COUNTY OF SAN MATEO
INTER-DEPARTMENTAL CORRESPONDENCE

April 22, 2003

To: Honorable Board of Supervisors

From: Sidney C. McCausland, Chief Executive Officer, *SamCERA*

Subject: Adoption of Medicare Part-B Premium Reimbursement 401(h) Reserve Contribution for Fiscal Year 2003-2004

RECOMMENDATION: The Board of Retirement recommends that the Board approve a Resolution adopting a Medicare Part-B Premium Reimbursement 401(h) Reserve Contribution for Fiscal Year 2003-2004.

BACKGROUND: 1,597 eligible SamCERA retirees, survivors and beneficiaries were receiving \$58.70 tax-exempt from SamCERA's Medicare Part-B Premium Reimbursement Program as of March 31st.

The federal Medicare program includes Medicare Part-B, which provides outpatient coverage. Individuals eligible for Medicare are required to pay a premium for Part-B coverage. The premium is deducted from their monthly Social Security benefit. On January 1,2003 the monthly premium increased from \$54 to \$58.70.

The reimbursement is paid in accordance with the specific provisions of Internal Revenue Code §401(h) & the '37 Act.

IRC§401(h) sets forth complex tax-exemption qualification rules for ad hoc benefits. In essence, IRC§401(h) mandates that the employer appropriate the funds for the tax-exempt benefit, but it also authorizes the Retirement Fund to reimburse the County for the cost of the benefit.

In the '37 Act, GC§31592.2 defines "excess earnings" as any earnings not credited to Reserves and authorizes the use of those "excess earnings" for the payment of ad hoc benefits. GC§31592.4 authorizes the use of "excess earnings" for IRC§401(h) benefits.

The Board of Supervisors and Board of Retirement jointly sponsor SamCERA's program.

On June 2, 1998, after extensive negotiations between the two boards, the Board of Supervisors adopted Resolution No. 61970 *[see page 4]* appropriating funds for the payment of Medicare Part-B Premium Reimbursements in conformance with the requirements of IRC§401(h).

Board of Retirement Resolution 97-98-11, as amended May 26, 1998, *[see page 6]* implemented the tax-exempt Medicare Part-B Premium Reimbursement Program in conformance with the requirements of IRC§401(h). Resolution 97-98-11 sets forth the specific Internal Revenue Code requirements to maintain the tax-exempt status of the benefit. So long as these IRC requirements are met, the premium reimbursement is not treated as reportable income.

DISCUSSION:

Fiscal Impact: SamCERA's actuary estimates that the cost for fiscal year 2003-2004 will be \$1,305,000. The actuary recommends that the Board appropriate \$1,435,000, which includes a 10% safety margin.

The IRC requires that the Medicare Part-B Premium reimbursement be appropriated by the Board of Supervisors in order to make the benefit exempt from taxation. However, the IRC also permits the Board of Retirement to offset the County's appropriation.

COST OF SamCERA'S MEDICARE PART-B PREMIUM REIMBURSEMENT PROGRAM

Fiscal Year	Medicare Part-B Premium at end of fiscal year		Total Reimbursed	
98/99	\$43.80	Increase	\$720,003	Increase
99/00	\$45.50	3.9%	\$765,447	6.3%
00/01	\$50.00	9.9%	\$858,555	12.2%
01/02	\$54.00	8.0%	\$993,968	15.8%
02/03	\$58.70	8.7%	*\$1,100,000 e*	*10.7% e*
03/04	*\$63.80 e*	*8.7% e*	*\$1,305,000 e*	*18.6% e*

The use of "Excess Earnings" to pay for Post-Retirement Benefits: SamCERA may be the only '37 Act Retirement Association that has a policy of crediting all earnings to actuarial reserves.

Most '37 Act Boards retain earnings in excess of the actuarial interest rate as "excess earnings" for the payment of ad hoc benefits.

According to a survey of post-retirement benefits conducted by CRCEA, 13 of the 20 '37 Act Counties provide supplemental COLAs (two or more protect purchasing power) funded by the Retirement Fund, 11 Counties provide for a new post-retirement spouse continuance, 10 Counties provide medical benefits partially or completely funded by the Retirement Fund, **6 Counties provide Medicare Part-B Premium Reimbursements** and 3 Counties provide for COLA Bank Compounding.

Your Board did not grant Plan 2 retirees any Cost of Living Allowances from the inception of Plan 2 in 1980 until 1993, resulting in a significant loss in purchasing power for all early Plan 2 retirees. In addition, older retirees in Plan 1 [illegible] purchasing power during the double-digit inflation of the 1970's. Finally, your Board created Plan 3 with zero COLA benefits. Consequently, there is a large group of **Retired San Mateo County Employees** who rely on the financial assistance provided by this $58.70 monthly reimbursement.

Since SamCERA has no other ad hoc benefit programs, a great deal rides on the continuation of the Medicare Part-B Premium Reimbursements. **Retired San Mateo County Employees** are not present at the bargaining table and, therefore, must rely on your good graces for recognition.

Funding Policy Issues: The Board of Retirement wants your Board to be cognizant of the Funding Issues posed by the continuing decline in the investment markets.

The Board of Retirement's Interest Crediting Policy generates specific "excess earnings" for the funding of the Medicare Part-B premium offset. Normally that funding comes from investment returns in excess of the actuarial interest rate. In 2002-2003 the funding was provided from interest previously credited to the *Ventura Contingency Reserve*. Funding for 2003-2004 will be forced through SamCERA's interest crediting process as a priority claim on cash income.

When SamCERA's program was implemented in 1998, the agreement between the two Boards was that the program could continue so long as (1) SamCERA's Funding Ratio does not fall below 80% and so long as (2) the program "will not add to the County's cost of funding SamCERA benefits for this or any other fiscal year."

(1) While the Funding Ratio is currently 85.3%, the combination of the County's generous new benefit formulas and stumbling investment markets suggests to SamCERA's staff that the Funding Ratio could fall below 80% within the next two fiscal years.

(2) Because of SamCERA's unique policy of crediting all earnings to actuarial reserves, it has never been possible to live up to the specific letter of the second requirement. By definition, earnings that do not flow to actuarial reserves result in a cost to the employer that is spread over the remaining life of the Unfunded Actuarial Accrued Liability. The County Manager articulated his concern regarding this issue at the time the program was initiated. Nevertheless, SamCERA's new 20-year funding period minimizes the annual impact of the program.

Once the current County fiscal crisis is under control, the two Boards should consider meeting to review and revise these two criteria. However, the authorization for the current program expires on June 30, 2003. Therefore, action to fund the program for next fiscal year should not be delayed.

Your Board's new benefit formulas for **Active San Mateo County Employees**, when combined with the new actuarial assumptions and investment shortfalls, increased SamCERA's Unfunded Actuarial Accrued Liability from $19.5 million to $243.7 million, an increase of **1,150%.**

By contrast, the Board of Retirement respectfully requests that your Board agree to increase SamCERA's Unfunded Actuarial Accrued Liability by **6/10 of 1%** in order to continue the tax-exempt Medicare Part-B Premium Reimbursement Program for **Retired San Mateo County Employees** for Fiscal Year 2003-2004.

This increase in the UAAL will be amortized over the next nineteen years, along with the cost of the new benefit formulas. **The Medicare Part-B Premium Reimbursement Program will have zero impact on the County's 2003-2004 budget.**