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Agenda Date: July 19, 2006
Memorandum Date: July 19, 2006

TO: Board of County Commissioners

DEPARTMENT: Management Services

PRESENTED BY: Kay Blackburn, Financial Service Manager

AGENDA ITEM TITLE: IN THE MATTER OF CONSIDERING CREATION OF A FORMAL TRUST FOR RETIREE HEALTH BENEFITS

I. MOTION

None at this time.

II. AGENDA ITEM SUMMARY

The Board is being asked to review an external auditor management letter comment which recommended that the County consider formalizing an actual trust agreement for the accounting and administration of retiree health benefits.

III. BACKGROUND/IMPLICATIONS OF ACTION

A. Board Action and Other History

On June 20, 2003 by Ordinance 4-03 the County created a Retiree Health Trust Fund as a separate and dedicated fund to accumulate resources and pay the medical benefits promised to retirees. These benefits are defined by GASB as "OPEB" (Other Post Employment Benefits). Although the fund is referred to in Lane Code as a "Trust" fund, there is no separate formal trust agreement, and the funds are not held in separate investment accounts from the County. Moss Adams has recommended that the County consider formalizing an actual trust agreement, which would enable the County to invest retiree benefits at a higher rate of return than is currently available under State law. This issue was reviewed by the Finance and Audit Committee on June 27, 2006 and referred to the Board for consideration.

B. Policy Issues

The policy issues for consideration are the level of protection the County wants to assure for the assets dedicated to this obligation, and the level of risk the County is willing to take with regard to the investment of the assets.

C. Board Goals

This issue relates to the goal of providing efficient and effective financial and administrative support and systems.

D. Financial and/or Resource Considerations

If a formal trust is created, the potential exists for investment losses or investment returns insufficient to cover additional administrative costs. In the event of losses or inadequate returns, the County would be required to contribute additional funds to provide the benefit to retirees.

E. Analysis

Benefits of a Formal Trust

- The assets of the trust would be protected from County creditors.
- The assets of the trust are dedicated for the purpose stated in the trust documents, and would be protected from Board appropriation for other purposes.
- The assets could be invested in instruments that are not available to the County, and could therefore generate higher investment returns.
- Potential higher investment returns would reduce any unfunded actuarial liability recorded on the County's book in accordance with GASB 45.

Drawbacks of a Formal Trust

- Additional administrative costs would be incurred – Legal fees, investment advisory fees, trustee fees, third party administrator.
- The investment options that could provide higher rates of return are also riskier than current County investments, and could result in losses.
- Care must be taken to ensure that the trust is not "overfunded". If overfunding occurs, assets escheat to the State.

Creation of a Formal Trust
The following actions would be taken in order to formalize a trust:

- Create a Trust Agreement
- Designate a Trustee(s). The trustee could be an individual outside of the County (banker, attorney, consultant). County staff who do not benefit under the plan could be designated as trustees.
- Obtain a federal ID number for the trust and open bank and/or investment accounts.
- Retain an investment advisor unless the Trustee will be charged with investment responsibilities.
- Retain a third party administrator to process the transactions (see below).
- Create a written plan document.

Operation of a Formal Trust

- On an ongoing basis, the County contributes funds to the trust.
- The trust pays the insurance premiums as incurred to the selected providers.
- The trust also refunds Medicare Part B and Supplement premiums to beneficiaries. The Medicare refunds are currently processed through Lane County payroll software. This task would likely need to be transferred to a third party administrator.
- The trust would be required by GASB 43 to prepare annual financial reports separate from the County, and would need to obtain a separate annual audit.

DISCUSSION:

The primary benefits of a formal Trust arrangement are the additional protection of assets for the designated purpose and the ability to place the assets in more aggressive investments. The current Fund established by Lane Code dedicates assets of the fund for the defined purpose and requires that they "shall be used for no other so long as there is an outstanding un-funded liability". Assets may only be transferred out of the fund when a qualified independent actuary determines that the fund is fully-funded. Additionally, the contributions to the fund do not represent beneficiary contributions, but rather monies coming from Lane County, as an employer.

Lane County has historically taken a conservative approach to investments where the welfare of employees and retirees is concerned. In order to take advantage of the potential for higher rates of return, the Trustees would need to balance those potential returns with the additional risk involved in alternate investments. Loss of principal and lower investment returns are possible. In order to cover additional trust expenses and recognize a greater return, it is projected that the trust would need to earn an additional 1.5% return above the County's projected returns.

Under GASB 45, an OPEB plan uses it's expected rate of return to determine the discount rate in the calculation of the required annual contribution. If a plan has higher returns, the annual required contribution will be lower, and thus could lower any unfunded actuarial liability that must be reported in the financial statements. Based on the County's current plan for funding the benefit, formation of a formal trust would have little or no impact on the financial statements.

It is possible to "overfund" the trust, and consideration should be given to any excess assets remaining when the liability is satisfied. GASB 45 requires that the liability for "implicit rate subsidy" be included in the total liability reported for financial statements. This represents the cost of subsidizing rates for certain retirees under ORS 243.303. Although the liability is included in the actuarial calculation, the payment is made by the County through higher rates for active employees. Lane Code 2.500 provides a method for transfer of any excess funds back to the County. A formal trust that would protect the assets from creditors would require irrevocable contribution, with any excess funds going to the State.

F. Alternatives/Options

1. Create a formal trust for administration of the retiree health liability.
2. Leave the Fund 714 as currently established under lane Code 2.500.

V. TIMING/IMPLEMENTATION

If the Board elects to proceed with formation of a separate formal trust, Financial Services will work with County Counsel to draft the necessary documents and select professionals for the administration of the trust.

VI. RECOMMENDATION

In view of the current dedication of funds under Lane Code, the County's conservative approach to investments and the fact that the Fund does not contain monies contributed by beneficiaries, Financial Services does not believe that formation of a formal trust is warranted. Recommend Option 2.