reasonableness and necessity of a particular measure, unless a government seeks to impair its own contracts. But even where the government acts to impair its own contracts some degree of deference is appropriate. *United States Trust of New York v. New Jersey*, 431 U.S. 1 (1977); *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234.

II. ANALYSIS

A. Retirement

1. The County's retirement plans.

Charter Section 401 requires a retirement plan. The County's mandatory retirement plans—the Employees' Retirement System (ERS), a defined benefit plan, and the Retirement Savings Plan (RSP), a defined contribution plan—are set forth in County Code Chapter 33, Articles III and VIII.³ Employees hired before October 1, 1994, and represented public safety employees participate in the ERS. At retirement, participants receive a monthly benefit determined by years of service and average final earnings. Within the ERS, different benefit structures exist for various groups of employees (e.g., fire fighters, police officers, employees hired after 1984 receive decreased benefits at social security normal retirement age). County Code Section 33-40 requires the County to fund retirement benefits on an actuarially determined basis. As required by federal law, the funds are held in trust, established under County Code Section 33-58. The funds become ERS assets, not County assets.

Non public safety employees and unrepresented public safety employees hired after October 1, 1994, chose to participate in either the RSP or the Guaranteed Retirement Income Plan (GRIP), a cash balance plan, established within the ERS. In both plans, each pay period, employees generally contribute 4% percent of their salary and the County contributes 8% percent of their salary (unrepresented public safety employees contributions are different). RSP participants invest the contributions in selected investment options. GRIP participants receive earnings at an annual rate of 7.25%. At retirement or termination of employment RSP and GRIP participants receive the value of their account balance. The County deposits the RSP contributions in a trust, established under County Code Section 33-124.

As established under Maryland case law, the retirement plans in the County Code are contractual benefits protected by the Contract Clause. In addition, County Code Section 33-34 specifically provides Contract Clause-like protection against reduction of pension benefits, precluding modifications that reduce existing benefits except as necessary to maintain the fiscal integrity of the system. County Code Section 33-34, which is part of the ERS, provides in part:

It is the policy of the county to maintain a system of retirement pay and benefits for its employees which is adequately funded and insures employees sufficient income to enjoy during their retirement years. Any modifications to such retirement system shall not reduce the overall value of benefits which existed for members immediately prior to such modifications except that benefits may be reduced if necessary to maintain the fiscal integrity of the system after a finding by the county council that such change is necessary.

2. Case law

Maryland courts have held that pension plan statutes contain contractual rights between

³ The County also offers a voluntary deferred compensation plan under Internal Revenue Code Section 457(b) in Article IX of Chapter 33 of the County Code.

employees and the government protected under the Contract Clause.

Because a Contract Clause issue only exists if the legislation operates retroactively and not prospectively, the court in *Maryland State Teachers Association, Inc. v. Hughes*, 594 F. Supp. (D. Md. 1984) stated that there can be no expectation that pension plans can not be altered as to future benefits to be earned by future service. Likewise, in *Howell v. Anne Arundel County*, 14 F. Supp. 2d 752 (D. Md. 1998) the court recognized that the contract clause only protects against retroactive diminution of vested benefits and no contract clause violation occurs when legislation applies prospectively to non vested plan benefits. In these cases, there was no impairment because a reduced COLA would only apply to benefits earned after the effective date of the legislation. In both case, members would have COLA adjustments calculated under a bifurcated formula. In addition to a reduced COLA, *Hughes* involved a number of prospective changes to the retirement system and also included a bifurcated option under which the formula changed from 1.8% of average final compensation to .8% of average final compensation for years of service earned after the effective date of the legislation.

The retroactive diminution of pension benefits is more likely than not a substantial impairment because individuals plan their lives based on pension benefits. *Andrews v. Anne Arundel County*, 931 F. Supp. 1255 (1996), *aff'd without opinion*, 114 F.3d 1175 (1997), *cert. denied*, 522 U.S. 1015 (1997). But the government can modify pension terms as long as the changes do not adversely affect the benefits, or if adversely affected, are replaced with comparable benefits. *City of Frederick v. Quinn*, 371 A.2d 724 (1977).

If the government makes a substantial retroactive impairment to pension benefits, the court will examine the necessity and reasonableness of the government's decision. The necessity and reasonableness of a particular legislative act is a factual inquiry. In *Baltimore Teachers Union v. Baltimore*, the court held that a salary reduction plan adopted to meet immediate budgetary shortfalls did not violate the Contract Clause. While the court found that the plan was a substantial impairment, it concluded that the City's action was reasonable and necessary. Protecting the City's financial integrity was a significant public purpose justifying city action. Although the *Hughes* court held that the plaintiffs did not suffer any impairment because the changes to the pension plan were prospective, the court discussed whether the changes were reasonable and necessary had there been an impairment. The court concluded that due to the financial circumstances of the pension system and the State, the non drastic nature of the impairment and the unavailability of a more moderate course of action, the changes would be permitted, even if retroactive.

However, in *Andrews v. Anne Arundel County*, 931 F. Supp. 1255 (1996), *aff'd without opinion*, 114 F.3d 1175, *cert. denied*, 522 U.S. 1015 (1997), a case involving retroactive changes to the pension plan, the court did not find the County's action to be reasonable and necessary. Although the County argued the legislation was necessary for the "restoration of the actuarial

soundness" of the plan, the court ruled that the County "has failed to make a sufficient showing that the means which it has adopted to address the problem is the least drastic available." The court also noted that the County acknowledged that an emergency did not exist and that courts have typically upheld "such extreme modifications only in the face of an emergency or temporary situations."

3. Conclusion

If the Council wanted to change retirement benefits, it could modify benefits for new employees or for current employees as to benefits not yet earned (i.e., for future service). This would comply with the Contract Clause and County Code Section 33-34 because the Council would not reduce benefits "earned," only future benefits.⁴

In order to substantially impair the benefits for retirees or current employees who have already earned service, the Council would have to find under Section 33-34 that such modifications were reasonable and necessary to "maintain the fiscal integrity of the system." This also meets the standard established under the Contract Clause (i.e., such a drastic action was necessary and that no less dramatic remedial actions were available).

In addition to the County Code, the collective bargaining agreements contain retirement benefit provisions. These provisions typically call for the County Executive to seek an amendment to Chapter 33 of the County Code to implement the parties' negotiated changes to the retirement law. The Council may either enact the legislation or decline in which case the retirement benefits do not become effective. But even when the Council does enact the requested legislation, the retirement provisions typically remain in the collective bargaining agreements. By retaining this language in a collective bargaining agreement, the parties arguably intend that the benefits remain for the term of the agreement.

It is unclear whether these collective bargaining agreements, independent of Chapter 33, provide an interest protected by the Contract Clause. This office addressed this issue in the context of Bill 45-10, which proposes changes to the disability retirement provisions in the retirement law. As this office noted, the most conservative course of action would make any changes be effective after the dates of the current collective bargaining agreements (i.e., 2011 and 2012). Any changes before then could be subject to the Contract Clause analysis, requiring the County Council to find that any substantial retroactive modifications are necessary and reasonable for the public good. The change must be due to "effects that were unforeseen and unintended by the legislature" with no other less drastic modification available and the County Council cannot achieve its goals without altering the contractual terms.

⁴ Although certain changes are clearly prospective, other changes are more difficult to classify as prospective or retroactive (e.g., increasing years of service for current employees in order to qualify for full benefits at retirement and changes in the cost of living adjustments (COLA)).

B. Health Benefits

1. The County's health plans

While retirement benefits are required under the Charter, there is no such requirement for health benefits. County Code Section 20-37(b) provides the only authority for the County to offer health benefits:

The county is hereby authorized and empowered to adopt or install a plan or system of group health and life insurance and group hospitalization in cooperation with the employees or any portion thereof in any office, agency or branch of the government of the county and with paid employees of quasi-public corporations engaged in the performance of governmental functions, such as fire departments, whenever it may deem such to be advisable in the interest of the health, comfort and welfare of the county.

Unlike retirement benefits, which are provided in the County Code, the County has established health benefits solely through policy, collective bargaining agreements, and the budget. Currently, only the Summary Description formally describes benefits and eligibility. In addition, since 1994, the Summary Description has contained a provision reserving the right to amend plan terms. The Summary Description for active employees and retirees and all health plan communications state:

The County expects to continue the Plan, but it is the County's position that there is no implied contract between employees and the County to do so, and reserves the right at any time and for any reason to amend or terminate the Plan, subject to the County's collective bargaining agreements. The Plan may also be amended by the County at any time, either prospectively or retroactively.

Over the years the County has modified and otherwise made changes to health benefits (e.g., changes in copayments; change in plan structure). This demonstrates that the County has no contractual obligation to provide specific benefits. However, the County has often modified and changed active employee health benefits in conjunction with collective bargaining.

a. active employee health coverage

With regard to active employees, the County offers health coverage to all permanent employees with merit status (as well as appointed and elected officials). The cost sharing arrangement differs depending upon collective bargaining unit and number of hours worked (e.g., represented employees and full time employees hired before 1994 have a cost share of

20%). Through collective bargaining, the collective bargaining units have negotiated certain benefits, most notably the cost sharing arrangement.

b. retiree health coverage

The County offers retiree health coverage to employees who retire at a certain age with a specified number of years of service. The age and service requirement varies (e.g., age 60 with five years of service for non public safety employees). The cost a retiree pays for the health benefit varies with years of service (e.g., a retiree with 15 years of service pays 30%). Employees hired before 1987 can elect a cost share of 20% for the number of years they participated in group insurance and then pay 100% of the cost. In 1986 and 2002-2003, these retirees had the opportunity to change to the lifetime cost share option, which provides for an employee contribution of 30%.

In 1995 and 1998 two County attorney opinions counseled that the County may amend or discontinue retiree health benefits. The opinions stated that no written contract of the County promised retirees specific benefits at a specific cost for a specific duration without modification and that there was no indication that the County intended to create a contract enforceable against the County. A supplemental 1996 County Attorney opinion noted that although the County Code created limited collective bargaining of retiree health benefits, no collective bargaining agreement provided for retiree health benefits.

However, the current FOP collective bargaining agreement sets forth several provisions regarding retiree health benefits. First, the agreement sets forth the cost split described above and also includes a 30% cost for retirees with a service connected disability. Second a surviving spouse, eligible domestic partner and other dependents eligible for coverage at the time of death may continue retiree coverage as if he/she was the retiree until remarriage. Third, the agreement provides that for employees hired before July 1, 2008, eligibility and contributions for retiree health coverage will remain as is, except as modified by a collective bargaining agreement.

Although no legislation for retiree health coverage exists, in 1986, the Council adopted Resolution 10-2233 providing a cost sharing structure for retiree health coverage. The Resolution notes that the County's policy is to provide health benefits for retirees younger than age 65 with the same benefits as active employees and to provide for retirees age 65 or older a "lifetime" Medicare supplemental plan with a \$1,500 stop loss and 80% coinsurance for prescription drugs after a \$25 deductible (subject to cost of living increases). Subsequently, in 2002, the Council adopted Resolution 14-1168 providing retirees whose cost sharing arrangement would end⁵ an option to change to a "lifetime" cost sharing option. The word "lifetime" in these Resolutions

⁵ Employees hired before 1987 can elect to participate in retiree health insurance at a cost share of 20% for the number of years they participated in group insurance; then they would pay 100% of the cost. In 1986, retirees had the opportunity to change to the lifetime cost share option of 30%.

strongly suggests health benefits will be provided indefinitely and could be viewed as a contractual right. However, it is questionable whether the County intended to create a contractual right, especially in the 2002 Resolution which gave retirees an additional benefit after retirement and they did not perform any additional service in exchange for this benefit. The 1998 County attorney opinion rejects the view that any Resolution could become a contract because the Resolutions lack the requirements of legislation. Finally, the Council did not define what health benefits the County would provide and did not state that benefits would remain unchanged.

2. Case law

There are currently no Maryland court cases addressing Contract Clause rights for health care in the government sector. Most government cases, where there are no collective bargaining agreements, have not found any contractual right to retiree health benefits. Because there is usually little or no statutory authority, the courts examine any statutes or documents and have generally held that the statutes and/or document must clearly set forth an explicit contractual intent. Cases where there are collective bargaining agreements have varying results. Like retirement cases, the analysis involves a factual determination.

Some cases address statutes providing for health benefits. The court in *Davis v. Wilson County*, 70 S.W.3d 724 (Tenn. 2002) held that employees do not automatically have a vested interest in welfare plan benefits such as retiree health care benefits absent "clear and express language" in the law indicating such an intent. In addition the Wilson county's statement in its resolution reserving the right to modify or terminate benefits was inconsistent with any intent to vest or guarantee benefits. Similarly, in *Colorado Springs Fire Fighters Ass'n v. City of Colorado Springs*, 784 P.2d 766 (Colo. 1989) retirees believed that an ordinance providing for payment of retiree health insurance costs was a "contractual, quasi-pension benefit" and a subsequent ordinance reducing the benefits was an unconstitutional impairment of the contract. The court found that the ordinance was not a pension benefit, the amount of the City's payment was determined on an annual basis and the cost and design of the program could change. In addition, the retirees' argument of vested rights to health benefits was inconsistent with the City charter which prohibited imposing future liability upon the City, unless prior appropriation was made. The retirees could not have reasonably relied upon such an interpretation of the ordinance.

Some cases addresses collective bargaining agreements providing health benefits. In *Poole v. City of Waterbury*, 831 A.2d 211 (Conn. 2003), the City, while in a financial crisis, entered into a new collective bargaining agreement and replaced an indemnity plan. Retirees argued that they had a vested right under the collective bargaining agreement at the time of retirement. While the court held that the retirees had a vested right to retiree medical benefits generally, they did not have a vested right in the particular benefits provided in an expired collective bargaining agreement. The court would look to whether the benefits provided to retirees were "reasonably commensurate" with the benefits under the collective bargaining

agreement. In discussing whether there should be a presumption in favor of vesting of retiree health benefits like pension benefits, the court compared the inability to predict or control health insurance costs with the more predictable nature of pension benefits. The court stated it would be "counter to all of the parties' interests" to construe the collective bargaining agreements to freeze the health benefits provided at retirement. In contrast to *Poole*, the court in *Roth v. City of Glendale*, 614 N.W.2d 467 (Wis. 2000), interpreted collective bargaining agreements which had provisions for subsidizing retiree health care benefits to presume health benefits vest unless the language of the contract provides otherwise. The health benefits are part of retirement benefits which last beyond the life of the contract, in the absence of contract language or extrinsic evidence demonstrating to the contrary.

3. Conclusion

It is doubtful that the Council resolutions regarding retiree health care benefits provide an interest protected by the Contract Clause. The Maryland Attorney General has concluded that the General Assembly's ability to modify the state's program of retiree health benefits was not limited by the Contract Clause. In 90 Op. Att'y Gen. Md. 195 (2005), the Attorney General examined the State Employee and Retiree Health and Welfare Benefits Program, Md. Code Ann., State Pers. & Pens. § 2-501 et seq., and concluded that it did not create a contractual obligation under the Contract Clause because "it does not purport to promise any particular level of benefits or subsidy to employees." *Id.* at 209.

The benefits and subsidy made available to retirees are keyed to those to which current employees are entitled. The statute does not appear to confer any greater right to benefits and a State subsidy to retirees. Nor is there any clear and express language that vests retirees with benefits. We are not aware of any Maryland cases that hold that State retiree health care benefits authorized by statute generally are a contractual right."

Id. at 209-210. In contrast to the state pension law, the Attorney General noted that the state law regarding retiree health benefits

neither states that a retiree "vests" in Program or subsidy eligibility, nor characterizes any portion of the Program as an "obligation of the State" to retirees. Rather, there is a statutory right, the delineation of which has been largely delegated to the Secretary of [the Department of Budget and Management] and the Governor, and which is subject to change by the General Assembly.

Id. at 217.

The legislatively chosen method of funding retiree health benefits further solidified the

difference between the pension statute and the retiree health benefit statute. The former provided for advance funding of pension benefits, with the creation of a specific fund for each retirement system (made up of government and employee contributions). The funding of the retiree health benefits, with limited exceptions, was left to the Governor's judgment in the proposed annual budget. Although the General Assembly had created special funds to help finance retiree health benefits, the statutes creating those funds did not create any specific obligation to retirees or commit to provide them with health care benefits. *Id.* at 218.⁶ Finally, the materials published to employees and retirees regarding health care benefits explicitly disclaimed any intention to create a contractual obligation to provide health care benefits. *Id.* at 218-19.

The Council's resolutions do not preclude it from making changes to retiree health, especially those employees hired after 1994 because of the disclaimer on all communications. Even for employees hired before 1994, although certain retirees/employees could claim that the Council resolutions create an interest in health benefits protected by the Contract Clause due to the use of the word "lifetime," that claim would be dubious because (a) the County has made many changes to the health plans; (b) the resolutions are not binding law or a contract; and (c) health benefits are subject to annual appropriation. Charter Section 311 restricts the Council from making expenditures beyond funds appropriated. Each year the Council makes appropriations of employee compensation and benefits, including health benefits.

The County's collective bargaining agreements create an interest in health care benefits protected by the Contract Clause only to the extent the County Council adopts those benefits in law. That was the conclusion of the Attorney General in 90 Op. Att'y Gen. Md. 195 (2005) when reviewing state collective bargaining agreements providing for retiree health care benefits. A similar result should apply to the County. The State's collective bargaining law, like the County's collective bargaining law, contemplates that the Governor/County Executive will recommend full funding of all collective bargaining agreements in the annual proposed operating budget.⁷ But, in both the State and the County, the legislature makes the final decision on the budget. Thus, collective bargaining agreements, even multi-year contracts, are subject to annual General Assembly/Council appropriations. Similarly, to the extent the collective bargaining agreements call for legislation (e.g., amendments to the retirement law in Chapter 33), they are dependent upon the legislature to acquiesce to that call. In other words, terms in a collective bargaining agreement that are inconsistent with current law become effective only if the legislature amends the applicable law. *Id.* at 220-21.

⁶ Similarly, the Council created a trust in 2008 to fund retiree health benefits under County Code Section 33-159 in order to benefit from new accounting rules. The County was not required to create the trust, nor is the County required to fund the trust.

⁷ The County Executive is free to recommend a budget to the Council that is in the public's best interest even if the recommendation is does not fully fund a collective bargaining agreement.

For retirees with retiree health benefits set forth in a collective bargaining agreement (presently only the FOP), even if that agreement provides interests protected by the Contract Clause, those interests are limited to cost sharing and/or eligibility because those are the only topics addressed in the FOP collective bargaining agreement. The Council faces no barrier to modifying other aspects of retiree health care. And even with regard to modifying cost sharing and/or eligibility, there is a persuasive argument (with which we concur) that retirees can not rely on benefits beyond the current fiscal year because, as noted above, the collective bargaining agreements are subject to annual appropriation by the Council.

Even if certain retirees/employees have an interest in health benefits protected by the Contract Clause due to the resolutions and collective bargaining agreements, as described in the retirement section of this memo, the Council has the legislative power to make necessary and reasonable modifications when justified as described previously under the contract clause analysis. If the Resolutions and collective bargaining agreements could be viewed as a contract, the issue becomes whether any proposed change substantially impairs that contract or whether it reasonably modifies that contract. In addition, the retirees and employees not covered by the collective bargaining agreement would need to prove that they continued to work in exchange for or in reliance of this promise and there would need to be an analysis of the expectations of the promise to determine if there was any substantial impairment of the contract because of changes. Finally, neither the Resolutions nor the collective bargaining agreement clearly state an indication to enter into a binding contract.

C. Salaries

Neither the Contract Clause, nor the collective bargaining agreements themselves, prohibit the imposition of a furlough or reduction-in-force (RIF), whether imposed in the midst of a fiscal year or planned for a future fiscal year, as was done for FY 11. The County Executive may impose a mid-year furlough or RIF because he retains management rights under the collective bargaining laws permitting the imposition of furloughs or RIF's (under certain circumstances). The collective bargaining laws provide that these management rights are a part of every collective bargaining agreement. Thus, the imposition of a mid-year furlough or RIF (under conditions specified in the contract) does not violate the collective bargaining agreement and, accordingly, could not violate the Contract Clause.⁸ *Fraternal Order of Police Lodge No. 89 v. Canales*, 608 F.3d 183 (4th Cir. 2010) (imposition of furloughs during fiscal year did not violate Contract Clause because relevant collective bargaining laws provided that management right to impose furloughs must be read into every collective bargaining agreement). For the same

⁸ The County Executive has an obligation under the Council's collective bargaining laws to negotiate furlough and RIF procedures and a union could grieve that County's failure to follow those procedures in the imposition of a furlough or RIF. In addition, unless the Council provides otherwise in imposing a furlough or RIF, language in a collective bargaining agreement may impede the Executive's ability to implement a Council-planned furlough or RIF, including the realization of anticipated monetary savings underlying the furlough or RIF.

Karen Orlansky
October 28, 2010
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reasons, a furlough or RIF planned for a future fiscal year does not violate the Contract Clause. In addition, because the Council appropriates salaries on an annual basis (even where a collective bargaining agreement spans more than one fiscal year), a planned furlough or RIF cannot be a retroactive impairment of any collective bargaining agreement.

As noted above, Charter Section 311 restricts the Council from making expenditures beyond funds appropriated. Each year the Council makes appropriations of employee compensation and benefits, including health benefits. Even though a collective bargaining agreement may span more than one year, the collective bargaining laws provide that the Council's appropriation decision is made on a year-by-year basis, as part of the annual operating budget resolution. See §§ 33-80 (FOP), 33-108 (MCGEO), and 33-153 (IAFF).

Similarly, the same logic allows the Council to impose salary reductions for a future fiscal year. But, salary reductions in the midst of a fiscal year would likely be a substantial retroactive impairment of the collective bargaining agreements, permissible only if the reduction was reasonable and necessary to serve an important public purpose.

cc: Timothy Firestine, CAO
Joseph Adler, Director, OHR
Kathleen Boucher, Assistant CAO
Robert Drummer, Senior Legislative Attorney

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Resolution No.: 17-163
Introduced: May 26, 2011
Adopted: June 14, 2011

**COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND**

By: County Council

SUBJECT: County Policy on Group Insurance Benefits for Retired County Employees

Background

1. On October 16, 1986, the County Council adopted Resolution No. 10-2233. That resolution established the Council's policy for insurance benefits for retired County employees, which applied to any employee hired on or after January 1, 1987. The resolution included the following cost-sharing formula for retiree health insurance:
 - 50% County/50% retiree for each employee with 5 years of plan participation as an active employee;
 - for each additional year above 5, the County's share was increased two percentage points up to a maximum County share of 70%.
2. On November 23, 1999, the Council adopted Resolution No 14-348. That resolution issued policy guidance regarding group insurance benefits. The resolution stated that all County agencies should link eligibility and cost-sharing decisions regarding retiree group insurance benefits to years of service, rather than the number of years of plan participation.
3. The 2011 County Government Group Insurance Summary Description lists the following requirements for a retired employee to be eligible for group insurance benefits:
 - If an employee is a member of the optional or integrated plan under the Employees' Retirement System and retires under normal, early, disability or discontinued service retirement, the employee is eligible for group insurance benefits.
 - If an employee is a member of the Elected Officials' Plan, the Retirement Savings Plan, or the Guaranteed Retirement Income Plan, the employee is eligible for group insurance when the employee separates from County service if the employee's age and credited service under a County Retirement Plan at the time of separation from service meet the following requirements:

If you belong to Group:	And you have credited service of at least:	And your age is at least:
RN, RM RC; or CN, CM, CC, CZ; or ZK	5 years	60
	15 years	50
	20 years	45
RP, CP – Police, Corrections, Sheriffs	15 years	45
	20 years	41
RP, CP – Fire	20 years	Any age

- If an employee qualifies for a disability benefit and does not meet the minimum age and credited service criteria in the preceding table, the employee is eligible for group insurance continuation as follows:
 - If the disability is non-service connected, the employee is eligible for group insurance benefits for the duration of the initial and continued disability if the employee had 5 years of credited service before becoming disabled.
 - If the disability is service-connected, the employee is eligible for group insurance benefits for the duration of the initial and continued disability.

- 4. The 2011 County Government Group Insurance Summary Description contains the following description of the cost share arrangement for retired employees:
 - The cost share arrangement for each eligible employee hired after December 31, 1986 for medical, dental, discount vision, standard option prescription, term life, and dependent life insurance is:
 - 50% County/50% retiree for each employee with 5 years of eligibility under the group insurance plan as an active employee;
 - 70% County/30% retiree for each employee with 15 or more years of eligibility under the group insurance plan as an active employee;
 - For each year between 5 and 15 years that the employee is eligible under the group insurance plan as an active employee, the County's share increases 2%.

 - At the time of retirement, each employee hired before January 1, 1987 may choose between the cost share arrangement for employees hired after December 1, 1986 or an 80% County contribution for medical, dental, discount vision, standard option prescription, term life, and dependent life insurance, effective for the period of time after retirement equal to the number of years the employee is eligible under the group insurance plan, beginning from the employee's retirement date. After this time period expires, the retiree must pay 100% of the group insurance costs.

 - Each retiree (regardless of when the retiree was hired) must pay a higher cost share of the plan cost if the retiree enrolls in the high option prescription plan.

 - Regardless of an employee's cost sharing arrangement, at age 65 a retiree's term life insurance becomes 100% County paid. Also, if an employee retires on a

disability, the employee's term life insurance is 100% County paid until the employee reaches the normal retirement date. From that time until age 65, the cost sharing arrangement in effect for that employee's other benefits apply to the cost of term life insurance if the employee is eligible for term life insurance at the time of the disability. If the employee had not met the special eligibility requirements for term life insurance at the time of the disability, the term life coverage ends at the employee's normal retirement date.

- If an employee retires on a service-connected disability either under the Employees' Retirement System, the Elected Officials' Plan, the Retirement Savings Plan, or the Guaranteed Retirement Income Plan, to calculate the employee's cost share, 5 years must be added to the employee's years of eligibility under the group insurance plan.
5. The 2011 County Government Group Insurance Summary Description contains the following provision:

The County expects to continue the Plan, but it is the County's position that there is no implied contract between employees and the County to do so, and reserves the right at any time and for any reason to amend or terminate the Plan, subject to the County's collective bargaining agreements.

The Plan may also be amended by the County at any time, either prospectively or retroactively, to conform with the Internal Revenue Code.

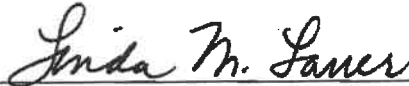
Action

The County Council for Montgomery County, Maryland approves the following resolution:

1. With regard to retiree group insurance benefits for any employee hired or rehired as a permanent employee on or after July 1, 2011, the Council's policy is:
 - Each employee hired or rehired as a permanent employee on or after July 1, 2011, including any employee awarded a non-service connected disability, and who is a member of a County retirement plan must have at least 10 years of County service to be eligible for group insurance continuation when the employee leaves County service. All other eligibility criteria remain the same as applied before that date.
 - The cost-sharing formula for each employee hired or rehired as a permanent employee on or after July 1, 2011, for medical, dental, discount vision, standard option prescription, basic life, and dependent life insurance (\$2,000/\$1,000/\$100 tier), is:
 - 50% County/50% retiree for each retiree with 10 years of eligibility under the group insurance plan as an active employee;

- 70% County/30% retiree for each retiree with 25 or more years of eligibility under the group insurance plan as an active employee; and
 - for each year between 10 and 25 years that the employee is eligible under the group insurance plan as an active employee, the County's share must increase 1.33 percentage points to the maximum County share of 70%.
- If an employee retires on a service-connected disability under the Employees' Retirement System, the Elected Officials' Plan, the Retirement Savings Plan, or the Guaranteed Retirement Income Plan, and the employee does not have 10 years of eligibility under the group insurance plan, for group insurance eligibility and cost-sharing purposes the employee must be treated as having 10 years of County service.
2. Any other retiree group insurance benefit provision that applies to all or some employees hired before July 1, 2011, or that applies to an employee regardless of when the employee was hired, is not affected by this resolution.
 3. The Council recognizes the County Executive's authority at any time and for any lawful reason to amend or terminate the County's group insurance benefits and policies for retired employees. However, any material change in any part of this resolution or its application to any retired or active employee or group of employees, including any premium holiday or other waiver of premiums for County-provided health or life insurance, is subject to Council approval.

This is a correct copy of Council action.


Linda M. Lauer, Clerk of the Council

S&P Global

Date: 06/28/2018

Publisher: Montgomery County Council
Address: Council Office Building, 100 Maryland Avenue, 4th Floor, Rockville, MD 20850
Attention: Aron Trombka

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Date: Jan 03, 2011

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Name: Hassan Khan
Title: Manager, Client Services

AGREED TO AND ACCEPTED BY:

By: Aron Trombka
Name: Aron Trombka
Title: Senior Legislative Analyst

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