Retiree Health Care Authority
HB 728 Work Group Report

December 15, 2007

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HB 728 WORK GROUP MEMBERS

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BACKGROUND

The New Mexico Retiree Health Care Authority (RHCA) was created in 1990 to provide health insurance benefits to eligible retirees, their spouses and dependents. RHCA provides benefits to approximately 42,000 members from 466 participating entities including state government, public schools, universities, counties, and municipalities. State government retirees represent approximately 30% of RHCA's membership. The agency has an annual budget for FY08 of $216.6 million and offers six self insured plans for non-Medicare eligible retirees through two carriers, four fully insured plans for Medicare eligible retirees through two carriers, and two self insured plans for Medicare eligible retirees through a third carrier.

RHCA is governed by an 11 member Board of Directors (Board) representing retirees, current employees and public employers. The Board sets overall policy for the agency, oversees the procurement of insurance benefits and approves premium adjustments and benefit packages. RHCA was pre-funded for six months prior to providing benefits. This brief period is in contrast to other retirement benefits for state employees that had much longer pre-funding periods before benefits were paid out and has had significant ramifications as discussed below.

RHCA is facing three significant challenges:

1. The RHCA fund is projected to be insolvent by June 2014. Annual revenues have fallen short of expenditures and RHCA has taken funding from its reserves and long term investments to cover current costs.
2. New accounting standards require New Mexico to publish the unfunded liability associated with non-pension retirement benefits and a significant unfunded actuarial accrued liability could eventually affect the state's bond rating.
3. Because costs exceed revenues, benefits are not being pre-funded leaving the future viability of the system in doubt.

HB 728 Work Group

In response to these challenges the Legislature in 2007 passed and the Governor enacted House Bill 728 establishing a work group to study how to preserve benefits for current and future retirees. HB 728 also appropriated an additional $3 million per year for fiscal years 2008 through 2010 to the existing flow of revenue to RHCA from the Suspense Fund. Membership in the work group included the Office of the Governor, the Department of Finance and Administration, the Legislative Finance Committee, the Legislative Council Service, and staff and Board members from RHCA.

HB 728 tasked the work group to:

- Examine the long-term actuarial trend and condition of the RHCA fund,

- Examine the equitable nature of the current contribution rates between retirees and current employees,
- Determine the percent of the fund balance derived from state sources versus the percent derived from the sources of political subdivisions, compare those percentages with the expenditures from the fund for state retirees versus retirees of the political subdivisions and study the feasibility of creating two separate programs for the two classes of retirees,
- Examine options to improve the actuarial soundness of the RHCA fund,
- Evaluate the need for, and the feasibility of, securing the RHCA fund as an irrevocable trust.

The work group met throughout the summer and fall and received briefings from the National Conference of State Legislatures, RHCA actuaries, private sector entities, and had participation from experts at the Department of Human Services. Based on the information presented, the work group developed a problem statement that identified the major issues affecting RHCA, including administrative issues, and developed consensus recommendations to be presented to the Governor and Legislature. The work group also supported an outside analysis of the customer services functions of RHCA.

The work group members initially concentrated on restoring the RHCA fund to 25 years solvency as the principal goal. However, the group also recognized that solvency is but one of three measures that require ongoing attention. In addition to extending the solvency period, if the State does not also address the unfunded accrued actuarial liability (UAAL) and shortfall in the annual required contribution (ARC) that currently fails to provide any significant pre-funding for future retirees, New Mexico will have made little progress towards insuring a viable retiree health insurance system for future generations.

The work group acknowledges that its recommendations must be viewed in context of decisions that other actors may make that affect the system. The RHCA Board is vested with authority over certain issues such as subsidy levels and premium adjustments. Decisions taken by the State in how health benefits are purchased and future possible actions by the Governor and Legislature that affect the overall health care system will impact RHCA and may supersede recommendations by the work group.

The work group recommendations are addressed in detail below but, in general, the group considered and accepted all feasible options that would extend the solvency of the fund, reduce the UAAL, and begin to provide some level of pre-funding of benefits for future retirees.

LONG TERM ACTUARIAL TREND AND CONDITION OF THE RHCA FUND

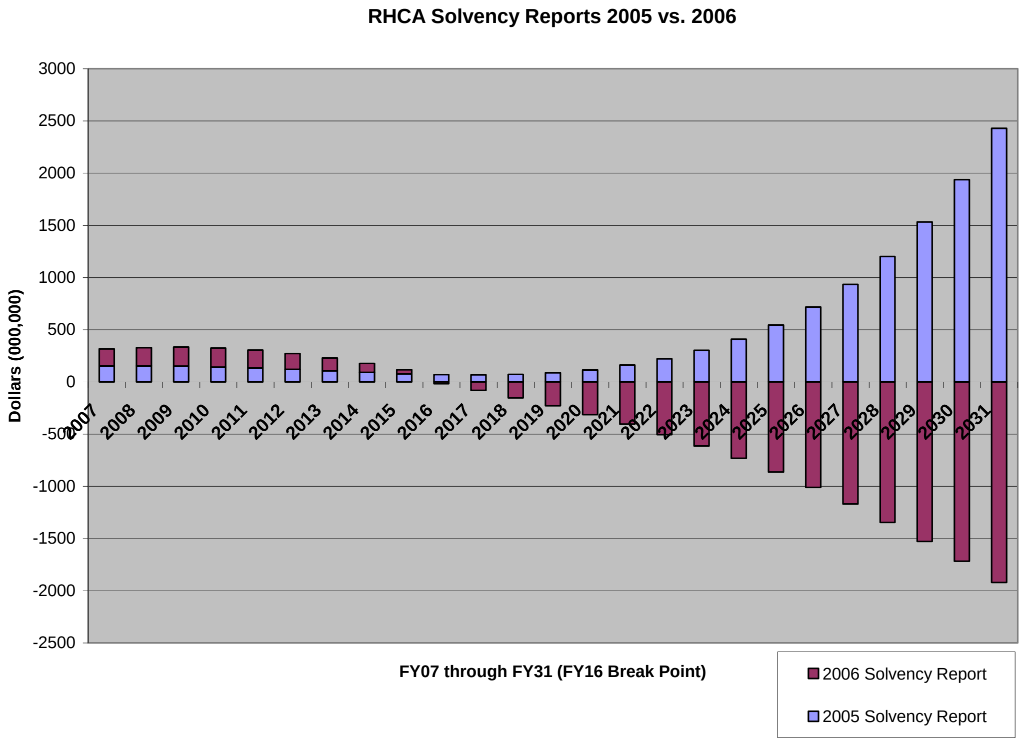
In 2006 and for many previous years, the solvency of the RHCA fund was projected by contracted actuaries to be 25 years. However, as of September 2007, the solvency was projected to extend only to June 30, 2014 unless significant changes are made to the system. This dramatic revision in the solvency estimates was the result of a change in the expected program participation rate, which was increased from 35% to 75%. In other words, for many years, RHCA and New Mexico have operated under an inadequate participation assumption resulting in unrealistic projections of the financial stability and long-term viability of the system.

Additionally, in 2004 the General Accounting Standards Board (GASB) issued Statements 43 and 45 requiring that states and other governmental entities publish, as part of their audited financial statements, their UAAL for non-pension retirement benefits such as health insurance. Initial estimates of New Mexico's UAAL were as high as $5 billion. The level of UAAL depends on the amount of annual revenue received and whether or not the fund is placed in an irrevocable trust or its equivalent thereby allowing the state to take advantage of a lower discount rate. Based upon the presumption that RHCA operates as an "equivalent arrangement" to an irrevocable trust, the most recent estimates place New Mexico's UAAL at $4.1 billion. The ARC necessary to pre-fund the state's current obligation is $373.9 million without interest and the current gap between the ARC necessary to fully fund the UAAL over 30 years and the forecasted FY08 budget is $200.5 million.

Solvency

In 2006 RHCA's actuary produced a solvency report that put the agency's solvency at 25 years, where it had been the previous year as well. However, as noted above, after a revision of the projected retiree and dependent participation rate in the program from 35% to 75%, and subsequent updates of projections and assumptions, including a significant reduction in projected revenue received from the Medicare subsidy program based on actual results, the forecasted solvency was extended only until June 2014.

This significant, and unforeseen, decline in the period in which the system would become insolvent became the catalyst for action by the Board, the Governor and the Legislature.



The Challenge of GASB

The Governmental Accounting Standards Board (GASB) is a private, nonprofit organization responsible for establishing and improving accounting and financial reporting standards for the more than 84,000 governmental units in the United States (not including the federal government). The governmental units include states, counties, cities and other local governments, as well as any organizations under those governments' jurisdictions, such as public power authorities, municipal hospitals, and state universities. Governments are required to follow GASB standards in order to obtain clean opinions from their auditors. The GASB operates under the auspices of the nonprofit Financial Accounting Foundation which oversees and financially supports the GASB and appoints new members.

GASB Statements 43 and 45 established uniform financial reporting standards for Other Post-Employment Benefits (OPEB), such as healthcare benefits, prescription drug coverage, long-term care insurance and other benefits. GASB disclosure is based on accrual accounting rather than cash accounting for retiree healthcare expenditures. GASB also requires that public entities:

- Associate the costs of OPEB's with the accounting periods the benefits are earned rather than when benefits are paid or provided (at a future time),
- Recognize the liability for OPEB's earned by employees during the time they were actually employed,
- Calculate an actuarially determined liability for OPEB's,

- Provide a calculation of the portion of the liability that must be reported as an annual accounting expense in their financial statements; and
- Provide a cumulative liability accounting recognizing the extent to which the employer actually makes contributions to offset the accrued expense.

As a new disclosure standard, GASB allowed the cost of benefits attributable to past service to be recognized over a 30 year amortization period, plus recognition of future service as it accrues in the calculation of the ARC.

In order to encourage public sector entities to advance fund such obligations on an accrual basis, the GASB Board adopted policies that allow a plan to recognize assets already contributed as an offset to such liabilities and value the liabilities based on expected investment returns on invested assets to the extent the plan is funding its ARC into an irrevocable trust or an equivalent arrangement. Such an arrangement must satisfy a three part test which includes:

- Employer contributions to the plan are irrevocable,
- Plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan,
- Plan assets are legally protected from creditors of the employer(s) or the plan administrator.

If such conditions are not met, then investment assets may not be recognized as an offset to liabilities and the interest rate for valuation of such liabilities must be reduced to a low risk short term rate of return, resulting in significantly higher liabilities for disclosure purposes.

In 2006, RHCA performed a GASB 43 valuation to determine New Mexico's UAAL. The initial UAAL was determined to be as high as $5 billion; however, because the RHCA system serves as an "equivalent arrangement" to an irrevocable trust, the most recent estimated UAAL is $4.1 billion.

RHCA actuaries valued the liability as a Multiple Employer Cost Sharing Plan operating through an arrangement that qualifies as an "equivalent arrangement" to an irrevocable trust. This view is based on the statutory provisions that establish membership in the program as *irrevocable*, the operating characteristics that assets held are for the *exclusive use of providing benefits to retirees of member employers*, and the fact that assets appear to be *beyond the reach of creditors* of member employers. If the RHCA fund is not treated in this manner, member employers would have to report liabilities under GASB 45 on an individual basis without the ability to fully recognize assets held by RHCA and the total liability for all member employers would likely increase by a magnitude of at least 10%. In addition, the economic cost of performing 466 separate GASB valuations is not cost effective. (See Appendix I for further discussion)

GASB Accounting and Annual Required Contribution

The annual required contribution (ARC) necessary to pre-fund the state's obligation to current and projected retirees is $373.9 million without interest. The ARC is currently composed of the following components:

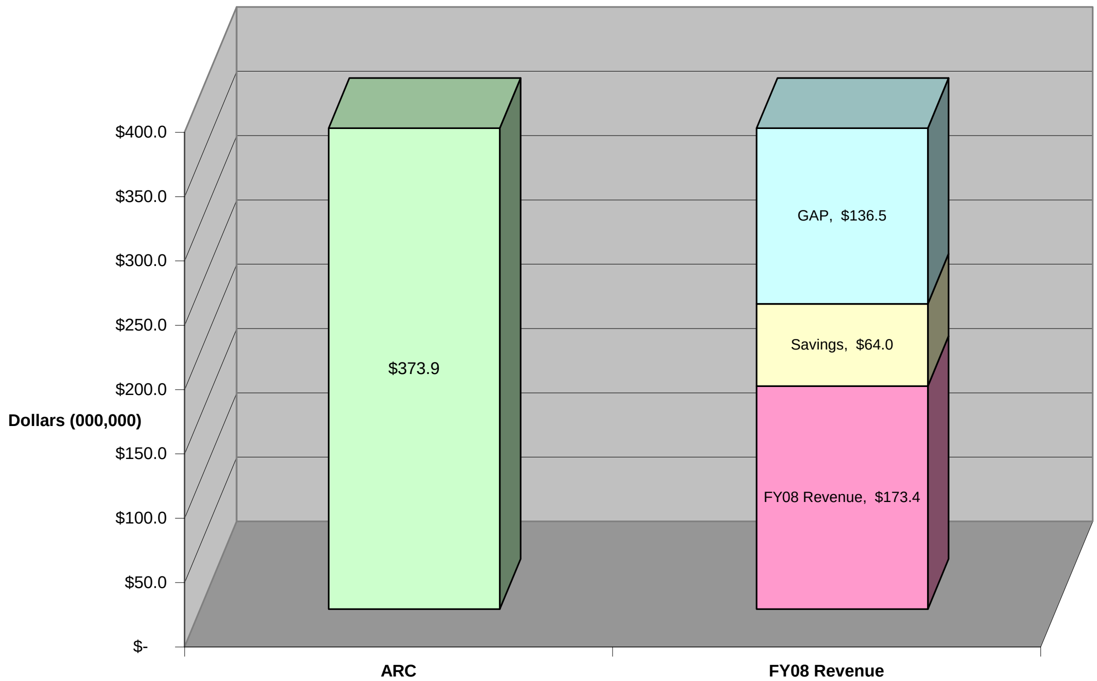
$ 62,400,000 (17%): 30 year amortization of retiree's unfunded actuarial accrued liability (w/o interest)
$ 94,400,000 (25%): 30 year amortization of active employee's unfunded actuarial accrued liability (w/o interest)
$217,100,000 (58%): Active employee's normal cost for 1 year of accrued service (w/o interest)
$373,900,000 Annual Required Contribution (w/o interest)

For illustration purposes, an increase in the total employer/employee contribution from 1.95% of pay to 2.4% of pay generates an estimated $19 million, approximately equal to an additional 5% of the current ARC and represents an improvement in the pre-funding of active employees liability on an accrual basis.

If the increase were paid using an additional 0.30% from the employer and 0.15% from the employee, it would result in an estimated additional annual cost of $12.7 million to employers and $6.3 million to employees.

As the chart below demonstrates, New Mexico is far short in the revenues it collects from employer/employee contributions, premiums from retirees and other sources, from being able to adequately fund the current cost of the system and set aside revenues for future retirees. Even if the $64 million in savings generated by the work group's recommendations are put into place, the gap between the ARC, FY08 forecasted revenue, and recommended savings is $136.5 million. Additionally, this gap will increase every year unless there are continual adjustments to the retiree premiums, level of benefits and other sources of income.

FY09 Gap Between ARC, FY08 Revenue & Recommended Savings



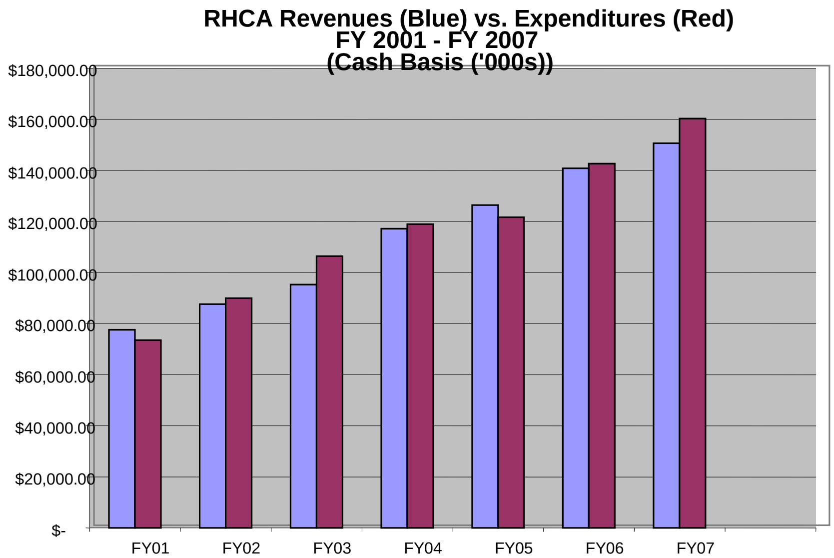
Problem Statement

The HB 728 work group developed a problem statement that set out the following major issues facing RHCA: rising cost of healthcare and insurance, rapidly increasing membership, lack of rationalization in benefit packages benefits, insufficient premium contributions and lack of pre-funding for future beneficiaries.

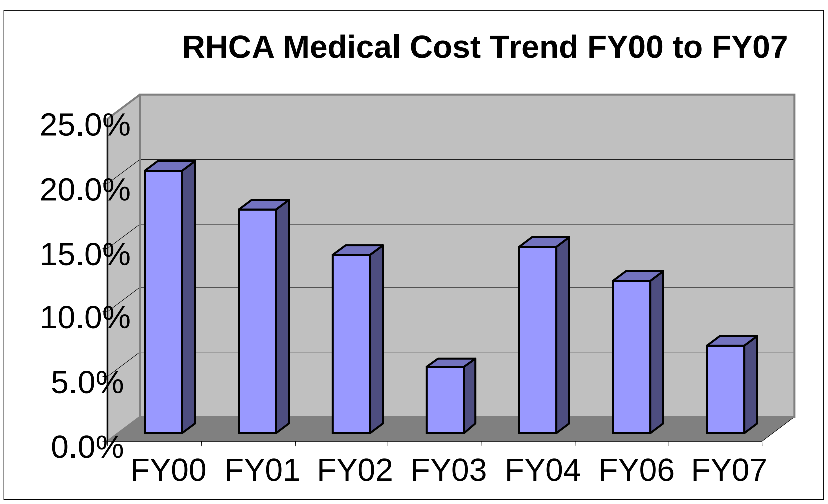
<u>Rising Costs of Healthcare and Insurance:</u>

Nationally, few states or entities were prepared for the rapid rise of healthcare costs from 1990 to 2006. During that time, RHCA saw high single and low double digit increases in healthcare, outstripping the increases in retiree premiums and active employee/employer contributions.

Since 2000, expenditures have grown rapidly, outpacing revenues as the chart below demonstrates. RHCA has taken funding from its reserves and long term investments to meet ever rising claims costs. If this trend is not reversed insolvency will occur in FY 2014.



The chart below shows the annual percentage increases of the cost of healthcare for RHCA from FY00 to FY07.

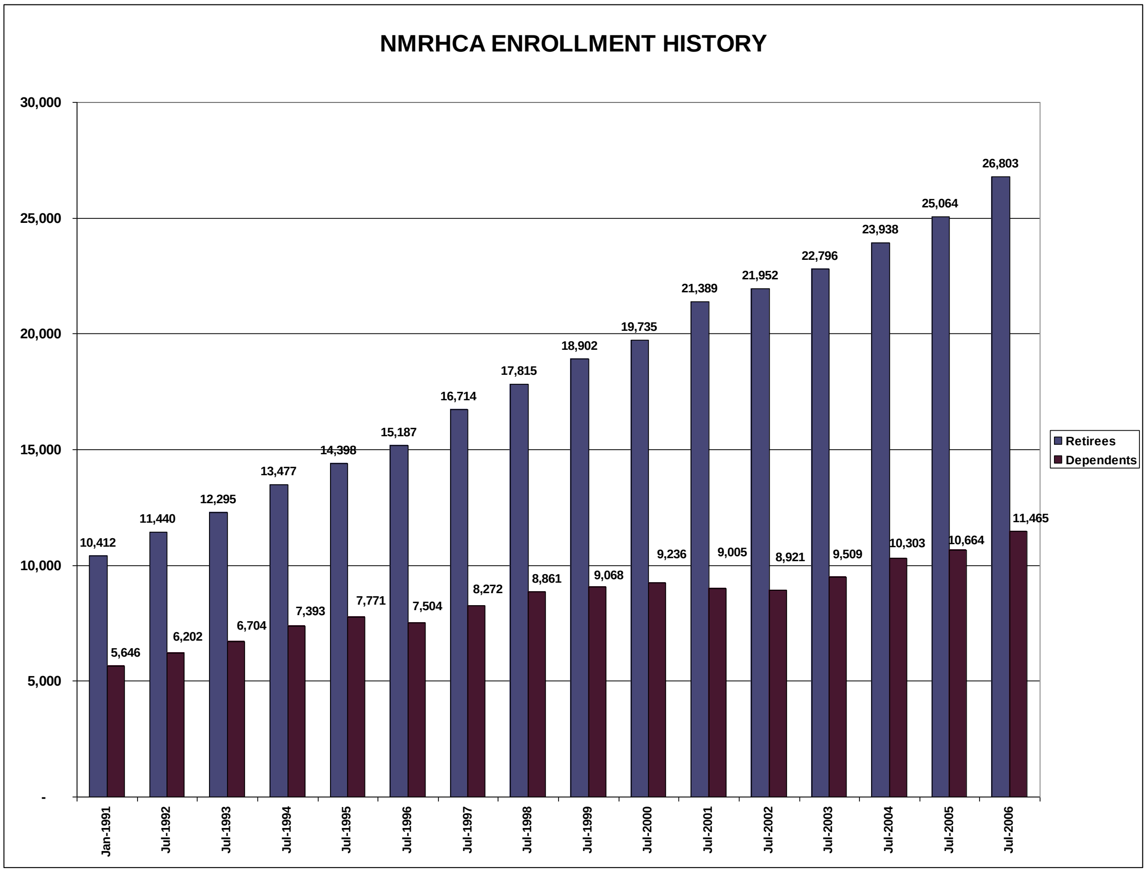


While medical cost trends were lower in the last two years, and RHCA's actuary based their projections on an ultimate medical trend rate of 5% for GASB disclosure purposes and 8% ultimate trend rate for planning purposes, it is clear that New Mexico will be dealing with the effects of high healthcare costs for many years to come.

Increasing Membership:

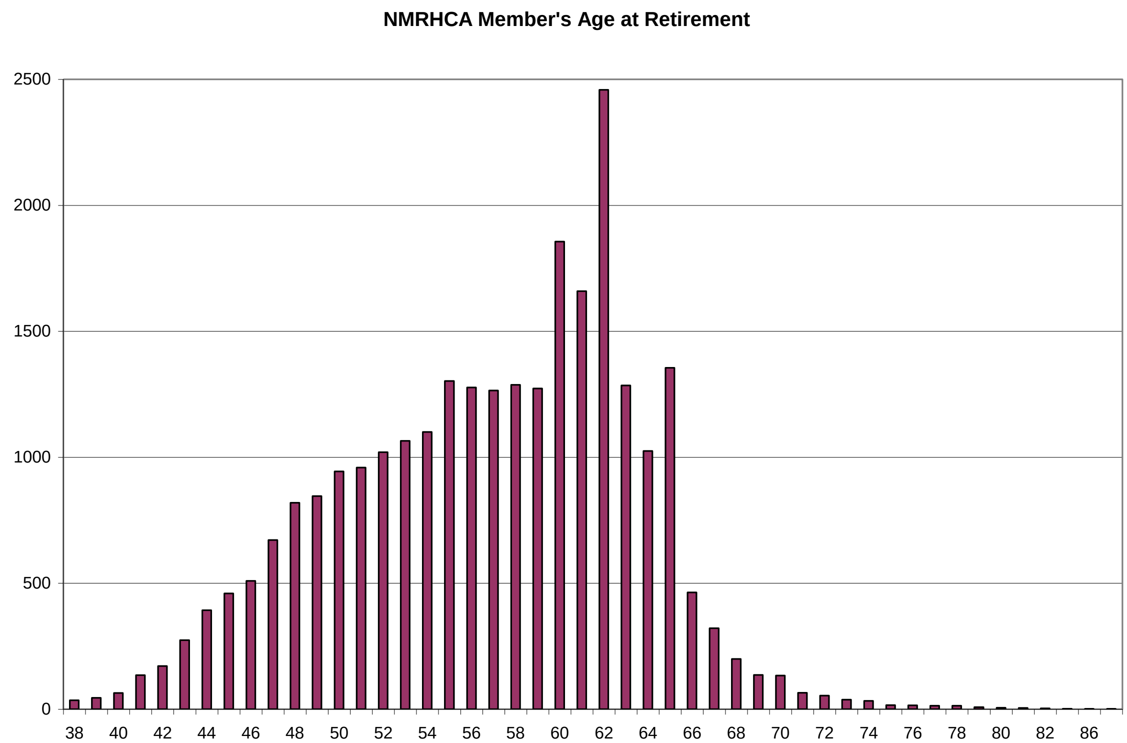
Since 1990, the average annual growth rate of eligible participants has been 7% for retirees and 5% for dependents.

The increase in RHCA membership and the cost of providing care, which is rising faster than revenues, have contributed significantly to the reduction in the solvency period.



Eligibility/Years of Service Requirements:

Unlike many post-employment benefits across the nation, RHCA has service requirements, established in statute, allowing a retiree with 20 years service to have the highest amount of premium subsidy (The least amount of subsidy is for five years.) A significant number of public retirees enter RHCA's health insurance program at a relatively young age, with the majority retiring between 48 and 69 years of age, as demonstrated by the graph below. Once retirees reach Medicare eligibility (typically age 65), the retiree is eligible for lower cost Medical plans due to the integration with various federally funded Medicare options.



The current RHCA subsidy varies based on years of service prior to retirement. The following charts show a snap shot of the current enrollment by years of service and age.

Distribution by Years of Service

YOS	% of Retiree Population
5-9	0.4%
10-14	1.8%
15-19	3.5%
20+	94.3%

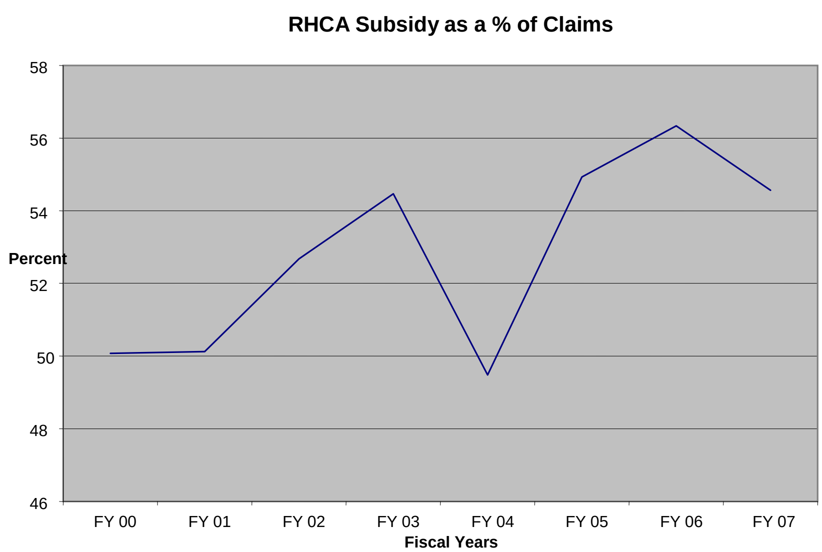
Distribution by Age

Age	% of Retiree Population
<50	3.2%
50-54	6.6%
55-59	14.3%
60+	75.9%

Benefit Design and Subsidy:

Both benefit design and the baseline subsidies are determined by the RHCA Board. Currently, the benefit package that the majority of RHCA participants choose is more generous than other plans offered. The Board is required to ensure that the premiums, subsidy and other money appropriated to the fund, are sufficient to provide the required insurance coverage and to pay the expenses of the Authority.

The history of subsidy percentages and the relationship of premiums and subsidy can be found below. The combination of low co-payments, deductibles and coinsurance with the subsidy structure has exacerbated RHCA's poor financial position.



Detail regarding the variation of this RHCA subsidy by plan enrollment is found in the following chart.

Current Projected 2008 Retiree Share - Base Plan				
Plan	Total Mo. Cost	RHCA Subsidy	Retiree Cost	Retiree Share
Non-Medicare Retiree	$372.34	$255.59	$116.75	31.40%
Non-Medicare Spouse	$497.35	$238.11	$259.24	52.10%
Self-funded Medicare Retiree	$282.51	$187.64	$94.87	33.60%
Self-funded Medicare Spouse	$294.59	$135.88	$158.71	53.90%
Medicare Advantage Retiree	$63.34	$26.73	$36.61	57.80%
Medicare Advantage Spouse	$65.30	$13.84	$51.46	78.80%

The base plan for Non-Medicare Retirees is the Silver Plan
The base plan for self-funded Medicare Retirees is the Complementary Plan
No base plan designated for Medicare Advantage, average reported

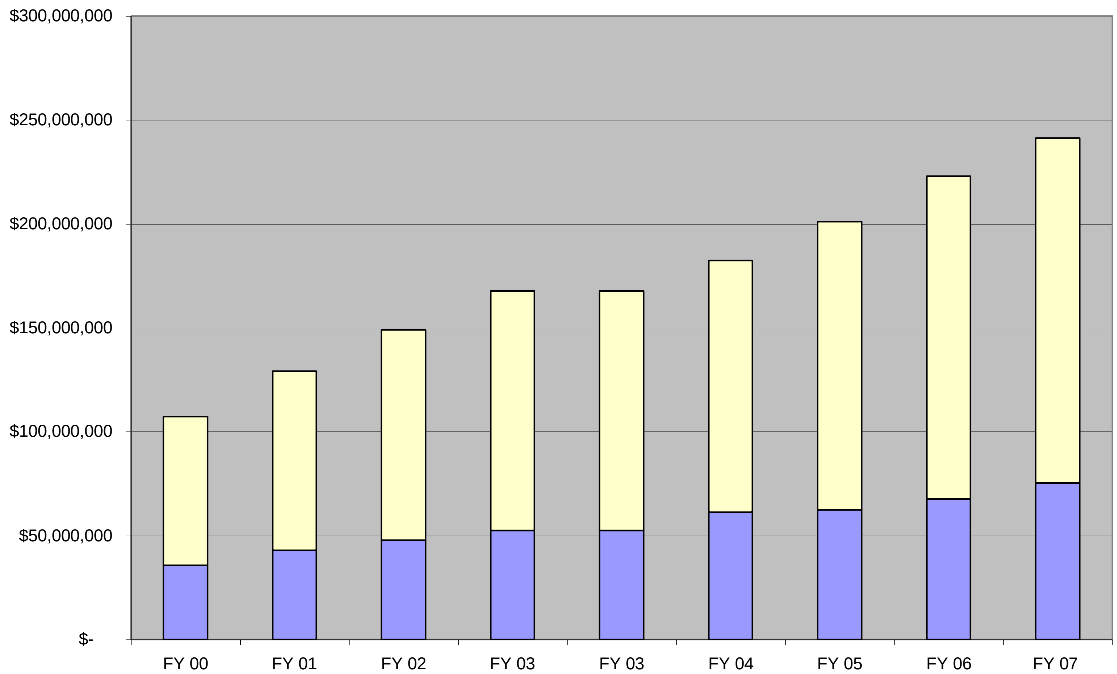
In addition to the base plans, RHCA offers premium plans which are more highly subsidized. Recognizing this, RHCA in 2007 agreed to increase the monthly retiree cost for the premium plans more rapidly than the base plans until the retirees had to pay the full actuarial value of the difference between the two plans in addition to their base plan costs. The Board expected to implement this adjustment over a period of two to three years. The retiree share for the premium plans is shown in the following chart.

Current Projected 2008 Retiree Share - Premium Plans				
Plan	Total Mo. Cost	RHCA Subsidy	Retiree Cost	Retiree Share
Non-Medicare Gold Retiree	$734.31	$562.93	$171.38	23.30%
Non-Medicare Gold Spouse	$701.72	$385.67	$316.05	45.00%
Medicare Self-funded Plus Retiree	$339.86	$177.95	$161.91	47.60%
Medicare Self-funded Plus Spouse	$356.01	$127.59	$228.42	64.20%

Insufficient Premiums:

For many years premium increases have lagged behind the rate of increase in the cost of benefits. Additionally, the most recent analysis of the actuarial distribution of premiums by plan and by vendor reveals that the inequitable pricing of premiums has caused a migration of members from middle ground plans to the more expensive premium plans. This impact has had an even more dramatic effect on the bottom line, given that as of FY06, 52% of the retirees and their dependents receive their care through the richest pre-Medicare and Medicare plans.

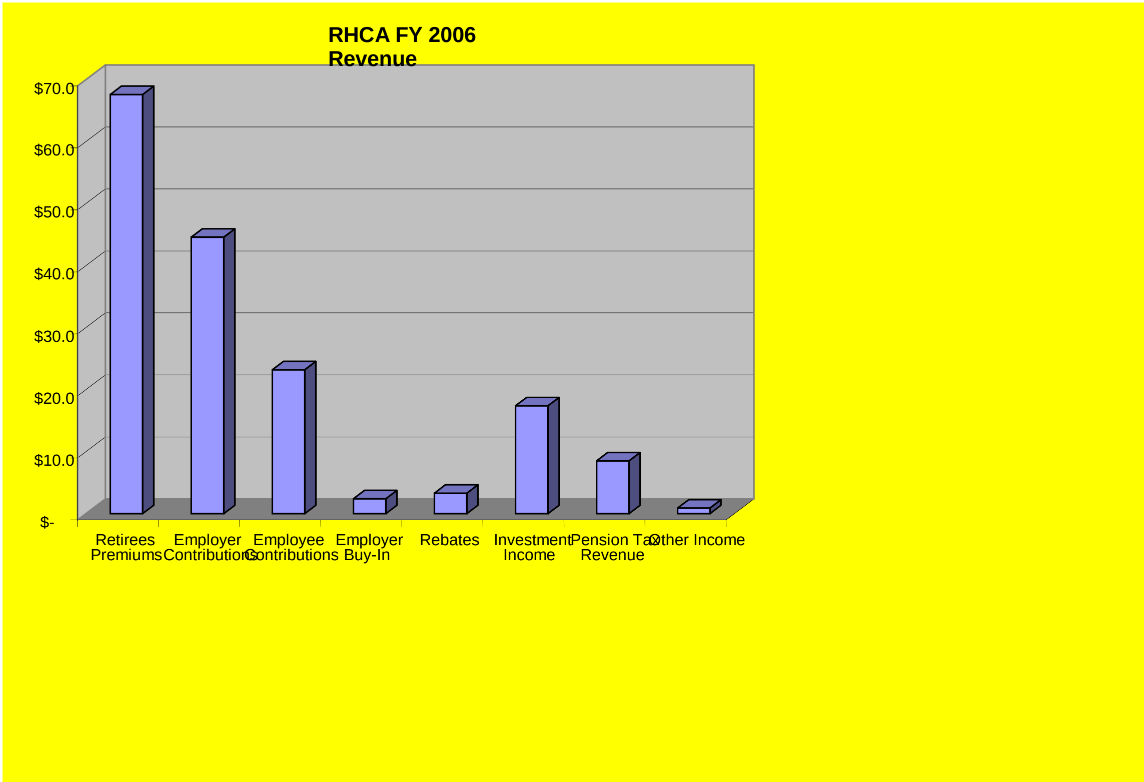
NMRHCA Historical Premiums (Blue) & Claims (Yellow)



For 2008, the RHCA Board approved an average 9% premium increase, which generally tracks with medical cost trends. This increase was applied more heavily to the premium plans than the base plans. However, the increase will not be enough to remedy past years where premium increases were too low to keep pace with medical trends.

Pay as You Go:

At its inception, RHCA was expected to pre-fund or pay for, benefits for future retirees. However, as noted above, that has never happened and currently all of the active employer/employee contributions are being spent to provide benefits to current retirees and their families. For example, the active employer/employee contributions for FY06 made up 40.4% of RHCA's agency annual revenue.



The lack of any pre-funding of benefits puts the entire system at risk and calls into question whether today's employees will have access to a retiree healthcare benefit at all, even though they have paid into the system throughout their careers.

<u>Under Funding of RHCA:</u>

At the inception of RHCA in 1990, 16,058 retirees and their dependents were brought into the program and provided benefits after having paid into the system for only six months. Unlike New Mexico's Public Employee Retirement Authority which had a six year moratorium in which contributions were collected prior to any benefits being paid out, there was only six months pre-funding of RHCA.

RHCA estimates that if the program had been pre-funded by requiring 20 years of contributions by active employees and their employers prior to paying out benefits and all contributions since 1970 had been used to pre-fund the benefit, the funding ratio would be 84% as of December 31, 2006 and would represent 84% of New Mexico's UAAL.

HB 728 WORK GROUP RECOMMENDATIONS

In order to extend the solvency period, reduce the UAAL, and provide pre-funding of future benefits, the HB 728 work group considered a wide range of options. While the RHCA Board has general authority to make changes in areas such as premiums and benefit design, other changes like increasing the employer/employee contribution, require legislative action. Therefore, the work group placed recommendations in the following categories: changes recently enacted by the RHCA Board, recommendations that would increase the fund by $4 million or more, recommendations that would increase the fund by $2 to $4 million, low impact recommendations of $2 million or less, and recommendations for future consideration.

Additional improvements in the projected financial status of RHCA may occur as a result of the current effort by the State to determine if more cost effective medical delivery alternatives are available in the marketplace. Other, future legislative activity could also alter the financial status of RHCA.

RHCA Board Action

In August, 2007, the RHCA Board approved a number of measures intended to extend the solvency period:

- Moved the self-funded Medicare prescription drug coverage to an RHCA sponsored prescription drug plan;
- Adjusted benefit designs including increases to certain co payments and out-of-pocket expenses; and
- Approved an average 9% increase in premiums across the benefit plans while committing to tying future premium increases to medical and pharmacy trends.

Taken together, these actions are expected to generate $7.5 million in saving and extend the solvency period by 1.6 years using an 8% ultimate trend rate beginning in 2010.

HB 728 Work Group Recommendations

In addition to the changes enacted by the RHCA Board, the work group agreed on the majority of the following recommendations that, if enacted, are expected to extend the solvency period to 20 years at an assumed ultimate annual health care trend rate of 8% for FY10 and after and add approximately $64 million in revenues.

There was general consensus from all work group participants on the recommendations throughout the process and agreement that any proposed solution to the crisis facing RHCA must be balanced and include both current employers and employees, as well as retirees. It should be noted, however, that the Board has subsequently come out in opposition to changes to age and service requirements or graduated subsidy levels based on age of retirement as discussed below. Instead the Board's position now is to significantly increase costs for current employees and the state by raising the employer/employee contributions further.

Focus on Solvency, ARC and UAAL: Develop a comprehensive set of actions that will focus not only on extending solvency but also pre-fund benefits for future retirees and reduce the UAAL, thereby protecting the states' financial position.

Solvency Period: Establish a near-term goal of achieving a 25 year solvency period with provision for regular adjustments to premiums and other revenue streams that maintain that solvency period going forward.

Employer/Employee Contribution Increase: Increase the employer/employee contribution to a total of 2.4% of pay. The current employer/employee contribution is a total of 1.95% of pay based on 1.3% of pay for the employer share and .65% of pay for the employee share, with the recommended increase to a total of 2.4% pay resulting in partial pre-funding of unfunded liabilities for active employees.

Increases to the employee share might further exacerbate the state's goal of providing attractive compensation to recruit and retain high quality employees. Any consideration of increasing the employee share must be made in light of the total compensation package. (See Appendix III for results of recent Central States Compensation Survey)

This change is estimated to produce $19 million in revenues and add an additional two years of solvency to the fund.

Suspense Fund Allocation: Extend the $3 million per year increase from the Suspense Fund that was authorized in HB 728 and use to pre-fund future benefits.

Because the work group was committed to having all parties share in the financial solution, it was determined that non-state participating employers should be assessed annually in much the same way that the state is providing a $3 million supplemental contribution to the fund. Therefore, except for public schools, an additional $1 million annual assessment would be obtained from non-state participating entities, in the aggregate. The percent assessment would begin July 1, 2008 and be determined annually by the Board.

This change is estimated to produce $3 million in revenues and add an additional half year of solvency to the fund.

Adjust Spouse and Dependent Subsidy: Establish the maximum amount of subsidy for spouses and dependents (the current average is 47.6% for spouses/dependents in the pre-Medicare plans) as follow:

a. Retiree under age 50: no subsidy
b. Retiree 50 and over: 25% subsidy

Adopt Graduate Subsidy Based on Age of Retirement: Establish the amount of subsidy received by retirees (the current average is 67.6% for retirees for retirees in the pre-Medicare plans) as follows:

a. Retiree under age 50: no subsidy
b. Retiree aged 50 to 54: 25% subsidy
c. Retiree aged 55 to 59: 40% subsidy
d. Retiree aged 60 and over: 50% subsidy

The age adjustment would not apply to anyone meeting the definition of disabled for purposes of receiving Social Security Disability Income benefits. The work group did not resolve the issue of whether to grandfather current retirees.

Taken together, these two options are expected to produce $38 million in revenues and add 9.7 years to the solvency of the fund.

In addition, the fully insured Medicare benefit partial subsidy is expected to produce $4 million in revenues and add an additional .8 years of solvency to the fund.

Additional HB 728 Recommendations

In addition to these changes, the HB 728 work group recommends the following changes that, while not having significant impact on the long-term solvency or UAAL, will improve the operations of RHCA and the prospects for the state's retiree health care system:

<u>Board of Directors Composition</u>: Rebalance the Board to add representation by the Secretary of the Department of Finance and Administration and include representation by a Chief Financial Officer of one of the state's colleges or universities.

<u>Annual GASB valuations and solvency modeling</u>: Provide annual valuations each December 15 to the Legislature which update GASB 43 disclosures and long term solvency projections and model the impact of changes being recommended by the RHCA Board (including the expected impact of the total package of changes on the UAAL).

<u>Health and Disease Management</u>: Provide health and disease management programs from RHCA's contracted insurance vendors that include measurable health outcomes and mandate health risk assessments for members as a condition of initial and ongoing enrollment.

<u>State-wide Consolidation</u>: Explore economies-of-scale that can be gained from consolidating administrative functions of RHCA, the General Services Department Group Benefits Division, other smaller publicly financed health insurance pools, the Public Schools Insurance Authority and the Albuquerque Public Schools.

<u>Attestation Requirement</u>: Require that all enrollees attest that they are not eligible for other health care coverage due to other employment as a condition of initial and ongoing enrollment.

OPEB Obligation Bonds: Explore the possibility of issuing bonds at a lower interest rate than can be expected to be earned on assets held by the State Investment Council. The influx of bond capital would make it possible to increase the actuarial discount rate used to value the Actuarial Accrued Liabilities and lower the resulting UAAL, while providing a cash flow advantage to RHCA on the front end.

Conversion to Defined Contribution Approach: Explore changing the nature of the program from a defined benefit obligation subsidized from numerous sources to a defined contribution obligation. Under such an approach, specific contributions would be made into individual accounts during an active employee's career which would earn interest and be available to apply to the purchase of health care during the individuals retirement years. This approach eliminates placement of long term GASB 43 liabilities on financial statements and concerns about RHCA solvency by shifting the responsibility for the ultimate cost of healthcare to the retiree.

CONCLUSIONS

Taken together the recommendations of the work group and recent actions by the Board would produce $64 million in savings and result in a 20 year solvency period. While that is short of the goal of 25 years it is within the range of generally acceptable projections.

No single action by the Executive, Legislature or RHCA will restore the balance needed to the current retiree health insurance system. The HB 728 work group realized early on in its study that all participants in the system, retirees, active employees, and employers, will need to participate in addressing the state's unfunded liability and in moving the system into permanent solvency. While it is not feasible or prudent to fully prefund the program in a single year, the work group developed short-term recommendations to move the system into solvency and longer term recommendations that will need to be considered as New Mexico develops an approach for addressing the ARC and UAAL in a manner and over a time period that is fiscally responsible.

As the study began, it became apparent that New Mexico must take fiscally prudent actions now to plan for liabilities that have been accrued for retiree health care and develop an equitable approach given the current lack of pre-funding of benefits. Additionally, the state must ensure that its actions maintain the bond ratings of the state and participating entities.

In response to comments received at various legislative hearings and other meetings during the interim, the work group believes that additional work should be undertaken to obtain input from retirees and active employees who participate in the program, to secure additional expertise to analyze policy options, and to develop further, joint recommendations from all parties.

TERMINOLOGY

Actuarial Present Value (APVB): Present value of all future benefit payments for current retirees and active employees taking into account assumptions about demographics, turnover, mortality, disability, retirement, health care trends, and other actuarial assumptions. GASB does not require disclosure of this number.

Actuarial Accrued Liability (AAL): The portion of the APVB allocated to years of employment prior to the measurement date.

Actuarial Value of Assets (AVA): The value of assets used by the actuary in the valuation. These may be at market value or some other method used to smooth variations in market value from one valuation to the next.

Funded Ratio: The ratio AVA/AAL.

GASB: Governmental Accounting Standards Board.

Unfunded Actuarial Accrued Liability (UAAL): The difference between the AAL and the AVA.

Normal Cost (NC): The portion of the APVB allocated to the valuation year of service.

Annual Required Contribution (ARC): The NC plus amortization of the UAAL (must be amortized over a period of no more than 30 years)**.**

Net OPEB Obligation (NOO): The amount of ARC which was not funded and which is accumulated from year to year with interest. This number and it's progression over time is likely to be focused on by financial analysts.

APPENDIX I: AUGUST 6, 2007 MEMO ON GASB REPORTING STATUS

MEMORANDUM

To: Marie Thames

From: Gary Petersen

Date: August 6, 2007

Re: Response to legal form of organization for GASB Reporting Purposes

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This memo is to respond to your request for comments on the above topic. Segal is not a law firm or an accounting/auditing firm and is not able to provide legal counsel or accounting/auditing advice to NMRHCA or its other clients. In addition, although attorneys may offer opinions and interpretations of the GASB requirements, we believe rather than being a legal matter, it is more appropriately a matter for interpretation by your auditors, whose opinions ultimately must satisfy the bond rating agencies. Thus, we defer to your Auditors and those of the State of New Mexico to make a determination of the proper form of organization under which NMRHCA will be categorized for financial reporting purposes.

That being said, Segal has performed its valuation under the expectation that NMRHCA will be seen as a Multiple Employer Cost Sharing Plan operating through an arrangement that qualifies as an "Equivalent Arrangement" to a trust. This view is based on the statutory provisions that establish membership in the program as *irrevocable*, the operating characteristics that assets held are for the *exclusive use of providing benefits to retirees of member employers,* and the fact that assets appear to be *beyond reach of the creditors* of member employers. Any other interpretation would not be consistent with the member employers current belief that their only obligation is to fund statutory payroll contributions, and would likely not be in the interest of member employers as it would result in them having to report liabilities under GASB 45 on an individual basis without the ability to fully recognize assets held by NMRHCA. To the extent the auditors recommend operational or statutory changes necessary to support this interpretation we strongly support their consideration.

In performing our preliminary GASB 43 valuation we valued the plan at three interest rates. This included a valuation at 5% based on characterization of NMRHCA as a partially funded plan. Verbal discussions with Robert Schmidt of Milliman resulted in his support of 5% as a reasonable assumption for valuing the NMRHCA program as a partially funded program at its current funding level. In consultation with Milliman regarding various options for interpretation of GASB 43 requirements, we now believe that your FY2007 financial report should be based on this 5% estimate updated to include retiree life liabilities calculated in accordance with their recommendations. We previously took a more conservative approach in selecting the 3.5% discount assumption but have come to believe this conservatism is unnecessary and may not be fully supportive of the interpretation of NMRHCA as an “Equivalent Arrangement”. We estimate this final calculation will be 2-5% higher than the prior preliminary estimate, which did not include retiree life liabilities as previously disclosed. At your direction, we can make the adjustment and finalize the GASB report for your auditors.

Please contact us if you have any further questions on our interpretation of the GASB reporting requirements or our recommendation for finalizing the Disclosure Projections for FY 2007.

APPENDIX II: OVERVIEW OF GASB 43 AND 45

GASB Statements 43 and 45 were established to develop uniform financial reporting standards for Other Post Employment Benefits, i.e. retiree life, health and other benefits that are not pension benefits. It is designed to be consistent in its approach with GASB 25 which applies to pension benefits. The goal is to identify the present value of future benefit promises, both formal and implied, and to account for and allocate such projected costs over the effective working lifetime of the active employees to whom benefits will ultimately be paid. As a new standard, GASB allowed the cost of benefits attributable to past service to be recognized over a 30 year amortization period, plus recognition of future service as it accrues.

In order to encourage public sector entities to advance fund such obligations on an accrual basis, the GASB Board adopted policies that allow a plan to recognize assets already contributed as an offset to such liabilities and value the liabilities based on expected investment returns on invested assets to the extent the plan is funding it's Annual Required Contributions into an Irrevocable Trust or an Equivalent Arrangement. Such an arrangement must satisfy a three part test which includes:

- Employer contributions to the plan are irrevocable
- Plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan
- Plan assets are legally protected from creditors of the employer(s) or the plan administrator

If such conditions are not met, then investment assets may not be recognized as an offset to liabilities and the interest rate for valuation of such liabilities must be reduced to a short term rate of return, resulting in significantly higher liabilities for disclosure purposes.

APPENDIX III: ILLUSTRATIVE IMPACT ON AVERAGE RETIREE

Appendix III

	Years of Service	**2**	**20**	
	Percent of Subsidy	**0**	**100**	
NON-MEDICARE MEDICAL				
Gold	**Retiree**	4		**Retiree Share @ 20 YOS**
1/1/08 Retiree Contribution		$734.31	$160.31	21.83%
7/1/08 Retiree Contribution		$734.31	$265.37	36.14%
1/1/09 Retiree Contribution		$800.40	$282.13	35.25%
1/1/10 Retiree Contribution		$872.44	$300.39	34.43%
	Spouse			
1/1/08 Retiree Contribution		$701.72	$307.28	43.79%
7/1/08 Retiree Contribution		$701.72	$455.38	64.89%
1/1/09 Retiree Contribution		$764.87	$488.95	63.93%
1/1/10 Retiree Contribution		$833.71	$525.55	63.04%
	Dependent			
1/1/08 Retiree Contribution		$171.63	$193.58	112.79%
7/1/08 Retiree Contribution		$171.63	$193.58	112.79%
1/1/09 Retiree Contribution		$187.08	$193.58	103.47%
1/1/10 Retiree Contribution		$203.92	$203.92	100.00%
Silver	**Retiree**			
1/1/08 Retiree Contribution		$372.34	$112.65	30.25%
7/1/08 Retiree Contribution		$372.34	$186.17	50.00%
1/1/09 Retiree Contribution		$405.85	$202.93	50.00%
1/1/10 Retiree Contribution		$442.38	$221.19	50.00%
	Spouse			
1/1/08 Retiree Contribution		$497.35	$253.71	51.01%
7/1/08 Retiree Contribution		$497.35	$373.01	75.00%
1/1/09 Retiree Contribution		$542.11	$406.58	75.00%
1/1/10 Retiree		$590.90	$443.18	75.00%

Contribution				
	Dependent			
1/1/08 Retiree Contribution		$155.10	$174.05	112.22%
7/1/08 Retiree Contribution		$155.10	$174.05	112.22%
1/1/09 Retiree Contribution		$169.06	$174.05	102.95%
1/1/10 Retiree Contribution		$184.28	$184.28	100.00%
Bronze	**Retiree**			
1/1/08 Retiree Contribution		$265.58	$111.76	42.08%
7/1/08 Retiree Contribution		$265.58	$122.50	46.13%
1/1/09 Retiree Contribution		$289.48	$139.26	48.11%
1/1/10 Retiree Contribution		$315.53	$157.52	49.92%
	Spouse			
1/1/08 Retiree Contribution		$201.73	$199.58	98.93%
7/1/08 Retiree Contribution		$201.73	$306.99	152.18%
1/1/09 Retiree Contribution		$219.89	$340.56	154.88%
1/1/10 Retiree Contribution		$239.68	$377.16	157.36%
	Years of Service	**2**	**20**	**Retiree Share @ 20 YOS**
	Percent of Subsidy	**0**	**100**	
Bronze	**Dependent**			
1/1/08 Retiree Contribution		$87.85	$163.95	186.62%
7/1/08 Retiree Contribution		$87.85	$163.95	186.62%
1/1/09 Retiree Contribution		$95.76	$163.95	171.21%
1/1/10 Retiree Contribution		$104.38	$163.95	157.07%
MEDICARE MEDICAL				
BCBS Carveout	**Retiree**			
1/1/08 Retiree Contribution		$339.86	$158.48	46.63%
7/1/08 Retiree Contribution		$339.86	$202.76	59.66%
1/1/09 Retiree Contribution		$370.45	$215.47	58.16%
1/1/10 Retiree Contribution		$403.79	$229.33	56.79%
	Spouse			
1/1/08 Retiree Contribution		$356.01	$225.99	63.48%
7/1/08 Retiree Contribution		$356.01	$284.89	80.02%
1/1/09 Retiree Contribution		$388.05	$304.78	78.54%
1/1/10 Retiree		$422.97	$326.45	77.18%

Contribution				
	Dependent			
1/1/08 Retiree Contribution		$250.93	$157.43	62.74%
7/1/08 Retiree Contribution		$250.93	$250.93	100.00%
1/1/09 Retiree Contribution		$273.51	$273.51	100.00%
1/1/10 Retiree Contribution		$298.13	$298.13	100.00%
BCBS Complementary	**Retiree**			
1/1/08 Retiree Contribution		$282.51	$89.49	31.68%
7/1/08 Retiree Contribution		$282.51	$141.26	50.00%
1/1/09 Retiree Contribution		$307.94	$153.97	50.00%
1/1/10 Retiree Contribution		$335.65	$167.83	50.00%
	Spouse			
1/1/08 Retiree Contribution		$294.59	$155.34	52.73%
7/1/08 Retiree Contribution		$294.59	$220.94	75.00%
1/1/09 Retiree Contribution		$321.10	$240.83	75.00%
1/1/10 Retiree Contribution		$350.00	$262.50	75.00%
	Dependent			
1/1/08 Retiree Contribution		$164.02	$112.27	68.45%
7/1/08 Retiree Contribution		$164.02	$164.02	100.00%
1/1/09 Retiree Contribution		$178.78	$178.78	100.00%
1/1/10 Retiree Contribution		$194.87	$194.87	100.00%

- Assumes 50%/75%/100% applies to base plan for 20 year service retiree

- Assumes phase in of full actuarial adjustment to Gold, Bronze and Carveout Plus on 7/1/08

- Does not include yet to be determined adjustment for participation fee

- Assumes 9% annual increase in total medical costs on a calendar year basis

APPENDIX IV: ILLUSTRATIVE IMPACT ON AVERAGE ACTIVE

Appendix IV - Illustrative Impact on Average Active

ER/EE Payroll Contribution		Employer	Employee	Total	Last Year of Solvency
50% Retiree / 75% Spouse Share with 8% ultimate trend		1.600%	0.800%	2.400%	06/30/2022

Last Year of Solvency is FYE during which Investment Assets drop to $0

Annual Increase in Active Contributions	Employer	Employee	Total
$25,000 Annual Pay			
Current Active Contribution	$325.00	$162.50	$487.50
Increase in Active Contribution	$75.00	$37.50	$112.50
Total Active Contribution	$400.00	$200.00	$600.00
$40,000 Annual Pay			
Current Active Contribution	$520.00	$260.00	$780.00
Increase in Active Contribution	$120.00	$60.00	$180.00
Total Active Contribution	$640.00	$320.00	$960.00

APPENDIX V: ACTIVE MEMBER EMPLOYER'S IN RHCA

BERNALILLO CO FIRE
BERNALILLO CO SHERIFF
BERNALILLO COUNTY OF
CHAVES COUNTY OF
CIBOLA COUNTY OF
COLFAX COUNTY
CURRY COUNTY OF
EDDY COUNTY OF
GRANT COUNTY
LEA COUNTY OF
LINCOLN COUNTY OF
LOS ALAMOS COUNTY
LUNA COUNTY OF
MC KINLEY COUNTY OF
NORTH CENTRAL SOLID WASTE AUTHORITY
RIO ARRIBA COUNTY
ROOSEVELT COUNTY OF
SAN JUAN COUNTY FIRE
SAN JUAN COUNTY OF
SAN JUAN COUNTY POLICE
SAN MIGUEL COUNTY OF
SANDOVAL COUNTY OF
SANDOVAL COUNTY SHERIFF
SANTA FE COUNTY OF
TAOS COUNTY OF
TORRANCE COUNTY OF
UNION COUNTY
VALENCIA COUNTY OF

ALAMOGORDO CITY FIRE
ALAMOGORDO CITY OF
ALAMOGORDO CITY POLICE
ALBUQUERQUE CITY OF
AZTEC CITY OF
BELEN CITY FIRE
BELEN CITY OF
BELEN CITY POLICE
BERNALILLO TOWN OF
BLOOMFIELD CITY OF
BOSQUE FARMS VILLAGE OF
CARLSBAD CITY FIRE
CARLSBAD CITY OF
CARLSBAD CITY POLICE
CHAMA VILLAGE OF

CLOVIS CITY FIRE
CLOVIS CITY OF
CLOVIS CITY POLICE
DEMING CITY OF
DES MOINES VILLAGE OF
ELIDA TOWN OF
ESPANOLA CITY OF
ESTANCIA TOWN OF
FT SUMNER VILLAGE OF
GALLUP CITY HOUSING AUTH
GALLUP CITY OF
HATCH VILLAGE OF
JAL CITY OF
JEMEZ SPRINGS VILLAGE OF
LAS CRUCES CITY OF
LAS VEGAS CITY OF
LOGAN VILLAGE OF
MELROSE VILLAGE OF
MILAN VILLAGE FIRE
MILAN VILLAGE OF
MORIARTY CITY FIRE
MORIARTY CITY OF
MORIARTY CITY POLICE
PECOS VILLAGE OF
PORTALES CITY FIRE
PORTALES CITY OF
QUESTA VILLAGE OF
RATON CITY OF
RATON PUBLIC SERVICE
RESERVE VILLAGE OF
ROSWELL CITY OF
SANTA FE CITY OF
SANTA FE CIVIC HOUSING AUTH
SANTA ROSA CITY OF
SILVER CITY TOWN OF
SOCORRO CITY FIRE
SOCORRO CITY OF
SOCORRO CITY POLICE
SPRINGER TOWN OF
SUNLAND PARK CITY OF
T OR C CITY OF
T OR C CITY HOUSING AUTH
TAOS TOWN OF
TATUM TOWN OF
TEXICO TOWN OF
TEXICO TOWN POLICE
TIJERAS VILLAGE OF
TUCUMCARI CITY OF

CENTRAL REGION EDUCATION COOPERATIVE
HIGH PLAINS REG EDUC COOP
NEA - NEW MEXICO
NORTHEAST REGIONAL EDUCATIONAL COOP #4
PECOS VALLEY REC #8
RATON HOUSING AUTHORITY
REC #6 (REGIONAL EDUCATIONAL #6)
REGION IX EDUCATION COOPERATIVE
SANTA FE COMMUNITY COLLEGE
SOUTHERN SANDOVAL COUNTY ARROYO FLOOD CTRL AUTH
SOUTHWEST NM COUNCIL OF GOV
SOUTHWEST REG. EDU. #10
TIERRA Y MONTES SWCD

21ST CENTURY MIDDLE SCHOOL
ACADEMIA DE LENGUA Y CULTURA
ACADEMY FOR TECH & CLASSICS
AIMS/HIGH TECH HIGH
ALAMOGORDO PUBLIC SCHOOLS
ALBUQUERQUE PUBLIC SCHOOLS
ALDO LEOPOLD CHARTER SCHOOL
ALMA DE ARTE
AMISTAD CHARTER SCHOOL
AMY BIEHL CHARTER SCHOOL
ANANSI CHARTER SCHOOL
ANIMAS PUBLIC SCHOOLS
ARTESIA PUBLIC SCHOOLS
AZTEC MUNICIPAL SCHOOLS
BELEN CONSOLIDATED SCHOOL
BERNALILLO PUBLIC SCHOOLS
BLOOMFIELD MUNICIPAL SCH
BRIDGE ACADEMY CHARTER SCHOOL
CAPITAN MUNICIPAL SCHOOLS
CARLSBAD MUNICIPAL SCHOOL
CARRIZOZO SCHOOL DISTRICT
CENTRAL CONSOLIDATED SCH. DIST 22
CESAR CHAVEZ COMMUNITY CHARTER SCHOOL
CHAMA VALLEY INDEP. SCHOO
CHRISTINE DUNCAN COMMUNITY SCHOOL
CIMARRON MUNICIPAL SCHOOL
CLAYTON MUNICIPAL SCHOOLS
CLOUDCROFT SCHOOL DISTRICT
CLOVIS MUNICIPAL SCHOOLS
COBRE CONSOLIDATED SCHOOL
CORONA PUBLIC SCHOOLS
COTTONWOOD VALLEY CHARTER SCHOOL
CREATIVE EDUC PREP INST #1

CREATIVE EDUC PREP INST #2
CUBA INDEPENDENT SCHOOLS
DATA (DIGITAL ARTS & TECH ACADEMY)
DEMING PUBLIC SCHOOLS
DES MOINES MUNICIPAL SCHOOL
DEXTER CONSOLIDATED SCHOOLS
DORA CONSOLIDATED SCHOOLS
DULCE INDEPENDENT SCHOOLS
EAST MOUNTAIN HIGH SCHOOL
ELIDA MUNICIPAL SCHOOLS
ESPANOLA MILITARY ACADEMY
ESPANOLA PUBLIC SCHOOLS
ESTANCIA MUNICIPAL SCHOOL
EUNICE PUBLIC SCHOOLS
FARMINGTON MUNICIPAL SCHOOLS
FLOYD MUNICIPAL SCHOOLS
FT SUMNER MUNICIPAL SCHOOL
GADSDEN INDEPENDENT SCHOOL DISTRICT
GALLUP-MCKINLEY COUNTY SCHOOLS
GRADY MUNICIPAL SCHOOLS
GRANTS-CIBOLA COUNTY SCHOOLS
HAGERMAN MUNICIPAL SCHOOL
HATCH VALLEY MUNICIPAL SCHOOL
HOBBS MUNICIPAL SCHOOLS
HONDO VALLEY PUBLIC SCHOOL
HORIZON ACADEMY SOUTH
HORIZON ACADEMY WEST
HOUSE MUNICIPAL SCHOOLS
JAL PUBLIC SCHOOLS
JEFFERSON MONTESSORI ACADEMY
JEMEZ MOUNTAIN SCHOOL DISTRICT
JEMEZ VALLEY PUBLIC SCHOOLS
LA ACADEMIA DE DOLORES HUERTA
LA ACADEMIA DE ESPERANZA CHARTER SCHOOL
LA LUZ DEL MONTE LEARNING CENTER
LA PROMESA EARLY LEARNING CENTER
LACY SIMMS MIDDLE SCHOOL
LAKE ARTHUR SCHOOLS
LAS CRUCES MUNICIPAL SCHOOLS
LAS VEGAS CITY SCHOOLS
LAS VEGAS WEST PUBLIC SCHOOLS
LEA REGIONAL EDUCATION #VII
LEARNING COMMUNITY CHARTER SCHOOL
LOGAN MUNICIPAL SCHOOL
LORDSBURG MUNICIPAL SCHOOLS
LOS ALAMOS PUBLIC SCHOOLS
LOS LUNAS CONSOLIDATED SCHOOLS
LOS PUENTES CHARTER SCHOOL

LOVING MUNICIPAL SCHOOLS
LOVINGTON MUNICIPAL SCHOOLS
MAGDALENA MUNICIPAL SCHOOLS
MAXWELL MUNICIPAL SCHOOLS
MELROSE MUNICIPAL SCHOOLS
MESA VISTA SCHOOLS
MONTE DEL SOL CHARTER SCHOOL
MONTESSORI ELEM CHARTER SCHOOL
MONTESSORI OF THE RIO GRANDE CHARTER
MORA INDEPENDENT SCHOOLS
MORENO VALLEY CHARTER HIGH SCHOOL
MORIARTY MUNICIPAL SCHOOL
MOSAIC ACADEMY CHARTER SCHOOL MOSAIC ACAD CHARTER
MOSQUERO MUNICIPAL SCHOOL
MOUNTAIN MAHOGANY
MOUNTAINAIR PUBLIC SCHOOL
NACC CHARTER SCHOOL
NM ACTIVITIES ASSOC.
NM HIGHLANDS UNIVERSITY
NM SCHOOL FOR THE DEAF
NORTH VALLEY ACADEMY\HORIZON ACAD NW
NORTHERN NM COLLEGE
NUESTROS VALORES CHARTER SCHOOL
PECOS INDEPENDENT SCHOOLS
PENASCO INDEPENDENT SCHOOLS
POJOAQUE VALLEY SCHOOLS
PORTALES MUNICIPAL SCHOOL
PUBLIC ACAD FOR PERFORMING ARTS
QUEMADO IND SCHOOL DISTRICT
QUESTA INDEPENDENT SCHOOL
RALPH J. BUNCHE ACADEMY
RATON PUBLIC SCHOOLS
RED RIVER VALLEY CHARTER SCHOOL
RESERVE SCHOOL DISTRICT
RIO RANCHO PUBLIC SCHOOLS
ROBERT F KENNEDY CHARTER SCHOOL
ROOTS AND WINGS COMMUNITY SCHOOL
ROSWELL INDEPENDENT SCHOOLS
ROY SCHOOLS
RUIDOSO MUNICIPAL SCHOOLS
S I A . TECH-ALBUQUERQUE
SAN JON MUNICIPAL SCHOOLS
SANTA FE PUBLIC SCHOOLS
SANTA ROSA CONSOLIDATED SCHOOLS
SIDNEY GUTIERREZ MIDDLE SCHOOL
SILVER CONSOLIDATED SCHOOLS
SOCORRO CONSOLIDATED SCHOOLS

SOUTH VALLEY ACADEMY
SOUTHWEST PRIMARY LEARNING CENTER
SOUTHWEST SECONDARY LEARNING CTR
SPRINGER MUNICIPAL SCHOOL
SSCAFCA
T OR C MUNICIPAL SCHOOLS
TAOS MUNICIPAL CHARTER SCHOOL
TAOS MUNICIPAL SCHOOLS
TATUM MUNICIPAL SCHOOLS
TEXICO MUNICIPAL SCHOOL
TUCUMCARI MUNICIPAL SCHOOL
TULAROSA MUNICIPAL SCHOOL
TURQUOISE TRAIL ELEM SCHOOL
VAUGHN MUNICIPAL SCHOOLS
WAGON MOUND PUBLIC SCHOOL
WALATOWA CHARTER HIGH SCHOOL
WESTERN NM UNIV
YOUTH BUILD TRADE & TECHNOLOGY
ZUNI PUBLIC SCHOOL

CENTRAL NM COMMUNITY COLLEGE
EASTERN NM UNIV-PORTALES
EASTERN NM UNIV-ROSWELL
LUNA COMMUNITY COLLEGE
MESALANDS COMMUNITY COLLEGE
NM JUNIOR COLLEGE
NM MILITARY INSTITUTE

APPENDIX VI: CENTRAL STATE COMPENSATION SURVEY