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Contact: TARYN KINNEY
(916) 445-2636

State Controller Yee Updates Unfunded Retiree Health Care Liability

SACRAMENTO—The state's cost for retiree health and dental benefits has grown to \$74.10 billion, according to a report published today by State Controller Betty T. Yee. The so-called "unfunded liability" is a closely watched figure that represents the present-day cost to provide retiree health and dental benefits earned as of June 30, 2015 – one of the state's largest long-term debts.

The state traditionally paid these costs as they came due rather than setting aside and investing money beforehand. However, Governor Jerry Brown, in contract negotiations with public employee unions, is moving towards an approach more like that used for public employee pensions, in which the costs are paid upfront using employee and state contributions and investment earnings.

The total liability grew \$2.38 billion compared to the prior fiscal year, but the size of the increase was \$1.50 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 and assumptions about long-term trends helped to lower costs by \$1.76 billion. Conversely, demographic shifts added more than a quarter billion dollars 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 \$1.90 billion, or about 1.6 percent of the budget. If no changes are made to the state's method of funding retiree health care costs, the current \$74.10 billion unfunded liability will grow to more than \$100 billion by the 2020-21 fiscal year, and \$300 billion by 2047-48.

"California has a duty to ensure it can meet obligations to workers who earned these retirement benefits," said Controller Yee, the state's chief fiscal officer and a board member of CalPERS and CalSTRS, the nation's two largest public pension systems. "We need to assure through collective bargaining that we set aside money to meet this obligation and keep the state on sound fiscal footing."

Under standards created by the federal 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 in the 2017-18 fiscal year, a new GASB standard calls on state and local governments to incorporate OPEB costs in their financial statements. Many, like California, are expected to report substantial unfunded liabilities for retiree health care.

State pensions are prefunded with contributions from employees and the state, allowing investment returns to significantly reduce liabilities. By contrast, California pays for retiree health benefits on a pay-as-you-go basis, covering costs as they come due. Today's OPEB report provides estimates of California's obligation for retiree health and dental benefits based on two different funding scenarios:

- 1 The current pay-as-you-go policy results in an unfunded liability of \$74.10 billion. The shortcomings of this method are apparent in the numbers. While the current fiscal year's budget sets aside \$1.9 billion to cover just actual costs, a true accounting of existing and future costs would have required more than \$5 billion.
- 1 If the state shifted to fully prefunding future benefits, the unfunded liability for the current fiscal year would have been cut by 35 percent to \$48.41 billion. To take advantage of the hefty reduction in liability from full prefunding, the state would have needed to contribute \$3.99 billion in 2015-16, or \$2.09 billion more than it budgeted.

Recognizing that a move to prefunding likely will need to be gradual, Controller Yee noted that even incremental steps would 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 \$250 million but reduce the total unfunded liability over time by \$3.29 billion. Prefunding 50 percent would cost \$970 million more each year but ultimately result in savings of \$13.17 billion in the unfunded liability.

Governor Brown has proposed prefunding the entire liability by the 2044-45 fiscal year, saving the state more than \$240 billion in unfunded liability. In his contract negotiations with the state's bargaining units, the Governor is asking unions to agree to make contributions to retiree health costs. To aid in that effort, Controller Yee's team and the actuaries who prepared the report provided a briefing last week to the Department of Human Resources and the Department of Finance on the updated figures and the advantages of prefunding.

Controller Yee noted that CalPERS, the nation's largest public pension fund and second largest purchaser of health care benefits, already offers an optional California Employers' Retiree Benefit Trust Fund to help employers assure long-term sustainability and security of retiree health benefits. More than 450 California public employers currently participate in the fund, including the state through three of its bargaining units (California Highway Patrol, Craft and Maintenance, and Physicians, Dentists and Podiatrists). The fund is valued at more than \$4 billion.

The actuarial can be found on the Controller's website at .

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 [@CACController](#) and on Facebook at [California State Controller's Office](#).

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