

November 20, 2015

**TO:** Each Member  
Board of Retirement  
Board of Investments

**FROM:** Each Member, Operations Oversight Committee  
Joseph Kelly, Chair  
Yves Chery, Vice Chair  
Anthony Bravo  
Ronald Okum  
David Muir, Alternate

**FOR:** Board of Retirement Meeting of December 2, 2015  
Board of Investments Meeting of December 9, 2015

**SUBJECT: LACERA Other Post-Employment Benefits (OPEB) Funding Policy**

### **RECOMMENDATION**

Adopt the LACERA OPEB Funding Policy, which would allow LACERA, as an independent entity, to begin pre-funding its share of the Retiree Healthcare Program's liability for its employees.

### **EXECUTIVE SUMMARY**

The June 30, 2015 LACERA Chief Executive Officer's Report communicated to your Boards that when the County adopted their budget on June 22, 2015, the budget included a dedicated funding promise for Los Angeles County's (County's) unfunded Retiree Healthcare Program liability (also known as the OPEB liability). Specifically, the County will: (1) continue to pay for the Retiree Healthcare Program on a pay-as-you-go basis, which is approximately \$500 million annually; and (2) make gradually increasing additional annual contributions to the OPEB Trust Fund until the County is paying an amount that will sustain the Program on a pre-funding basis.

Similar to the County, LACERA also operates on a pay-as-you-go basis for our Retiree Healthcare Program's costs and has the opportunity to participate with the County in this OPEB liability pre-funding arrangement. In addition, LACERA may decide to pre-fund LACERA's portion of the future obligations independent of the County's funding stream. A Board-approved funding policy would allow LACERA to commit to reducing the OPEB liability for our retired workers.

### **BACKGROUND**

Since the County-sponsored Retiree Healthcare Program was established in 1971, LACERA, as an independent entity from the County, has consistently mirrored the County's generally accepted financing plan related to the OPEB liability. Thus, LACERA has essentially participated in any reference in this memo regarding the County's efforts to reduce the OPEB liability. Under the OPEB Trust, LACERA is defined as a "Contributing Employer" and separate accounts are maintained for the contributions and expense obligations of the County and LACERA.

The current funding mechanism the County practices for Retiree Healthcare Program's costs is essentially a "pay-as-you-go" system, which means that the County pays for current year retiree health

expenses as they become due. As of the latest July 1, 2014 actuarial valuation, this funding method has caused an accumulation of an unfunded Actuarial Accrued Liability for OPEB valued at \$27 billion. Additional employer groups participating in the OPEB Program who share a portion of the liability include Firefighters' Local 1014, Superior Court and South Coast Air Quality Management District. LACERA's portion of the liability is approximately \$98 million.<sup>1</sup>

The County has been looking at ways to reduce the Retiree Healthcare Program's costs and future liability, and move towards a "pre-funding" model. It has successfully taken steps to mitigate the increasing cost of the OPEB liability; for instance, establishing an OPEB Trust Fund for the primary purpose of holding and investing assets to fund the Retiree Healthcare Program; and creating a new retiree health insurance program structure for new County employees hired after June 30, 2014 and eligible for LACERA membership. The LACERA Board of Retirement, as the Retiree Healthcare Program administrator, has also successfully implemented several cost-saving strategies for the Program over the years, including: Medicare advantage plans; mail order pharmacy; federal reimbursement programs; and coordinated care.

## FUNDING

The County's 2015 budget-approved pre-funding plan addresses the County's portion of the OPEB liabilities and utilizes a multi-year strategy to phase in the pre-funding portion of the retiree healthcare benefits while continuing to make the pay-as-you-go contributions. Consistent with past practices, Staff believes it is in LACERA's best interest to join the County in pre-funding its portion of OPEB liabilities.

The County allocates costs using an active employee methodology to determine LACERA's pro-rata share of the costs, which are billed to LACERA on a monthly basis just like County departments. LACERA's current annual pay-as-you-go contribution is \$2 million, which is paid through our administrative operating budget and approved by both governing LACERA Boards.

In the table below is the County's initial estimate of LACERA's pre-funding portion of the Retiree Healthcare unfunded liability. It uses a multi-year approach to increase the LACERA retiree health payment each year in a consistent manner. Future pre-funding amounts will also be determined by the County. Staff also provided data on the financial impact, on a percentage basis, of the pre-funding contributions using the latest Fiscal Year 2015-2016 LACERA operating budget of \$73 million.

Fiscal Year	LACERA Pre-Funding Contribution	Percentage of FY 2015-16 LACERA Budget
2015-16	\$91,000	0.12%
2016-17	228,000	0.31%
2017-18	456,000	0.62%
2018-19	684,000	0.94%
2019-20	912,000	1.25%
2020-21	1,140,000	1.56%

<sup>1</sup> Estimate calculated by LACERA staff. The Actuarial Accrued Liability will be calculated by Consulting Actuary and presented in the July 1, 2016 Actuarial Valuation report.

The financial impact of pre-funding LACERA OPEB benefits is minimal. LACERA's participation in the County's initiative is critical in reducing the unfunded liability associated with the retiree healthcare benefits by pre-funding this benefit.

The attached OPEB Program Funding Policy is intended to provide LACERA with the ability to pre-fund retiree healthcare benefits when the County chooses to do so, and allow LACERA pre-fund its portion of the liability separately. LACERA is not legally obligated, under the Trust or otherwise, to match the County's funding practices, but such a course of action, which has been followed in the past, continues to seem prudent to reduce LACERA's share of the unfunded liability and to facilitate LACERA's administrative responsibilities for the OPEB Program. The Policy guides future funding actions and will ensure the security of the Retiree Healthcare Benefits for LACERA employees.

### **CONCLUSION**

The County prudently established an OPEB Trust Fund to pre-fund its OPEB liability. During its most recent budget cycle, the Board of Supervisors approved a mechanism to continue the pre-funding effort by providing a steady stream of increasing contributions to the OPEB Trust over a multi-year plan. The proposed plan includes the opportunity for LACERA, as an independent entity, to participate with the County and pre-fund its portion of the OPEB liability. In addition, LACERA may provide a funding stream that is distinct from the County. Establishing the proposed OPEB Funding Policy will enhance LACERA's commitment to providing Retiree Healthcare benefits and help reduce LACERA's unfunded liability for these benefits.

**IT IS, THEREFORE, RECOMMENDED THAT YOUR BOARDS** adopt the LACERA OPEB Funding Policy, which would allow LACERA, as an independent entity, to begin pre-funding its share of the Retiree Healthcare Program's liability for its employees.

**Los Angeles County Employees Retirement Association  
Other Post-employment Benefits (OPEB) Program – Funding Policy**

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**Funding Goal**

The Other Post-employment Benefits (OPEB) Program Funding Policy establishes the funding process the Board of Retirement and Board of Investments would like the Los Angeles County Employees Retirement Association (LACERA) to follow as a participating entity in the OPEB Program.

The primary objective is to provide post-employment benefits through the OPEB Program, which include Retiree Healthcare Benefits, dental and burial allowance, for LACERA retirees and to reduce LACERA's portion of the OPEB Actuarial Accrued Liability (AAL).

The Funded Ratio is the measurement of Valuation Assets to the AAL. When the assets available for funding equal the AAL, the OPEB Program is considered fully funded with a Funded Ratio of 100%. Assets in excess of those needed to reach 100% funding are considered excess funds for funding purposes. A Funded Ratio equal to 100% is the Funding Goal.

**Funding Policy**

LACERA establishes and operates with its own distinct budget, as an independent entity from Los Angeles County (County). LACERA retirees receive healthcare and other post-employment benefits through the OPEB Program, which is sponsored by the County and administered by LACERA.

Similar to the County, LACERA funds the Program monthly on a pay-as-you-go basis through the OPEB Agency Fund. The OPEB Trust contains assets contributed by the County and LACERA which have been set aside for future use. These assets are accounted for separately and owned by each agency.

LACERA intends to provide its proportionate share of funding when the County executes pre-funding arrangements, ramp-up contributions, or additional budget allocations. LACERA may budget for and provide a funding stream that is separate and distinct from the County, which satisfies the liability allocated to LACERA.

**Implementation**

LACERA's annual administrative budget includes an allocation for the pay-as-you-go Program costs.

When the County provides a pre-funding stream, LACERA will fund its pro-rata share of the Program contributions. The contribution frequency and amount are calculated by the County, reviewed by staff and presented in LACERA's annual administrative budget for the Boards' approval.

LACERA's governing Boards, may, at any time, decide to pre-fund LACERA's portion of the future obligations independent of the County's funding stream. The contribution frequency is determined and amounts are calculated by LACERA staff, and presented in LACERA's annual administrative budget for the Boards' review and approval.

**Los Angeles County Employees Retirement Association  
Other Post-employment Benefits (OPEB) Program – Funding Policy**

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**Valuation Cycle**

At least every two years, LACERA shall engage the services of an actuary to conduct a valuation of plan liabilities and assets to measure the funding progress of the Program. Every third year, the actuary shall conduct an investigation of experience to measure the effectiveness of plan assumptions, valuation methodology, and to identify trends. Upon request, the actuary may provide calculations specific to each participating entity in the OPEB Program. The Board of Retirement shall review the results of the valuation and experience study.

Any changes to actuarial assumptions and methodology as provided for in actuarial standards or financial statement reporting standards will be implemented.

**Amendments**

Amendments and exceptions to this Policy may be made from time to time with approval by the LACERA Board of Retirement and Board of Investments.