GO COMMITTEE #1
September 12, 2019
Worksession

MEMORANDUM

September 9, 2019

TO: Government Operations and Fiscal Policy (GO) Committee

FROM: Craig Howard, Senior Legislative Analyst CH
Aron Trombka, Senior Legislative Analyst, OLO AT

SUBJECT: **OLO Report 2019-11: Cost of Retiree Health Benefits (OPEB)**

PURPOSE: To receive briefing and have discussion

Expected Attendees:

- Rich Madaleno, Director, Office of Management and Budget
- Linda Herman, Executive Director, Montgomery County Employee Retirement Plans
- Corey Orlosky, Office of Management and Budget

Background

On July 30, 2019, the Council released Office of Legislative Oversight (OLO) Report 2019-11: Cost of Retiree Health Benefits (OPEB). The term OPEB refers to Other Post-Employment Benefits, primarily retiree health care benefits. This report responds to the Council's request for a comprehensive understanding of current and projected OPEB costs, and identification of possible strategies to control the growth of these costs.

Councilmembers should bring a copy of Report 2019-11 to the Committee meeting.

OLO Report 2019-11 is available online at:

https://www.montgomerycountymd.gov/OLO/Resources/Files/2019%20Reports/OLOReport2019-11.pdf

Report Summary

OLO Report 2019-11 contains detailed data and information on: retiree health benefits offered by county agencies, OPEB budget and fiscal considerations, OPEB funding from FY08-FY20, an analysis of County Government retiree enrollment and costs, a comparison of County OPEB liabilities with other jurisdictions, and information on OPEB cost control measures implemented in other jurisdictions.

Staff will present a summary of the report to the Committee; an executive summary detailing the report's key findings and recommendations is included on pages 3-4. The worksession will provide an opportunity for the Committee to have an initial discussion on the information included in the report with OLO/Council staff and Executive Branch representatives.

Recommendations and Potential Next Steps

Based on the findings of OLO Report 2019-11, staff offers four recommendations for Council consideration as summarized on page 4. Staff notes that these recommendations are focused on Montgomery County Government, but the Council could also encourage the governing bodies of the other tax supported agencies to review and consider these recommendations as well.

As evidenced in the report, OPEB is a very complex issue with many different components, stakeholders, and considerations. Moving forward with any of the report's recommendations will require additional work by Council and Executive Branch staff before any final decisions are made. As part of the Committee's initial review of the report, staff will also suggest potential next steps and timeframes associated with each recommendation.

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.