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State Controller Yee Updates State Retiree Health Care Liability

SACRAMENTO—The state's cost for retiree health and dental benefits has grown to $76.68 billion, according to a report published today by State Controller Betty T. Yee. The liability represents the present-day cost to provide retiree health and dental benefits earned as of June 30, 2016 – one of the state's largest long-term debts.

The total liability grew $2.49 billion compared to the prior fiscal year, but the size of the increase was $1.45 billion less than estimated in last year's report. Health care claims did not grow as rapidly as expected, and changes in health care delivery helped to lower costs by $3.78 billion. Conversely, demographic shifts and changes in assumptions about long-term health trends added $2.33 billion to the liability.

These costs have increased dramatically over the past 15 years. In 2001, retiree health care costs accounted for 0.6 percent of the state General Fund budget. This year, they will total $1.92 billion, or about 1.5 percent of the budget (FY 16-17).

"One of the greatest fiscal challenges facing California is the mounting cost of providing health care benefits to public sector workers," said Controller Yee, the state's chief fiscal officer and a board member of CalPERS and CalSTRS. "Through collective bargaining, there is positive progress towards the long-term security and sustainability of retiree health benefits. Barring drastic cuts into other public spending, these changes will not happen overnight but, in time, our long-term liabilities will be paid down."

State pensions are prefunded with contributions from employees and the state, allowing investment returns to significantly reduce liabilities. By contrast, California has traditionally paid for retiree health benefits on a pay-as-you-go basis, covering costs as they come due. Governor Jerry Brown, in contract negotiations with public employee unions, is moving towards a prefunding approach to health benefits more like that used for public employee pension funds.

Under standards created by the Governmental Accounting Standards Board (GASB), state and local governments have been reporting the costs of retiree health care and Other Postemployment Benefits (OPEB) in notes to their financial statements. Starting next fiscal year (17-18), a new GASB standard requires state and local governments to report OPEB liabilities and expenses in their financial statements. Many, like California, are expected to report substantial liabilities for retiree health care and the annual expense, and OPEB liability amounts will likely become much more volatile.

Today's OPEB report provides estimates of California's obligation for retiree health and dental coverage based on different funding scenarios:

- The current pay-as-you-go policy results in a liability of $76.68 billion. The shortcomings of this method are evident. While the current fiscal year's budget sets aside $1.92 billion to cover just actual costs, a true accounting of existing and future costs would have required $5.77 billion.
- If the state shifted to fully prefunding future benefits, the liability for the current fiscal year would have been cut by 34 percent to $50.29 billion. To take advantage of the significant reduction in liability from fully prefunding, the state would have needed to contribute $4.11 billion in FY 2016-17, or $2.19 billion more than it budgeted.

In Governor Brown's contract negotiations, he has asked unions to agree to make contributions to retiree health costs. Approved by members last week, the proposed contract for state government's biggest union, SEIU 1000, would phase in payroll deductions for retiree health care over several years. Contract negotiations also have included extending the period to qualify for retiree health benefits and reducing the employer subsidy for retiree health coverage.

Even these incremental steps can meaningfully reduce the state's liability. For example, prefunding just 10 percent of the annual service cost, in excess of pay-as-you-go expenses, would increase current annual costs by $260 million but reduce the total unfunded liability over time by $3.37 billion. Prefunding 50 percent would cost $990 million more each year but ultimately result in savings of $13.52 billion in the unfunded liability.

Controller Yee noted that CalPERS, the nation's largest public pension fund and largest public employer purchaser of health benefits in California, offers an optional California Employers' Retiree Benefit Trust Fund to help employers fund retiree health benefits. More than 500 California public employers currently participate in the fund. Last year's state budget included a one-time allocation of $240 million to the trust fund. The state has approximately $400 million set aside in the prefunding trust fund to pay for future retiree health benefits. According to the California Department of Finance, by June 2018 the trust fund balance will more than double and approach $1 billion.

The actuarial report can be found on the Controller's website at www.sco.ca.gov.

As the chief fiscal officer of California, Controller Yee is responsible for accountability and disbursement of the state's financial resources. The Controller also safeguards many types of property until claimed by the rightful owners, and has independent auditing authority over government agencies that spend state funds. She is a member of numerous financing authorities, and fiscal and financial oversight entities including the Franchise Tax Board. She also serves on the boards for the nation's two largest public pension funds. Elected in 2014, Controller Yee is the tenth woman elected to a statewide office in California's history. Follow the Controller on Twitter at @CAController and on Facebook at California State Controller's Office.

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