Oct. 31, 2003

FROM: Alvin L. Goldman, Professor
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RE: Reflections on the Recommendations of the Retiree Task Force (dated Aug. 12, 2003)

1. As is discussed below, the Task Force Report is unclear regarding some vital points. Fortunately, this morning's Herald-Leader front page article, assuming it was accurate, clarified some of these matters. Accordingly, portions of the discussion below are based on those clarifications.

2. The Report explains that the review was conducted in anticipation of a new Government Accounting Standards Board (GASB) standard. It should be noted that that organization is <u>not</u> a governmental body. It is an organization formed by various associations of state and local government financial officers. Thus, unless its standard is adopted by a governmental entity with authority over UK, its standards are of advisory significance only. Therefore, its impending release does not put any extraordinary pressure on the University to resolve this issue. The Herald-Leader article suggests that compliance with GASB accounting standards may affect the University's ability to sell bonds. When the University sells bonds, in order to get the lowest rates, normally it earmarks specific revenue for their repayment. Revenue bonds should not be affected by UK's accounting practices regarding contingent liability for medical benefits.

3. The Report does not provide a clear explanation of the goals of any changes that are to be made—other than to save money. It speaks of protecting the future of retiree health benefits but says nothing about making a contractual commitment to maintain the benefits program or vest those benefits upon retirement so that they cannot later be reduced or eliminated. It also speaks about reducing the University's "liability" when apparently what is involved is reducing the University's costs. Nor does the Report explain why those costs must be reduced or by how much they must be reduced. Most importantly, it does not explain why present and prospective retirees should bear the burden of cost reductions or what impact those reductions will have on faculty morale or the University's ability to retain and recruit faculty.

A particular weakness of the Report is that is ignores the benefits to the University of a health insurance program that provides a significant incentive for faculty to retire sooner rather than later. To identify just one such benefit, the retirement of every two or three senior faculty frees salaries that are sufficient to hire three or four junior faculty. Making medical insurance more expensive reduces the incentive for faculty members to retire in advance of having to be carried-out.

What the Report does say is that the needs of current and future retirees must be balanced against other salary, benefit and program needs of the University. The correct adjective for the proposal is "sacrifice", not "balance". What is the justification for asking retirees (people who have devoted a substantial portion of their working lives to UK) to suffer reduced benefits in order to pay higher salaries for new or continuing faculty and staff, pay bonuses to administrators, pay for new buildings and equipment, and the like? Those who are, and those who soon will be, retired built and strengthened this University through decades of under funding; decades when UK ranked at or near the bottom of the compensation scale for comparable institutions. Why should burden of expanding future budgets be added to their shoulders by disappointing their reasonable expectations respecting continuing medical insurance support?

The Report also says that such cuts are being made by many companies. However, traditionally, an incentive for accepting lower paid government employment has been the security of better and more reliable post employment benefits. Thus, private companies are not a relevant benchmark for the practices of a state institution's human resources policies.

Although there is wisdom in establishing an actuarially based trust fund to ensure the financial integrity of commitments to retirees (it is not clear that that will be done under the proposal), such a change is meaningless unless accompanied by the vesting of those benefits in the retirees, and is no excuse for reducing what is provided to the retirees.

4. The Report says the assumptions of the projected financing needs is based on the expectation that the costs of providing health benefits will annually increase "for infinity." That is a politically naive assumption. Congress eventually will have to expand national health insurance protections and regulate its costs. As a result, at some point, future burdens on the University will be reduced or eliminated, not increased.

5. The alternative Scenarios provided by the Report are confusing. If there is a distinction between Scenario A and Scenario B, it is not apparent on the face of the description. One Scenario involves a 4% <u>interest</u> calculation, the other a 4% <u>indexing</u>. Perhaps that distinction is clear to finance or insurance experts; it is unclear to the average future retiree. Additionally, there is no explanation of what is meant by "annual cap". Is that a cap on the contribution to the health care premium? On the amount of benefits paid? On something else? Perhaps those who already are retired understand this provision since it appears to be tied into the receipt of a "retiree health credit". However, that term is not self-evident for those who are not yet in this system.

Nor is there an explanation of how a “notional” account is to operate. One who consults the dictionary to try to discover what is meant by a “notional account”, is left quite uneasy since the first definition of “notion” is: “speculative or imaginary rather than factual.”

Fortunately, the Herald-Leader report appears to clarify how the proposal is to work and the remainder of this discussion is largely based on that clarification.

6. The breach of faith involved in imposing a cap on UK’s contributions to a retiree’s health insurance premium are obvious. This is aggravated by the fact that because it is a self-insurer, the University controls the cost accounting (including allocations of overhead) that determines the premium rate for that insurance.

Moreover, in proposing a cap (whether $6,000 or $7,500), no attention is given to inflation. With current record federal budget deficits, history teaches that high rates of inflation are around the corner. The real dollar value of a $7,500 cap in 2003 may well be $2,500 by 2012. Thus, even if a cap was justified, the only fair approach would be to tie it to the consumer price index.

It appears, too, that retirees will receive no further assistance from UK once UK has cumulatively paid $50,000 in premiums on their behalf plus the additional amount accrued at 4% per year. If that is a correct understanding, what it means, of course, is that when someone who retired at 65 reaches about 80 years of age (or less), and likely are burdened by increased need for medical care and medications, UK will cease providing any premium assistance. That result will surely dissuade many from retiring until forced to do so and is a breach of faith with the faculty and staff. Moreover, even if a cumulative limit on premium contributions was justifiable, it should be tied to inflation, not a fixed annual 4% increase.

7. In summary, the Committee operated under an unnecessary time constraint that obviously impaired both its analysis and explanation. This issue should be resubmitted for further study.