LACERS
LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM
Securing Your Tomorrows

August 28, 2014

The Honorable Members of City Council
c/o City Clerk's Office
200 N. Spring Street, Room 395
Los Angeles, CA 90012

SUBJECT: RETIREE MEDICAL SUBSIDY FOR PLAN YEAR 2015

Dear Councilmembers:

The Board of Administration of the Los Angeles City Employees' Retirement System (Board) requests that the Council adopt an increase in the retiree medical subsidy of 7.93% for plan year 2015 pursuant to its authority as contained in Los Angeles Administrative Code (LAAC) Section 4.1111(b) (Enclosure 1).

On August 12, 2014, our Board voted unanimously to increase the 2015 Tier 1 *Discretionary Retired Member* maximum monthly subsidy by 7.93%, from $1,464.00 to $1,580.08. Based on the application of the LAAC section cited above, any increase in the 2015 maximum medical subsidy above 3.50% that is approved by our Board requires City Council approval. Our Board's decision was based on several factors:

- Foremost, our Board perceived a potential inequity between groups of Retired Members if the 7.93% increase is not approved by Council. The individuals in the *Discretionary Retired Member* group retired prior to July 1, 2011 and, therefore, were never afforded the opportunity to pay additional contributions to receive vested increases to their maximum subsidies (as the *Vested Retired Members* did). We estimate that more than 1,500 Retired Members will be adversely impacted in the coming calendar year if the full 7.93% increase is not approved. More than half of those 1,500 Members had at least 25 years of Service and, therefore, were career City employees. Currently, 98.7% of all Active Members pay additional contributions to vest increases to their maximum subsidies. If that same 98.7% rate is applied to the 1,500 Retirees that will be adversely impacted, 1,480 would have vested the subsidy increases.
- The increase in the subsidy would meet the City's historical goal of fully subsidizing two party coverage for at least one health maintenance organization

(HMO) plan for retirees eligible for the maximum subsidy, (retirees with 25 or more years of service at retirement)..." as stated in former CAO William T Fujioka's January 7, 2002 report (Enclosure 2). To date, since the adoption of the retiree medical subsidy, the City always has subsidized to this level.

- There will be no additional out-of-pocket cost to the City than was already anticipated for providing the maximum subsidy increase. In fact, there will be a slight actuarial gain as the increase is lower than was anticipated. The 7.93% increase already was factored into the City's contribution rate for the upcoming fiscal years, as the assumed actuarial medical trend rate currently is 8.0%.

- Over the last ten years (2005–2014), LACERS' maximum subsidy has increased by an average of 5.28% and overall medical plan premium costs have increased by an average of 4.01%, compared to the average trend rate of 10.01% for the same period. This has resulted in significant actuarial gains and, therefore, cost savings for the City.

Pursuant to the LAAC, three categories of LACERS retirees exist in terms of health benefits:

- *Capped Retired Members* – The Members in this group retired on or after July 1, 2011 and belonged to bargaining groups that elected to not pay the additional retirement contributions in order to receive vested increases to their maximum medical plan premium subsidies (maximum subsidies). These Members have maximum subsidies that are capped at the 2011 maximum subsidy amount of $1,190.00 per month. This subsidy is set by City Ordinance and does not require Board action.

- *Vested Retired Members* – The Members in this group retired on or after July 1, 2011 and belonged to bargaining groups that elected to pay the additional retirement contributions to receive vested increases to their maximum subsidies. These Members are entitled to maximum subsidy increases that are not less than the increases in the Kaiser Permanente HMO two-party premium. The premium increase for 2015 will be $116.08, or 7.93%, which will increase the maximum subsidy from $1,464.00 to $1,580.08 per month. This subsidy increase is established by City Ordinance, but must be set by Board Resolution. On July 22, 2014 LACERS Board adopted the plan year 2015 maximum subsidy amount of $1,580.08 for this group.

- *Discretionary Retired Members* – The Members in this group retired prior to July 1, 2011 and, therefore, were never afforded the opportunity to pay additional contributions to receive vested increases to their maximum subsidies (as the Vested Retired Members did). These Members are entitled to maximum subsidy increases that typically are established by Board resolution; however, the LAAC provides the Council authority to adopt increases pursuant to LAAC Section

4.1111(b). **It is the Members in this group that will be impacted by the Council's decision regarding the subsidy increase.**

Our Board takes its fiscal responsibility to the City very seriously. Our overall health benefit plan increases for 2015 are just 4.8%, compared with the medical trend rate of 8.0%. Based on a recent RFP, LACERS dental premium costs will be reduced by 3.5% in 2015 with a four-year rate guarantee, which will result in savings of $1.4 million. It also is likely that there will be a reduction in our vision premium costs for the coming years.

Due to the potential inequity we perceive in regard to the maximum health subsidy and the historical goal as stated by the CAO to fully subsidize two party coverage for at least one HMO, we request your approval of the 7.93% increase in the maximum health subsidy for plan year 2015. A copy of the actuarial report required by LAAC Section 4.1111(b) is enclosed (Enclosure 3).

If you have any questions regarding this correspondence, please contact Tom Moutes, LACERS General Manager, at (213) 473-7280.

Sincerely,

Jaime L. Lee, President
LACERS Board of Administration

JLL:TM:bc
2014-0814-022

Enclosures

c: Eric Garcetti, Mayor
Paul Krekorian, Chair, Budget & Finance Committee
Paul Koretz, Chair. Personnel & Animal Welfare Committee
Gerry Miller, CLA
Miguel Santana, CAO
LACERS Board of Administration

ENCLOSURE 1

Los Angeles Administrative Code Section 4.1111(b):

(b) The maximum monthly medical plan premium subsidy for retired employees is $1,190.00. Beginning July 1, 2011, the Board, in its discretion, may change, by resolution, the maximum monthly amount of the medical plan premium subsidy provided to employees retired on or before June 30, 2011, so long as any increase:

(1) Does not exceed the dollar increase in the Kaiser two-party non-Medicare Part A and B premium; and

(2) The average percentage increase for the first year of the increase and the preceding two (2) years does not exceed the average assumed actuarial medical trend rates for the same period.

Any change made by the Board that exceeds the limits set forth in (b)(1) or (b)(2) herein must be submitted for Council review accompanied by an actuarial report (emphasis added). Any increases that are not acted upon by the Council within thirty (30) days after receipt of the report to Council for consideration of the increase are deemed approved. Should the Council reject the subsidy set by the Board, the Council shall determine the amount, if any, by which the subsidy shall be increased and shall adopt such change by resolution.

ENCLOSURE 2

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: January 7, 2002

CAO File No. 0420-00547-0003W
Council File No. 97-0871
Council District:

To: The Council

From: William T Fujioka, City Administrative Officer

Reference: Correspondence from the Los Angeles City Employees' Retirement System

Subject: **REQUEST TO INCREASE THE MAXIMUM MONTHLY HEALTH SUBSIDY FOR RETIRED CIVILIAN EMPLOYEES**

SUMMARY

The Board of Administration for the Los Angeles City Employees' Retirement System (LACERS) has requested an increase in the maximum monthly health subsidy for retirees. The maximum monthly health subsidy is currently $702; the Board recommends an increase of $49 (7%) to $751. LACERS' indicates the increase is needed to minimize the number of retirees who will have to have deductions taken for their health coverage. In addition, the increase will help mitigate the effect of cost containment features being implemented on January 1, 2002 that will increase copayments for prescription drugs (from $5 to $10) and emergency room visits (from $10 to $35).

The existing subsidy level of $702 per month meets the City's historical goal of fully subsidizing two party coverage for at least one health maintenance organization (HMO) plan for retirees eligible for the maximum subsidy, (retirees with 25 or more years of service at retirement), and covers the premium increases for 2002 for all of the HMO plans for retirees enrolled in single or two party coverage. Unlike actives, it has not been considered a policy to subsidize retirees who have family coverage.

Prior to 1999, the subsidy did not cover the premiums for the more expensive Preferred Provider Plans (PPO's), nor did it cover family coverage in any of the plans. Since the 38% increase in 2000, single party coverage has been subsidized in the PPO as well as family coverage for some of the HMO plans. LACERS wants to continue to subsidize at this higher level. Without the proposed increase, 22% of the 2,506 retirees eligible for the maximum subsidy would have out-of-pocket expenses of $65-76 per month to cover their families or $47 per month if they have single party PPO coverage. The proposed $49 increase would pick up all of the increased cost for the single party PPO enrollees and a significant portion of the family premium for the HMO plans.

Although LACERS indicates some of its neediest retirees will experience a cost increase, it is because the subsidy is prorated based upon years of service and many retirees are not eligible for the full $702 per month maximum. However, some of these retirees who did not serve a full career with the City may have coverage from other employers.

The maximum subsidy for active employees is $524 and covers the premiums for all HMO plans and single party coverage for the PPO plan. Employees enrolled in the PPO plans with two party or family coverage have payroll deductions.

The current LACERS subsidy significantly exceeds that provided to the City's sworn retirees, DWP retirees and all retirees covered under the PERS plan for State employees. It is less than the County's maximum subsidy and less than that for a very few local agencies covered by PERS. (See Table 1)

Retirees who have moved out of the area and are not eligible to enroll in LACERS sponsored HMO plans are eligible to receive a cash amount equivalent to the maximum subsidy to purchase coverage available in their area.

Although the system actuary indicates there is no cost associated with the increase proposed for the next year because it is less than the assumed increase for health care cost of 8.25%, it is relevant to consider that the City's contribution continues for the large increase that the Board approved for 2000. This amount does affect the City's total budgeted contribution to LACERS.

Therefore, in view of the year 2000 increase, the subsidy levels of active City employees and retirees of other agencies, the full $49 requested by LACERS is not recommended. An increase of $10 is recommended to mitigate the impact of the increase in the prescription drug copayment provision that will affect all retirees.

RECOMMENDATION

That the Council approve a $10 increase in the maximum health subsidy for retired members of the Los Angeles City Employees' Retirement System.

FISCAL IMPACT STATEMENT

According to the System's actuary, there is no additional cost.

WTF:SC:ss

Attachment

ERD01675

Segal Consulting

100 Montgomery Street Suite 500 San Francisco, CA 94104-4308
T 415.263.8200 www.segalco.com

VIA E-MAIL AND USPS

September 2, 2014

Mr. Tom Moutes
General Manager
Los Angeles City Employees' Retirement System
202 West First Street, Suite 500
Los Angeles, CA 90012-4401

Re: LACERS – Actuarial Analysis of the Updated 2015 Maximum Medical Plan Premium Subsidy as Recommended by the Board

Dear Tom:

This letter updates the results of our study dated August 8, 2014 to include three changes.

The first change is based on LACERS' request to apply a 7.93% increase in the maximum medical plan premium subsidy for 2015 (an adjustment from the 8.10% used in our August 8 study) finalized to reflect a 7.95%[1] increase in the 2015 premium for Kaiser non-Medicare A and B retirees.

The second change is based on including an additional 80 retirees subsequently identified by LACERS as being impacted by the Board's premium subsidy increase recommendation but who had not been included in the data for the earlier study. These include retirees over age 65 with Medicare Part B only and retirees under age 65 enrolled in the Medical Premium Reimbursement Program (MPRP).

The third change is based on a change to the program Segal originally used to determine the reduction in the liability associated with granting a 3.5% versus the then applicable 8.1% subsidy increase. In developing the original reduction in liability associated with a 3.5% increase in maximum subsidy for 2015, we had also applied the 3.5% as the level of projected increase in the 2015 medical premiums. Upon review, we have determined that the 2015 medical premium increase assumption should be the current medical trend assumption of 8.0%.

[1] The subsidy increase percentage is slightly different from the premium increase percentage because to calculate the 7.93% subsidy increase, the dollar premium increase of $116.08 (7.95% of the 2014 Kaiser 2-party premium of $1,459.66) was divided by the 2014 maximum subsidy of $1,464.00.

In our earlier results, we had applied the 3.5% trend to the maximum subsidy increase and to the medical premium increases. We have corrected the methodology used and applied the 3.5% trend to only the maximum subsidy increase and applied the 8.0% trend to the medical premium increases.

Actuarial Analysis

As requested, we have undertaken the study to evaluate the cost impact that would result if the City adopts a recommendation to increase the 2015 Tier 1 Discretionary Retired Member's maximum monthly medical plan premium subsidy by 7.93%, from $1,464.00 to $1,580.08. As discussed below, this action would result in a net actuarial gain of $0.1 million[2], which would result in a net decrease in contribution rate of 0.0005% of payroll.

Background

LACERS administers two tiers of retirement and health benefits. Tier 1 benefits are available to City employees who were hired prior to July 1, 2013. Under Tier 1, there are three categories of Retired Members classified according to the level of medical premium subsidy they are entitled to:

1) Capped – these Retired Members retired on or after July 1, 2011 and did not make any additional contributions to LACERS;

2) Vested – these Retired Members retired on or after July 1, 2011 and did make additional contributions to LACERS; and

3) Discretionary – these Retired Members retired on or before June 30, 2011.

For Tier 1 Capped Retired Members, the maximum medical plan premium subsidy is capped at the maximum medical plan premium subsidy of 2011. They are not eligible for subsidy increases above the amount of $1,190.00. This subsidy is set by City Ordinance and does not require Board action.

Tier 1 Vested Retired Members are entitled to an automatic increase in the maximum medical plan premium subsidy. This subsidy increase is established by City Ordinance, but must be set by Board Resolution.

Tier 1 Discretionary Retired Members are entitled to a maximum medical plan premium subsidy increase that is determined by the Board each year. The Board has the authority to increase the subsidy up to the amount of the increase in the Kaiser Permanente HMO two-party premium, subject to certain conditions as discussed below.

[2] This net actuarial gain is the result relative to the long term medical trend assumptions used in the valuation. We note that, as with any benefit increases, there will be an increase in cost as a result of a decision to increase the 2015 medical plan subsidy by 7.93% instead of 3.5%. As further discussed in the Methodology and Results sections of this letter, this cost increase is offset by the actuarial gain that will result if the subsidy increases by only 3.5%.

In this study, we have been asked by LACERS to evaluate the cost impact associated with providing an increase in the 2015 Tier 1 Discretionary Retired Member's maximum plan premium subsidy by 7.93%, from $1,464.00 to $1,580.08.

Process for Setting Discretionary Retiree Health Subsidy

The method that has been used by LACERS in determining the short-term (next year's) increase in the medical plan premium subsidy is provided in Section 4.1111 of the Administrative Code. In particular, Sec. 4.1111(b) of the Administrative Code states:

"The maximum monthly medical plan premium subsidy for retired employees is $1,190.00. Beginning July 1, 2011, the Board, in its discretion, may change, by resolution, the maximum monthly amount of the medical plan premium subsidy provided to employees retired on or before June 30, 2011, so long as any increase:

1) Does not exceed the dollar increase in the Kaiser two-party non-Medicare Part A and B premium; and

2) The average percentage increase for the first year of the increase and the preceding two (2) years does not exceed the average assumed actuarial medical trend rates for the same period.

Any change made by the Board that exceeds the limits set forth in (b)(1) or (b)(2) herein must be submitted for Council review accompanied by an actuarial report."

The table below shows the ten-year history (from 2005 to 2014) of Kaiser two-party non-Medicare Part A premiums. It is based on an extract from the July 22, 2014 report to the Board prepared by LACERS staff on behalf of the Benefits Committee (we have expanded the extract from that report to include the increase for 2015 as well as to realign the year for which the actuarial trend assumption should be applied).

Until recently, the three-year average of the actuarial trend assumption has exceeded the corresponding three-year average year-to-year Kaiser increase. Therefore, Section 4.1111(b)(2) has had no practical impact in the recent past and the actuarial trend assumption could be applied to set the increase without further conditions.

Year	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Year-to-Year Kaiser Increase	7.0%	5.2%	7.3%	3.9%	9.6%	0.3%	5.9%	0.0%	14.9%	7.1%	7.93%
Actuarial Trend Assumption	9.6%	12.0%	12.0%	12.0%	9.0%	9.0%	9.0%	10.0%	9.0%	8.5%	8.0%

For 2015, the Board is considering an increase to the maximum subsidy of 7.93%, but any increase above 3.5%[3] will require City Council approval. A 3.5% increase in the medical subsidy will increase the subsidy from $1,464.00 to $1,515.24, while a 7.93% increase in the medical subsidy will increase the subsidy from $1,464.00 to $1,580.08.

In preparing the contribution rates in the ongoing annual retiree health valuations, Segal has followed a practice of assuming that the subsidy for all Discretionary Members will increase at the rate of medical trend. We have not reflected the other potential limit in the Ordinance which references the average increase for the upcoming year under consideration and the actual increase for the preceding two years because our trend is intended to reflect overall experience in the long run.

In particular, with the practice that we have been following in the ongoing valuations, we have assumed that monthly medical premium subsidy will increase by 8.0% from 2014 to 2015 using the assumptions from the June 30, 2013 valuation. Again, it should be pointed out that the three-year average of the actuarial trend assumption has exceeded the corresponding three-year average year-to-year Kaiser increase from the last decade until the most recent three-year period.

Data

LACERS has provided us a data file with retired and deferred vested members[4] who will be affected by the subsidy level increase of 3.5% or 7.93%. The retirees include both non-Medicare A&B retirees and Medicare A&B retirees with more than single coverage. The subsidy level affects the latter group because the amount of subsidy applied toward the cost of dependent coverage cannot exceed the maximum amount of subsidy applied toward the cost of dependent coverage for a similarly situated non-Medicare A&B retiree.

The retirees also include Los Angeles City Attorneys Association ('LACAA', MOUs 29 and 31) who had previously been members of the Capped group. We understand that, following litigation and subsequent court order, they are now in the Discretionary group.[5]

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[3] In the report prepared by LACERS staff on behalf of the Benefits Administration Committee dated July 22, 2014, it was originally stated in that report that any increase above 2.0% will require City Council approval. LACERS subsequently revised that increase to 3.5% after we provided LACERS with clarifications on the alignment of the year for which the actuarial trend assumption should be applied.

[4] In the ongoing valuation as of June 30, 2013, deferred vested members who separated from employment prior to having a chance to make additional 4% contributions were valued in the Capped group. Subsequently to the date of the valuation a technical amendment enacted July 25, 2013 moved them into the Discretionary group and we will be reflecting the impact on cost from that reclassification in our June 30, 2014 valuation.

[5] In the ongoing valuation as of June 30, 2013, LACAA retirees had been classified as Capped in the valuation data. The court order reclassifying them as Discretionary was dated September 13, 2013 and we will be reflecting the impact on cost from that reclassification in our June 30, 2014 valuation.

We also received data for an additional 80 retirees subsequently identified as affected by LACERS' premium subsidy recommendation but who had not been included in the data for the earlier study. These include retirees over age 65 with Medicare Part B only and retirees under age 65 enrolled in the Medical Premium Reimbursement Program (MPRP).

Methodology

We first calculate the liability for the population using the assumptions and methods from the June 30, 2013 actuarial valuation ("Valuation Baseline"). We then remove the subsidy caps for deferred vesteds and the LACAA retirees ("Revised Baseline"). By comparing these two liabilities, we can isolate the effect of the technical amendment and court order, and exclude that from the subsidy increase impact.

Next, we calculate the liability with the maximum subsidy increased by the 7.93%, which requires City Council approval. We note that the 7.93% is very close to the 8.0% assumed increase from calendar year 2014 to 2015 that we assumed in our June 30, 2013 valuation. In other words, if the subsidy will be increased by 7.93%, the contribution rate calculated in the June 30, 2013 valuation (that will be updated in the upcoming June 30, 2014 valuation) will only slightly decrease. However, this slight increase may be further analyzed as the combined outcome of the two following events:

1) A 3.5% subsidy increase which would result in an actuarial gain and

2) Another increase to bring the total subsidy level for 2015 up 7.93% from 2014, which would offset most of the actuarial gain from (1) and would result in a small net actuarial gain.

In order to prepare the liabilities, we have assumed that all other actuarial experience would be those expected by the assumptions from our June 30, 2013 valuation, including other premiums increases. LACERS staff has notified us that average premium increases for all medical plans from 2014 to 2015 would be approximately 4.9%, or below the 8.0% assumption used in our June 30, 2013 valuation. Based on the 2015 premium renewals provided by LACERS most medical premiums increased less than the 8.0% projected in our June 30, 2013 valuation. For example, the premium for Kaiser Medicare A&B retirees only increased 4.0%. Everything else being equal, it is likely this overall favorable experience will lower the costs in our June 30, 2014 valuation.

Results as of June 30, 2014

The liability gain between the assumed 8.0% subsidy increase and the 3.5% subsidy increase is $11.3 million, which would produce a reduction in the contribution rate by 0.0489% of payroll (assuming contributions are prepaid on July 15).

Next, the liability change between the 3.5% subsidy increase and the 7.93% subsidy increase is $11.2 million, which would produce an increase in contribution rate by 0.0484% of payroll (assuming contributions are prepaid on July 15).

Taken together, the two changes in subsidy level results in a net actuarial gain of $0.1 million, which would produce a reduction in the contribution rate by 0.0005% of payroll (assuming contributions are prepaid on July 15).

Unless otherwise noted above, we have used the same methods and assumptions as in the June 30, 2013 actuarial valuation.

We are members of the American Academy of Actuaries and we meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion herein.

Please contact us with any comments or questions.

Sincerely,

Andy Yeung, ASA, MAAA, FCA, EA
Vice President and Associate Actuary

Paul Angelo, FSA, MAAA, FCA, EA
Senior Vice President and Actuary

Thomas Bergman, ASA, MAAA, EA
Assistant Actuary

TXB/gxk