



HARRIS COUNTY, TEXAS

Human Resources & Risk Management
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David Kester, Director

October 11, 2011

To: County Judge Emmett and
Commissioners Lee, Morman,
Radack and Cagle

Fm: David Kester *DKC*

Re: **FY 2011-12 Mid-Year Budget Recommendations**

Attached is my report that was submitted as part of FY 2011-12 Mid-Year Budget Review. Our office requests that Commissioners Court adopt the recommendations from the report as follows:

- Eliminate the TCDRS Optional Group Term Life Program effective January 1, 2012;
- Direct our office to review options regarding the Texas County and District Retirement System (TCDRS) 2012 plan study and come back to Commissioners Court no later than December 6, 2011 with a recommendation for the retirement plan effective January 1, 2012;
- Authorize our office to work with the County Attorney's Office to amend the deferred compensation 457-plan documents and contracts to allow a loan provision;
- Direct our office to coordinate with department heads, Information Technology Center, and Public Infrastructure as required to conduct a risk assessment of electronic systems equipment throughout the County to determine if additional safeguards should be implemented or if relocation of such equipment is appropriate; and
- Authorize the continuation of the policy to limit incentives, allowances and career ladders to current levels and to allow departments to make position changes, subject to review by Management Services.

Information and recommendations regarding the renewal of the Group Health Plans including rates and changes for the plan year 2012-13 are included under Purchasing as a separate agenda item.

If you have any questions or require additional information, please let me know.

Attachment
DEK1903



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Human Resources & Risk Management
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David Kester, Director

September 27, 2011

To: County Judge Emmett and
Commissioners Lee, Morman,
Radack, Eversole

Fm: David Kester

Re: **FY 2011-12 Mid-Year Budget Review - Group Health and Related
Benefits**

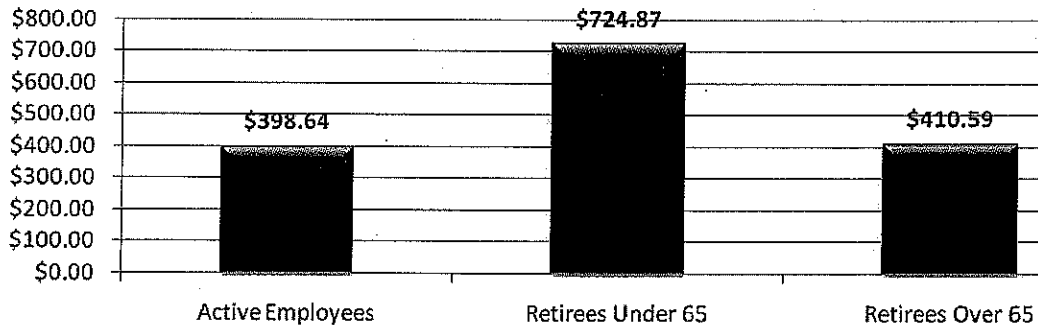
Due to budget constraints limiting growth, the number of active employees covered under the group health plans has decreased to the same level as 2006. This reduction has been more than offset by the increase in retirees over the same period. Over the last 10 years, the number of retirees covered under the plan has doubled while the net increase in covered employees has been 6% over the same period. Overall enrollment including dependents is currently at 31,685.

Medical Benefits

~~Paid claims and administrative cost through August 2011 is approximately \$93.3 million compared to premium funding of \$86.8 million, requiring the use of \$6.5 million in reserves. Aetna is currently projecting an ongoing medical cost increase trend of 10.8% per year, though the County's trend may be lower. The use of reserves from the Health Insurance Fund (6460) will likely continue to be required during the rest of this plan year.~~

The claims cost of retirees under age 65 have a significant impact on the overall medical plan as they accounted for 12.3% of total claims cost in FY 2010-11, and their claims were 82% higher than active employees and 77% higher than over age 65 retiree members.

FY 2010-11 Medical Claims Cost (Per Member Per Month)



■ Average Medical Claims Cost per Member per Month

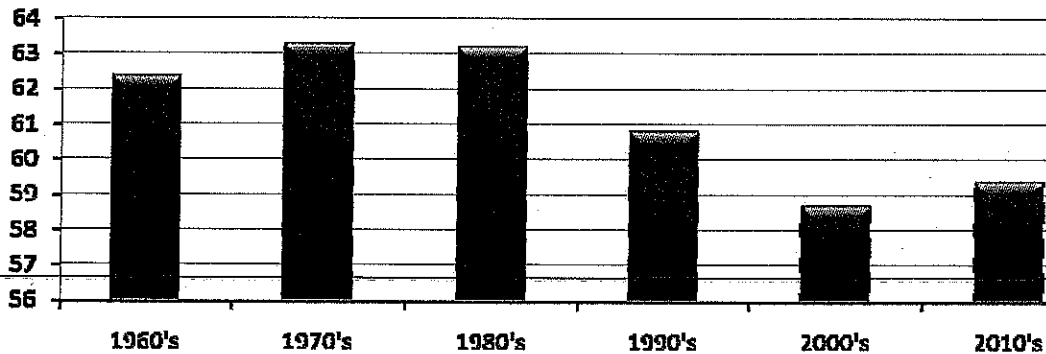
As a self-insured plan, Harris County is responsible for the payment of all claims up to an annual pre-determined, "stop loss" limit. The limit established by the County is currently \$800,000 for any one individual (specific), and a 125% aggregate limit of total projected claims for the plan year 2011-12. An actuarial report is conducted each year to determine the sufficiency of current and prior year incurred claims costs.

Retiree Health and Related Benefits

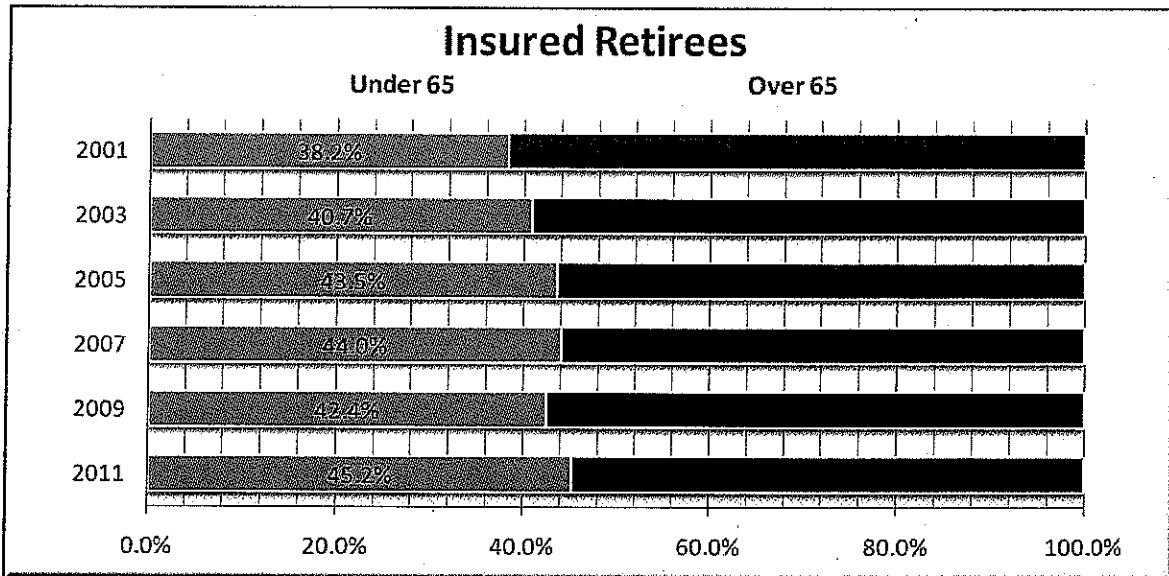
The total number of active employees currently eligible to retire with health insurance is approximately 2,379 or about 18% of the County's full-time workforce. Within the next five years, the percentage of employees eligible to retire will grow to 37%.

Harris County employees continue to retire at a younger age compared to employees in the past. Employees from the 1960's, 1970's, and 1980's retired between the ages of 62 and 63 years on average whereas employees who retired in the 1990's and later were age 60 and below on average. The chart includes all TCDRS retirees, both living and deceased.

Average Age at Retirement



The number and percentage of insured retirees under age 65 continued to increase over the decade as 45.2% of all retirees were under age 65 in 2011 compared to 38.2% in 2001.



Premium Rate Structure

For several years, premiums have been “blended” meaning retiree rates and active employee rates are the same. A recommendation will be made as part of the benefit renewal in October 2011 to charge higher premiums rates for retirees under age 65.

Factors Related to Healthcare Regulations and Financing

The impact of provisions of the Affordable Care Act (ACA), passed in March 2010, will affect the Harris County group health plan provisions for the upcoming plan year and in future years. Please refer to *Exhibit A* for highlights. We will continue to monitor implementation of the regulations as further administrative guidance is released and provisions become effective in later years.

In addition, the Governmental Accounting Standards Board (GASB) requires Harris County to estimate and report the liability and annual expense recognition for retiree healthcare in its financial statements. The continuation of “pay as you go” to fund retiree healthcare is recommended. Please refer to *Exhibit B* for highlights.

Plan Change Recommendations

The current plan cannot continue without a combination of plan changes and/or increased funding next fiscal year. We have reviewed several options including plan design changes and changes to the County, employee and retiree contribution amounts. These options will include a change in the rate structure for one dependent, creating a separate rate for an employee/retiree with a child versus an employee/retiree with a spouse. These recommendations will be included for the renewal of the medical plan effective March 1, 2012 and submitted to Commissioners Court next month.

Other Healthcare Benefit Plans

The dental, vision, long-term disability and life insurance plans will renew this year at no increase in the premium rate. It will be recommended that the employee pre-tax Qualified Transportation Accounts be discontinued effective March 1, 2012 as a result of burdensome administrative requirements and low participation.

Retirement Benefits-Texas County & District Retirement System (TCDRS)

TCDRS 2012 Plan Study

The TCERS plan study was received with rates and options for the calendar year beginning January 1, 2012. If the Court decides to continue the present plan with no changes, the County's contribution rate will increase from the current 9.82% to 10.67%. Required County funding for the retirement plan under the Annually Determined Contribution Rate will be approximately \$78.8 million in FY 2011-12 and would grow to \$83.8 million in FY 2012-13 assuming no payroll growth and no plan changes. The General Fund accounts for approximately 82% of the total contributions.

**TCERS Plan Costs, Contribution Rates, and Projections
FY 2003-04 through 2012-13**

Fiscal Year	2003-04	2004-05	2005-06	2006-07	² 2007-08
¹ County Contribution Rate	10.31%	10.53%	10.05%	9.81%	10.43%
County Contribution	\$59.5 million	\$63.4 million	\$63.6 million	\$68.8 million	\$79.1 million

Fiscal Year	2008-09	2009-10	2010-11	^{3,4} 2011-12	³ 2012-13
¹ County Contribution Rate	9.64%	9.74%	11.31%	9.82%	⁵ 10.67%
County Contribution	\$82.2 million	\$88.2 million	\$93.2 million	\$78.8 million	\$83.8 million

¹Employer contribution rates are established by the TCERS on a calendar year basis.

²The employer matching credit increased from 220% to 225% effective 1/1/07.

³Projected contributions for fiscal years 2011-12 and 2012-13 are based on July 2011 payroll and assume no plan changes.

⁴The employee deposit rate decreased from 7% to 6% effective 1/1/11.

⁵The County contribution rate assumes no plan changes.

Funded Ratio and Rate Increase Projections

At December 31, 2010, Harris County actuarial plan assets were \$2.74 billion and accrued liabilities were \$3.12 billion resulting in the projected unfunded accrued liability of \$383.5 million. The County's unfunded actuarial liability is appropriately amortized by the TCERS, and is accounted for and funded by the County based on an Annually Determined Contribution Rate. The County's consistent policy limiting retirement plan changes has minimized the increase in contribution rates and the unfunded liability.

The County's calculated funded ratio (actuarial assets/accrued liabilities) had steadily increased from 87% in 1996 to 94% at the end of 2007; however, it had dropped to 86.5% in 2008 primarily due to the significant investment losses that year. The TCERS had a partial recovery of the 2008 investment losses over the last two years helping increase the current funded ratio to 87.7%. In addition, the County's election to change the employee deposit rate from 7% to 6% effective January 1, 2011 also assisted in improving the funded ratio. It should be noted that approximately 78% of a retiree's annuity payment is attributable to investment returns emphasizing the significance of this component to retirement plan financing.

Pension Accounting and Financial Reporting

The Governmental Accounting Standards Board (GASB) has recently proposed significant changes to accounting and financial reporting of pensions by state and local governments. Please refer to *Exhibit B* for highlights.

TCDRS Optional Group Term Life Program

The TCDRS Optional Group Term Life program offers a \$5,000 death benefit for retirees and a benefit for employees based on their current annual salary. The current rate for this program is 0.26% of covered payroll in 2011 and is scheduled to increase to 0.28% in 2012. Based on flat payroll growth, the projected cost of this benefit for FY 2012-13 is \$2.2 million, an increase over FY 2011-12 of approximately \$116,000. If the County does not terminate this coverage, it is automatically approved with the new rates effective January 1, 2012.

Recommendation and Timetable for Commissioners Court Decision

The County has several available options in renewing the TCDRS plan each year including making no plan changes, changing the employer matching credit percentage, modifying the employee deposit rate, cost-of-living increases, allowing partial lump-sum distributions, 20-year retirement eligibility, regular buyback, and five year vesting. Any option to increase benefits or modify eligibility provisions are not recommended at this time.

The projections for funding retirement plans are based on a combination of factors including demographics, past and future anticipated investment returns, and employment trends. The most significant factor is the assumption of an 8% net return on investments. According to the TCDRS, the 2008 losses will cause the contribution rate to increase each year over the next several years.

If future returns are greater than the 8% assumption, the period for a full recovery of the 2008 investment losses will be sooner. On the other hand, when investments and other plan results do not match the expected actuarial assumptions, costs may increase higher and more rapidly.

If the Court is prepared to make a decision at this time, a "no plan change notice" can be adopted for calendar year 2012. One option that may be considered would be to lower the employer matching credit to 220% (which it was prior to 2007). The decrease to 220% would reduce the cost of the retirement plan approximately \$1.5 million next fiscal year compared to no plan changes. Commissioners Court must make a final decision on the TCDRS plan no later than the scheduled court meeting on December 6, 2011 since the TCDRS must receive any adopted options for the retirement plan no later than December 15, 2011.

To help contain the expected cost increase, at this time we recommend the Court cancel the TCDRS Optional Group Term Life Program effective January 1, 2012. This decision has to be made and communicated to the TCDRS prior to November 1, 2011.

Other Benefits

Deferred Compensation 457 Plans

The County offers employees a choice of three voluntary (non-contributory) deferred compensation 457 plans through ING, Nationwide Retirement Solutions, and VALIC. Currently there are 6,649 open accounts in these plans.

Under IRS regulations, active employees may only withdraw funds from their account when they leave the County or if they have an unforeseeable emergency, which is defined as a severe financial hardship of the participant, their spouse, beneficiary, or dependent resulting from extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or beneficiary. We recommend the County's deferred compensation plan being amended to allow a "loan" provision. Such a provision would require an amendment to the plan document and to the contracts with the County's deferred compensation providers. If approved, our office will work with the County Attorney's Office to amend the plan documents and submit them to Commissioners Court later this year for approval.

Workers' Compensation

Current cash, investments, and other assets in the Workers' Compensation Fund (5490) totaled \$51.4 million through July 2011 while claims liabilities were estimated at \$27.5 million leaving a net financial position of \$23.9 million. The current workers' compensation premiums generated from payroll will be approximately \$13.3 million for FY 2011-12 assuming no payroll growth while the projected actuarial discounted claims are \$11.7 million at an 85% estimated funding confidence level. Administration (including excess loss insurance) has been budgeted at \$3.3 million. While the program is fully funded, the potential of catastrophic claims and increased cost due to medical inflation and litigation are factors to be considered in the future funding of this program. Net reserves should be used to offset the potential increase in future costs or used for health plan and unemployment costs as necessary.

Unemployment Compensation

Prior to March 1, 2011, unemployment insurance was included in department budgets as a percentage of payroll. Actual cost of unemployment claims for eligible former employees were then charged back to the department's budget. Due to the uncertainty and timing of such charges, payments sometimes exceeded individual department budgets. As a result, departments are now charged a flat 0.28% of their payroll for this benefit, and the Unemployment Insurance Internal Service Fund (55U0) was established to manage and finance this benefit in FY 2011-12.

Through August 2011 the internal service fund has collected \$1.1 million in premiums while claims totaled \$1.9 million for two calendar quarters. A reduction in the County's workforce at the beginning of the fiscal year has caused the number of claimants to increase from 290 in the first quarter (March 2011) to 506 in the second quarter (June 2011). A preliminary analysis indicates that initial unemployment claim filings should potentially return to prior year levels, and our office will continue to monitor these claims, and work with Management Services to make any necessary adjustments in funding.

Update on Disaster Recovery Efforts

Hurricane Ike

Through August 2011, calculated damages and expenses to be considered under FEMA's Public Assistance Program caused by Hurricane Ike is approximately \$83.6 million for Harris County (not including the Reliant Complex, noted below). A total of 391 project worksheets have been obligated by FEMA in the amount of \$80.9 million. To date, FEMA recoveries total \$72.3 million, and insurance recoveries are an additional \$2.1 million. We estimate \$8.6 million in additional recoveries from FEMA.

An additional 24 project worksheets have been written by FEMA in the amount of \$9.2 million for the Reliant complex. To date, FEMA recoveries total \$2.0 million, and insurance recoveries by the Harris County Sports and Convention Corporation are an additional \$11.1 million. We estimate additional recoveries from FEMA and insurance of \$6.4 million.

Final resolution of the outstanding claims and funding from the Federal government through the State will take some time pending necessary audits, review and appeals. Our office will continue to reconcile eligible expenses and recover additional costs through FEMA, insurance, and other Federal and State programs for the County.

On October 7, 2008 Commissioners Court authorized the establishment of a special revenue fund (Hurricane Ike Fund 2710) to account for disaster related expenses. On October 21, 2008 an interfund borrowing and line of credit from the Harris County Toll Road Authority Revenue Fund to the Hurricane Ike Fund was approved and \$33.5 million was the source of initial funding. The agreement was extended on October 13, 2009 and again on October 12, 2010. Our office will work with Financial Services to extend the agreement for another year through October 12, 2012 until additional funds become available to pay the remaining balance.

Election Technology Center Fire and Recommendations for Storage of Electronic Equipment

On August 27, 2010, the Harris County Clerk's Election Technology Center was completely destroyed as a result of a three-alarm fire. To date, the County has been paid \$41.7 million from insurance proceeds, which will be applied to documented losses and eligible expenses.

On July 12, 2011 Commissioners Court approved the purchase of electronic computer server equipment for the Sheriff's Department, subject to placement as agreed by Purchasing, ITC and Management Services. Our office conducted a survey of the initial intended location, and it was agreed upon that the new equipment be placed at 406 Caroline. Commissioner Radack requested an additional inspection of equipment located at 330 Meadowfern. It is recommended that our office coordinate with department heads, ITC and Facilities & Property Management as required to conduct a risk assessment of electronic systems equipment throughout the County to determine if additional safeguards should be implemented or if relocation of such equipment is appropriate.

Budget Policy on Position Control, Incentives, Allowances and Benefits

One of the budget policy items approved by Commissioners Court for FY 2011-12 was to maintain or "freeze" incentives, allowances and career ladders at existing levels for current employees. On April 19, 2011, Commissioners Court adopted a procedure, which would allow departments to fill positions and make other changes subject to department budget availability. We recommend continuation of the policy to limit incentives, allowances and career ladders to current levels. In addition, we recommend continuation of the policy allowing departments to make position changes, subject to review by Management Services.

Incentive, allowance and career ladder changes may be considered in the FY 2012-13 budget process as part of an overall position budgeting process. The goal is to verify at budget adoption, that sufficient funds are available for approved positions and any requested incentives or allowances. To assist in this effort, a uniform benefits rate may be considered for adoption during the budget process. Departments will also be requested to delete any positions which are not funded.

Proposed Holiday Schedule

The proposed Harris County holiday schedule for calendar year 2012 is listed below. This schedule may be used in conjunction with the recommended Commissioners Court meeting schedule for the 2012 calendar year.

New Years Day (Observed)	January 2 (Monday)
Martin Luther King, Jr. Day	January 16 (Monday)
Good Friday	April 6 (Friday)
Memorial Day	May 28 (Monday)
Independence Day	July 4 (Wednesday)
Labor Day	September 3(Monday)
Thanksgiving Day	November 22 (Thursday)
Day after Thanksgiving	November 23 (Friday)
Christmas	December 24 (Monday)
Christmas	December 25 (Tuesday)
Floating Holiday	Employees Choice

If you have any questions or require additional information, please let me know.

C: Dick Raycraft

DEK1897

EXHIBIT A. *Impact of Federal Healthcare Reform Regulations*

In March 2010 Congress passed and the President signed into law what is now known as the Affordable Care Act (ACA), which contains several provisions impacting the County's group health and related benefit plans. Several of the interim regulations and guidance have been issued and already enacted as part of the legislation as follows:

- Limits on reimbursement for "over the counter" medications for employee healthcare spending accounts effective January 1, 2011.
- A requirement that "adult children" (to age 26) be allowed to enroll in the County's group medical plan (without regard to student status or marital status) if they are not eligible for their own employer provided coverage.
- Provide enrollment materials 60 days in advance of plan effective date.
- An "early retiree" reinsurance program, providing the ability for the County to apply for reimbursement of certain claims costs for retirees under age 65. To date, the County has received \$2.1 million in reimbursement under this program.

Mandated Plan Design and Other Regulatory Requirements

The County's group health plan will continue to experience plan design and eligibility changes in FY 2012-13 in order to comply with ongoing regulations. These include:

- ~~A requirement to allow adult children up to age 26 to enroll in the County's health plan regardless if they are eligible for their own employer provided coverage. Along with last year's similar mandate, these changes are estimated to increase the cost of dependent claims 1% to 1.5%.~~
- A limitation in the maximum amount of voluntary contributions to an employee's health flexible spending account of \$2,500 per year. There are currently 185 employees contributing more than this amount, and it is estimated this provision will cost the County an additional \$47,000 in Social Security and Medicare taxes. Employees will also pay higher Social Security, Medicare, and withholding taxes as a result of this limitation.
- Harris County losing its "grandfathered" status due to the expected adoption of certain plan design changes. The most significant impact of this requirement is a mandate to provide in-network preventive care at 100% (with no cost sharing such as a co-payment). The FY 2012-13 annual cost of this provision is estimated at \$900,000.
- A newly required "uniform summary of coverage" to be distributed to all employees and retirees of the plan. (Proposed regulations were recently published).

There are other provisions which will require administrative guidance and others that will go into effect in later years.

EXHIBIT B. Financial Statement Issues

GASB 45

As described in Governmental Accounting Standards Board (GASB) 45, Harris County is required to estimate the liabilities of its retiree healthcare plan (other post employment benefits), as well as recognize contribution amounts and reserves relating to its post-employment benefit plans for current retirees and employees in a biennial actuarial study. The County was first subject to GASB 45 for the fiscal year ending February 29, 2008.

The last actuarial study determined the unfunded accrued liability for County-paid retiree healthcare benefits was \$859.7 million on March 1, 2009 and required annual expense recognition under the GASB standard of \$91.4 million. The County's annual actuarial determined contribution of approximately \$33.6 million for retiree healthcare pays a portion of the liability. At February 28, 2011 the balance of the unpaid obligation was approximately \$253.8 million, which will increase by the annual expense (net of County contributions) from the next actuarial report.

The GASB standard includes a provision for the establishment of an irrevocable trust or equivalent method for financing retiree health care. Adopting this financing mechanism could involve some advanced funding of the projected accrued liability. Given the variety of factors that may impact future costs such as changes in plan design, demographics, economic factors, and the potential change in legislation and regulations, we recommend a continuation of "pay as you go" to fund retiree health care. Future plan and contribution changes can significantly impact these estimates. Any net changes in the unfunded accrued liability (including any adjustments in projections based on cost assumptions) will be reflected in the next required study for the plan year that began March 1, 2011.

GASB Pension Accounting and Financial Reporting

Recently, GASB has issued two Exposure Drafts proposing significant changes to financial reporting of pensions by state and local governments: *Accounting and Financial Reporting for Pensions* and *Financial Reporting for Pension Plans*. The documents would propose amendments to the existing pension standards with regards to how the costs and obligations associated with the pensions that governments provide to their employees are calculated and reported. In summary, this would include the following:

- Unfunded portion of pension obligation reported as "net pension liability" on the balance sheet instead of in the notes to the financial statements;
- Projected benefits that are not covered by projected assets would be discounted using a 30-year high quality municipal bond index rate instead of a long-term expected rate of pension plan investments;
- Differences between assumed and actual investment returns on pension plan assets would have to be recognized as a pension expense over a 5-year period rather than first being "smoothed" and then also being amortized as part of the unfunded liability;
- Ad-hoc Cost of Living Adjustments (COLA's) and other post employment benefit changes would be included in liability projections if employers' past practices indicate a pattern of adopting such changes; and
- Additional accounting and disclosure requirements.