BETTER BENEFITS FROM OUR BILLION BUCKS:

THE CASE FOR REFORMING MUNICIPAL UNION WELFARE FUNDS

August 2010

FOREWORD

Founded in 1932, the Citizens Budget Commission (CBC) is a nonprofit, nonpartisan civic organization devoted to influencing constructive change in the finances and services of New York State and New York City governments. A major activity of the Commission is conducting research on the financial and management practices of the State and the City.

Courtney Wolf, Research Associate, did most of the research for this report, and Courtney Wolf and Charles Brecher, Director of Research and Executive Vice President, wrote the report. Maria Doulis, Senior Research Associate, provided guidance and suggestions at all stages of the work. Connor Mealey, Research Assistant, provided research support. James Hanley, Commissioner of Labor Relations for the City of New York, and Gail Laufer and Dorothy Wolfe of the New York City Office of Labor Relations provided assistance and comments on a draft of the report. H. Tina Kim, Deputy Comptroller for Audit for the City of New York, also reviewed a draft of the report. Cary Cheung of the New York City Office of Management and Budget provided helpful comments and suggestions. We thank each of these public servants for their cooperation, but their willingness to be helpful does not necessarily indicate an endorsement of the views and recommendations presented in the report.

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INTRODUCTION

Municipal government is a labor intensive activity. The City of New York and its related agencies have more than 362,000 full-time equivalent employees; of the City's $63 billion annual expense budget, more than 57 percent, or $36 billion, is allocated to employee compensation.[1] Using this money effectively is critical to the City's fiscal health and efficient service delivery.

Like most workers, municipal employees receive their compensation in a variety of forms. In addition to a salary or wage, they receive fringe benefits such as employer paid social insurance taxes, employer contributions for health insurance premiums and employer contributions to pension funds. As shown in Table 1, fringe benefits represented nearly $12.7 billion in fiscal year 2009 and are projected to be nearly $13.8 billion in fiscal year 2010. The latter sum is equivalent to about 38 percent of total compensation costs and about 62 percent of salary and wage payments.

Table 1: City of New York Personal Service Spending By Type, Fiscal Years 2009 and 2010
(Dollars in Millions)

	Fiscal Year 2009	Fiscal Year 2010
Salaries and Wages	**$21,824**	**$22,275**
Full Time	17,665	NA
Part Time	111	NA
All Other[1]	4,048	NA
Fringe Benefits	**$12,673**	**$13,781**
Pensions	6,389	6,760
Health Insurance	3,411	3,712
Social Security	1,555	1,658
Union Welfare Funds[2]	940	1,123
All Other	378	528
Total Personal Service	**$34,497**	**$36,056**
All Spending[3]	**$62,615**	**$63,359**

NA = Not Available

[1] Includes overtime, shift differentials and other additional pay.

[2] Includes one-time payments totaling $117 million from the Health Insurance Stabilization Fund in fiscal year 2010.

[3] Includes off-budget debt service and adjusted for prepayments.

Sources: New York City Office of the Comptroller, *Comprehensive Annual Financial Report of the Comptroller for the Fiscal Year Ended June 30, 2009* , Schedule G6; New York City Office of Management and Budget, *Five Year Financial Plan Revenues and Expenditures,* June 2010; and updated data provided by the New York City Office of Management and Budget.

One significant, but not well understood, fringe benefit is employer contributions to union welfare funds. These City payments are now $1 billion annually. Yet, as this report indicates, these payments serve neither the City nor its workers well. Equivalent or better benefits could be provided for less money by using different arrangements; reforms could yield a "win-win" situation in which workers are better served and taxpayers save money.

The remainder of this report is organized in three parts. The next section describes the organization and financing of the union welfare funds. The following section identifies and documents three problems with the current arrangements – limited accountability, poor financial management and inefficient provision of benefits. The final section presents recommendations to improve the use of these payments and provide taxpayer savings.

ORGANIZATION AND FINANCING OF WELFARE FUNDS

Union welfare funds are distinct legal entities created by a union for the purpose of providing benefits to its members, who are active employees and retirees. The welfare funds are governed by a board, whose members are typically appointed by (and may overlap with) the leadership of the parent union. The funds hire employees to help administer their benefit programs.

Each of 58 unions that represent New York City employees has established at least one welfare fund.[2] Because some unions create separate funds, with separate benefit arrangements, for active members and for retirees, the total number of welfare funds operated by these unions is 81.

The unions with which the City deals vary in their size and the extent to which their membership is concentrated in municipal government. Some have a relatively small membership, all of whom work in (or have retired from) government – for example, the 148-member New York City Deputy Sheriffs Association. Others are larger, but also represent workers drawn exclusively from public sector jobs – for example, the nearly 47,000-member Patrolmen's Benevolent Association.

Unions have 81 welfare funds

Other unions represent workers in occupations engaged by the public and private sectors, and their members in municipal agencies often are a minority fraction of the total membership. For example, carpenters employed by the City belong to a carpenters' union whose membership is employed primarily by private firms, and some medical workers belong to Local 1199 of the Service Employees International Union, a group whose members are employed primarily by private hospitals.

Where the Money Comes From

The amount the City pays to a union's welfare fund or funds is negotiated with each union. The amount is typically specified on an annual "per head" (employee and/or retiree) basis with payments pro-rated during the course of the year. Such payments were first negotiated by the Uniformed Sanitationmen's Association (USA) in 1963, when the payment was $57. Two other large unions, the Patrolmen's Benevolent Association (PBA) and District Council 37 (DC37), began receiving payments of $80 and $60 annually, respectively, in 1964, and the United Federation of Teachers (UFT) negotiated annual payments of $100 beginning in 1966. (See Table 2.)

The City contribution for DC37 is $1,840 per head in 2010

Most other unions also negotiated payments in that period, and the payments typically have been increased with each subsequent round of negotiations. In fiscal year 2010, the recurring annual payment for the USA was $1,473, for the UFT it was $1,720, and for DC37 it was $1,640; in addition, each union also received a one-time payment of another $200 in that year. The average increase in per head welfare fund payments has far exceeded the rate of inflation with the constant dollar amount typically growing an average of four to seven percent annually.

Table 2: City Payment Per Head to Selected Union Welfare Funds, Selected Fiscal Years 1963 - 2010

Fiscal Year	Patrolmen's Benevolent Association	Uniformed Sanitationmen's Association	United Federation of Teachers	District Council 37
1963	NAP	$57	NAP	NAP
1964	$80	107	NAP	$60
1965	105	134	NAP	60
1966	130	159	$100	60
1970	190	219	205	125
1975	300	300	320	350
1980	400	400	445	350
1985	625	625	745	625
1990	825	675	945	825
1995	925	1,012 [a]	1,145	1,125
2000	1,200	1,125	1,420 [b]	1,375 [c]
2005	1,465	1,473	1,585	1,540
2006	1,565	1,573	1,685	1,640
2007	1,465	1,473	1,585	1,707 [d]
2008	1,465	1,473	1,852 [e]	1,640
2009	1,521	1,473	1,685	1,640
2010	1,779 [f]	1,673 [f]	1,920 [f]	1,840 [f]
Avg Annual Percent Change in Nominal Dollars	**7%**	**8%**	**7%**	**8%**
Avg Annual Percent Change in Constant Dollars	**5%**	**7%**	**4%**	**7%**

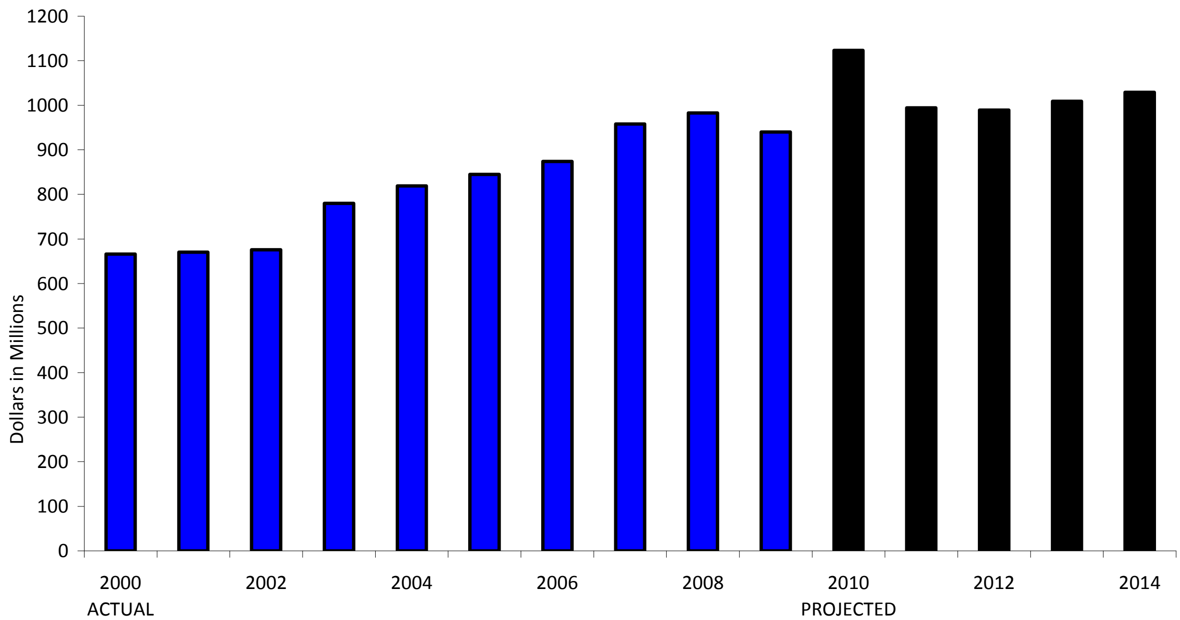
NAP = Not Applicable (no contributions made)

Notes: [a] Includes a $37 one-time payment. [b] Includes a $100 one-time payment. [c] Includes a $100 one-time payment. [d] Includes a $166.67 one-time payment. [e] Includes a $166.67 one-time payment. [f] Includes a $200 one-time payment.

Sources: Data supplied by the New York City Office of Labor Relations.

Increases in the per head payments have led to increasing costs to the City to fund these benefits. Figure 1 shows the City's aggregate cost of payments to the welfare funds from fiscal years 2000 through 2009, as well as the projected costs for fiscal years 2010 through 2014. From 2000 to 2009, costs to the City grew 41 percent, or about 4 percent on average annually. The spike in contributions in fiscal year 2010 is due to a one-time payment of $200 per member that was negotiated as part of the 2009 Health Benefits Agreement. That one time payment, costing $117 million, was paid from the Health Stabilization Fund, not from the City's general fund. (However, the Health Stabilization Fund is supported with annual payments from the City's general fund, so it too is taxpayer supported.) Adjusting for the $117 million lump-sum payment, over the plan years, the City payments to the funds are projected to grow about 2 percent or just over one-half of one percent on average annually. This notable slowdown in growth is due in part to the projected reduction in the number of workers. In addition, the projected figures assume no increase in per head payments in upcoming contract negotiations, an appropriate planning assumption but not a likely outcome of actual negotiations. Nonetheless, even with this cautious assumption, City payments will exceed $1 billion in each future year.

Figure 1: Total City Contributions to Union Welfare Funds, Fiscal Years 2000-2014



Note: Includes one-time payments totaling $117 million to union welfare funds from the Health Insurance Stabilization Fund in fiscal year 2010.

Sources: Actual data from New York City Office of the Comptroller, *Comprehensive Annual Financial Report of the Comptroller* , fiscal year 2000 – 2009 editions, Schedule G6; projected data provided by the New York City Office of Management and Budget.

Most of the City's payments go to several large unions. Ten large unions accounted for over 83 percent of the total the City paid to funds covered in the Comptroller's review of 2007 welfare fund reports. (See Table 3.) The union with the largest City revenue, DC37, received over $254 million from the City in 2007. The UFT received over $250 million and the PBA over $70 million. Seven other unions received between $20 million and $49 million. At the other end of the spectrum, ten unions received less than $275,000. The union with the smallest City payment, the Surrogates and Supreme Court Reporters Association, received $3,598 in total.

Table 3: Highest and Lowest New York City Payments to Union Welfare Funds, 2007

Name of Fund	Number of Members	City Payments	Total Revenue
Highest			
District Council 37	156,616	$254,052,851	$284,905,710
Local 2 United Federation of Teachers	163,777	$250,646,789	$261,025,405
Patrolmen's Benevolent Association	46,622	$70,717,162	$80,598,556
Local 237 Teamsters	26,812	$48,885,554	$54,950,765
Professional Staff Congress CUNY	17,487	$30,866,759	$34,316,715
Local 94 Uniformed Firefighters Association	18,950	$30,704,614	$38,620,855
Local 371 Social Service Employees	16,876	$30,248,445	$30,518,531
Local 1180 Communications Workers of America Municipal Management	15,441	$25,991,307	$31,604,928
Detectives Endowment Association	15,664	$24,256,323	$29,022,236
Correction Officers' Benevolent Association	13,694	$21,703,827	$22,206,503
Lowest			
New York City Deputy Sheriffs Association	148	$272,311	$296,299
District No. 1 MEBA City Employees	136	$204,538	$303,402
Local 14A-14B IUOE	75	$146,207	$172,953
Local No. 5 Municipal Employees	76	$120,065	$181,647
Local 40 Iron Workers	NA	$114,600	$75,749,375
Local 306 Municipal Employees	55	$104,963	$117,175
Captains Endowment Association	NA	$57,351	$57,951
New York State Court Clerks Association	NA	$28,598	$1,006,461
New York State Court Officers Association	NA	$5,464	$2,232,835
Surrogates and Supreme Court Reporters Association	NA	$3,598	$178,405

NA = Not Available

Source: New York City Office of the Comptroller, *Audit Report: Analysis of the Financial and Operating Practices of Union-Administered Benefit Funds With Fiscal Years Ending in Calendar Year 2007*, December 2009.

For most of the unions, the City payments are the major source of revenue to the welfare funds. However, for those unions with substantial membership in the private sector, the payment from those employers may exceed the City's contribution. For example, the City's payments to the Iron Workers' Union (Local 40) are less than one percent of that welfare fund's total revenue. In addition, welfare funds may receive supplemental revenue from interest and dividends on fund investments.

What the Money Buys

Union welfare funds are intended to provide benefits that supplement the fringe benefits provided directly by the City. The direct benefits include a hospital and medical insurance package; workers can chose from among 12 different insurance plans,[3] and the City pays the premium cost for workers and dependents (and retirees and spouses) up to the cost of the plan offered by the Health Insurance Plan of Greater New York (HIP). More than 90 percent of workers and retirees choose the HIP or the other plan (Group Health Incorporated, or GHI) for which the City pays the full basic plan premium cost. In fiscal year 2010, the cost to the City for this health insurance benefit is about $3.7 billion. (Refer to Table 1.)

These plans offer comprehensive hospital and medical coverage, but do not cover prescription drugs and some other services such as optical and dental services. Employees and retirees can purchase optional riders for prescription drugs; however, many receive this benefit as well as others at little or no personal cost from their union welfare fund.[4]

Each union has discretion over what benefits are provided through the funds and who is eligible to receive them, although any changes to benefits or eligibility must be approved by the City's Office of Labor Relations (OLR). Table 4 summarizes the benefits offered by 70 funds that provided detailed benefits information to the Comptroller. All 70 funds provide some kind of optical and dental coverage, and 56, or 80 percent of the funds, provide prescription drug coverage. It is mostly smaller funds that do not provide prescription drug coverage; of the 14 funds that do not provide drug coverage, all but three have annual revenues of less than $1 million.

The funds commonly provide optical, dental and prescription drug benefits at little or no personal cost to their members

Table 4: Type of Benefits Offered by Union Welfare Funds, 2007

	Funds Providing Benefit			**Funds Providing Benefit**	
	Number	*Percent*		*Number*	*Percent*
HEALTH BENEFITS			**OTHER BENEFITS**		
Optical Services	70	100.0%	Life Insurance	45	64.3%
Dental Services	70	100.0%	Legal Services	35	50.0%
Prescription Drugs	56	80.0%	Death or Severance Benefits	22	31.4%
Other Medical	47	67.1%	Disability	18	25.7%
Hearing / Hearing Aids	36	51.4%	Retirement Counseling	13	18.6%
Podiatry / Orthotics	15	21.4%	Training and Education	7	10.0%
Hospital Care	11	15.7%	Health Club / Social / Lifestyle	6	8.6%
Mental Health	4	5.7%	Maternity	6	8.6%

Note: Based on 70 funds that provided benefit information to the Comptroller for 2007.

Source: New York City Office of the Comptroller, *Audit Report: Analysis of the Financial and Operating Practices of Union-Administered Benefit Funds With Fiscal Years Ending in Calendar Year 2007*, December 2009, Exhibit D.

Other common benefits include screenings and medical reimbursements, audiology, life insurance and death or severance benefits and legal services. Some funds also offer memberships to health clubs, education or training programs and retirement counseling. Depending on the fund, benefits may cover active full and part-time employees, retirees and their spouses and children.

Table 5 summarizes benefit expenditures in 2007 by type of benefit for three of the largest unions, DC37, the UFT and the PBA. For each, over 80 percent of claims expenditures went toward dental, optical and drug benefits, with drug coverage constituting the largest share. The other benefits offered by these union funds vary but include death and disability insurance and legal services.

Table 5: Welfare Fund Benefit Expenditures by Type of Benefit, 2007

	District Council 37		United Federation of Teachers		Patrolmen's Benevolent Association	
Benefit Type	*Amount*	*Percent of Total*	*Amount*	*Percent of Total*	*Amount*	*Percent of Total*
Prescription Drugs	$150,185,593	68.8%	$108,289,622	44.9%	$40,631,713	58.6%
Dental	$42,160,067	19.3%	$91,793,620	38.1%	$21,459,467	30.9%
Optical	$1,007,817	0.5%	$3,512,903	1.5%	$1,953,255	2.8%
Subtotal	**$193,353,477**	**88.6%**	**$203,596,145**	**84.4%**	**$64,044,435**	**92.3%**
All Other	$24,953,703	11.4%	$37,506,595	15.6%	$5,336,245	7.7%
Total	**$218,307,180**	**100.0%**	**$241,102,740**	**100.0%**	**$69,380,680**	**100.0%**

Note: Patrolmen's Benevolent Association data is the combined expenditures for separate funds for active and retired employees.

Sources: *District Council 37 Health & Security Plan Trust Financial Statements June 30, 2007 and 2006* , p. 12; *United Federation of Teachers Welfare Fund Financial Statements and Supplemental Schedules for the Years Ended September 30, 2007 and 2006,* p. 19; *Health and Welfare Fund of the Patrolmen's Benevolent Association of the City of New York Directive 12 Filing for FYE 6/30/2007,* Exhibit B; *Retiree Health and Welfare Fund of the Patrolmen's Benevolent Association of the City of New York Directive 12 Filing for FYE 6/30/2007,* Exhibit B.

PERSISTENT PROBLEMS

The current arrangements for providing supplementary benefits through union welfare funds suffer from three long-standing problems – limited accountability for the use of funds, poor financial management by fund boards and inefficient provision of benefits to members.

Limited Accountability

Each welfare fund is managed separately by a board of trustees consisting of members appointed by the union leadership. The board administers the fund in accordance with a Declaration of Trust that outlines the board's duties and authority, member eligibility requirements, fund investment guidelines and general guidelines for fund expenditures. The board generally hires a staff to oversee the day-to-day management of the fund.

The Comptroller's Office has not audited the welfare funds with great frequency, and where problems are uncovered, little enforcement authority exists over poorly performing funds

The Trust agreement also has provisions for bookkeeping and auditing, in accordance with the City Comptroller's Directive #12. Directive #12, one of the Comptroller's City Charter-mandated Internal Control and Accountability Directives, prescribes accounting, auditing and financial guidelines for welfare funds that receive payments from the City. It requires that managers of the funds submit independently audited financial statements and other documentation to the Comptroller annually. The Comptroller uses these documents to compile an annual report on the operations and financial practices of the welfare funds that receive City contributions.[5] The most recent such report was released in December 2009 and covers calendar year 2007. Additionally, each fund may be subject to a more detailed audit by the Comptroller's office.

Unfortunately, compliance with Directive #12 by many funds is neither timely nor complete. While the directive mandates that funds provide financial and operating information within nine months of the close of their fiscal year, for fiscal year 2007, 69 funds submitted late filings, four of which were over a year late; 15 funds submitted filings that included qualified or adverse statements from their auditors; and two funds submitted no financial information.[6] The result of such lax reporting standards is that the Comptroller is unable to respond to problems with fund management in a timely manner. Perhaps equally or more important is that Directive #12 grants the Comptroller's Office no meaningful authority to sanction funds that do not comply or that submit reports that reveal weak or improper financial management.

While the Comptroller's Office has the discretion to audit individual funds, it has not audited more than eight funds in any year since 1985, and in several years no funds were audited.[7] Moreover, welfare fund boards are not required to take corrective action in response to the Comptroller's findings and recommendations. In the most extreme cases, such as when fund mismanagement is suspected to be criminal, the Comptroller may refer a matter to law enforcement. Such was the case with the 2009 audit of the United Probation Officers Association's welfare fund, which found $285,000 of questionable expenses including over $180,000 for a health and wellness program of which there was no record.[8] A February 2010 newspaper article publicized the audit's findings, but only after the fund manager was indicted by federal prosecutors for embezzling from another union welfare fund. The article reports that the Comptroller's office had referred its findings to law enforcement, but as of the article's publication no charges had been filed in conjunction with the handling of the United Probation Officers Association fund.[9]

In less egregious but more common cases of weak welfare fund financial management, the Comptroller may only point out these deficiencies in his reports and make recommendations for addressing them. The funds' trustees have no obligation to heed any recommendation in any audit report; in the case of the United Probation Officers Association Welfare Fund audit, in response to most of the Comptroller's findings and recommendations the trustees explicitly rejected the findings.[10] After an audit report is released publicly, absent any suspected criminal activity, the Comptroller has no further course of action to compel a fund's management to address fund management deficiencies.

A survey of recent audits reveals mismanagement among almost all the audited funds. The Comptroller's office found several common issues among the 19 welfare funds that were audited from 2002-2009.[11]

- Eleven of the 19 were owed money by their parent union or by that union's other welfare fund. Sometimes this was the result of the welfare fund offices being housed on union property and the union overcharging for rent or other expenses. In the case of the Detectives Endowment Association, the active and retiree funds each were overcharged nearly $18,000 by their union.[12] Other times funds from an active fund were used to cover the deficits of the corresponding retiree fund or vice versa.
- Sixteen of the 19 were cited for paying improper benefits or not keeping documentation for benefit payments. Among those 16 funds, the two funds representing the United Probation Officers Association were each found to have paid over $100,000 for programs that did not exist.[13] A smaller fund for the Local 333 paid out $94,560 worth of ineligible payments which amounted to almost one third of the total payments made.[14] The Superior Officers Council kept no documentation for 71 percent of its benefit payments.[15]
- Twelve of the 19 kept no record of employee attendance, sick leave or vacation, and five made improper or questionable reimbursements or payments to trustees. For example, Local 300 S.E.I.U Civil Service Forum Employees Fund paid an employee for 13 days she did not work and reimbursed trustees for $3,761 in questionable travel expenses, both while running an operating deficit.[16]
- Seventeen of the 19 were cited for paying claims without the corresponding eligibility documentation.

Weak Financial Management

Although compliance with reporting requirements is unsatisfactory, the Comptroller uses the available information to screen for weaknesses in welfare fund financial management. The most recent report addresses three types of issues: excessive administrative costs, inappropriately high reserve levels and signs of insolvency such as low reserves and operating deficits. Among the funds, 48 had at least one of these issues and three evidenced all three. (See Table 6.)

Table 6: Union Welfare Funds with Major Financial Weakness by Revenue Category, 2007
(Number of Funds)

	Less than $1 million	$1 million - $3 million	$3 million - $10 million	$10 million - $20 million	More than $20 million	All Funds
High Administrative Costs	8	3	2	2	-	15
High Reserves	10	6	3	1	-	20
Insolvent	2	-	1	-	-	3
Operating Deficit	6	2	4	2	2	16
Low Reserves	1	2	1	2	4	10
At least 1 issue	17	10	10	6	5	48
3 or more issues	3	-	-	-	-	3

Source: New York City Office of the Comptroller, *Audit Report: Analysis of the Financial and Operating Practices of Union-Administered Benefit Funds With Fiscal Years Ending in Calendar Year 2007*, December 2009.

High Administrative Costs. Administrative costs are those expenditures not associated with directly providing benefits, like salaries for fund managers, rent and other overhead costs. Some level of administrative spending is necessary and appropriate, but a high level of administrative spending may be a sign of inefficient management. For union welfare funds, the administrative cost-to-revenue ratio provides some sense of how efficiently these funds operate. While not a perfect measure, a higher administrative cost-to-revenue ratio may identify funds in which resources are being spent inefficiently.

The Comptroller notes that City contracts do not identify a specific level of administrative spending as reasonable or unreasonable. In his audit report, the Comptroller calculates the average administrative cost-to-revenue ratio for several fund categories (based on fund type and size) and compares each fund's ratio to that fund's category average. Using this method, the Comptroller identified 15 funds with an administrative cost-to-revenue ratio "significantly" above their group average. (See Table 6.) Of these funds, eight were small funds with less than $1 million in annual revenue.

Excessive Reserves. Funds with reasonable administrative costs may still spend small shares of their revenues on benefits, while putting large portions of the revenues into reserves. Maintaining some level of reserves is appropriate to provide a cushion against unanticipated adverse events, but excessive reserve amounts may indicate a fund is not providing adequate benefits and is instead stockpiling revenues. There is no hard and fast rule for what reserve level is appropriate, but the Comptroller suggests that reasonable reserve levels are 100 percent of total revenue for insured funds and 200 percent for self-insured funds.[17] In 2007, 20 funds had reserve levels in excess of the Comptroller's standard. While four of these funds ran deficits in 2007, the rest continued to add to their already excessive reserves, with ten funds putting more than 15 percent of their total revenues into reserves. The funds with excessive reserves all had total revenues below $20 million annually, including ten with revenues less than $1 million.

Insolvency and Risk of Insolvency. The Comptroller's Office identifies as insolvent funds with negative reserves and as at risk of insolvency funds with operating deficits or with relatively low reserves.

At the end of 2007, three funds were insolvent: the Teamsters Local 832's Retiree Welfare Fund,[18] the Local 1183 Board of Elections' Retiree Welfare Fund, and the Superior Officers Council's Retiree Welfare Fund. With respect to Local 832, which also had run operating deficits in the last two years, the Comptroller stated: "We question the ability of Local 832 Teamsters RWF to continue to operate and provide benefits to its members."[19]

Three funds were insolvent and 16 had operating deficits in 2007

In addition to the insolvent funds, the Comptroller identified ten funds with relatively low reserves and at risk of insolvency. This group includes the two largest funds in terms of City payments. The UFT Welfare Fund reserve of $138 million was 53 percent of its annual revenue, and the fund ran a deficit of over $6 million. DC37's welfare fund's reserves of $169 million represented 59.5 percent of its total revenue. While its fund ran a surplus of over $41 million in 2007, this surplus followed several years of annual deficits. DC37 was able to save its fund from insolvency by making some reforms to its benefits package and because it received a one-time lump sum payment of $167 per member and a $100 per-member increase in annual contributions from the City in its 2006 contract negotiations.

Sixteen funds ran operating deficits in 2007. While deficits do not always spell imminent financial trouble – many of the funds running deficits maintain substantial reserves to absorb such deficits, and the nature of self-insured funds may make the occasional deficit inevitable – several funds have run deficits for multiple years, suggesting that deficits may be due to structural budget imbalances rather than higher-than-expected claims for the year. Between 2001 and 2007, 46 funds ran deficits in more than one year.[20]

Inefficient Provision of Benefits

The primary reason for using multiple, independent welfare funds to provide supplementary welfare benefits is to allow for discretion and variability among different union memberships for the specific benefits they desire. The assumption is that, for example, police officers may want different benefits than teachers. Therefore, each union should be allowed to design the benefit package its welfare fund offers in order to be most responsive to its membership.

While theoretically attractive in some respects, in practice this approach has four serious shortcomings that more than offset its assumed benefit of responsiveness. *First, in practice there is relatively little variability in the benefits different union members seek*. As noted earlier, the vast majority of money in all funds is devoted to a few health related benefits – pharmaceutical, dental and optical. While some funds provide distinctive benefits such as legal assistance and life insurance, these types of benefits account for only a small share of the City's payments to the funds.

Second, the use of multiple small funds increases administrative costs. The need for each union to create its own administrative apparatus for delivering benefits creates unnecessary overhead expenses. The large number of small funds with a relatively high administrative cost-to-revenue ratio documents this inefficiency due to the lack of economies of scale in administration.

Third, the potential for greater economies of scale extend beyond administrative operations. For the health care benefits that consume most of the welfare funds' resources, the general rule is that better buys are available when the purchaser represents a larger volume of business. Welfare funds with relatively small memberships are likely to be paying more for benefits than groups representing larger constituencies; the number of “lives” involved is a major factor in the deals struck between employers and health insurance organizations. The large unions are likely getting better value than the smaller unions, but all might do better if they purchased for their combined memberships.

Finally, many of the smaller groups likely lack the expertise needed to design the most cost-effective benefit packages. Savings come not just from volume, but from selecting appropriate benefits for coverage. Especially for pharmaceutical benefits, the selection of an appropriate formulary (list of covered drugs) can play a major rule in reducing costs. Union welfare fund mangers may not be in the best position to make such complex decisions. Large employers often delegate such decisions to human resource specialists working in consultation with pharmacy benefit managers.

In sum, the initial reason for relying on multiple welfare funds, a desire to tailor benefits, may no longer be a driving concern for the most expensive benefits; at the same time inefficiencies related to a lack of economies of scale and of expertise may be creating unnecessary waste. New arrangements should be pursued.

RECOMMENDATIONS

Three reform strategies could yield a combination of better benefits for union members and savings for taxpayers.

1. Consolidate Supplementary Health Care Benefits under the City's Health Insurance Plan

The varying and inefficient package of drug, dental and optical benefits provided by the multiple welfare funds should be replaced by a standard set of benefits included under the City's health insurance program. Each of the health insurance plans that compete for the business of municipal employees and retirees should be asked to alter their package to include these benefits; alternatively multiple supplementary benefit packages might be offered separately from the medical and hospital insurance package. Either way, the municipal workers and retirees would benefit from the large scale purchasing through a citywide program and from the expertise of the staff administering the citywide program in benefit design.

Such consolidation of supplementary health benefits would generate substantial savings in administrative and benefits expenditures. New York City's Independent Budget Office has included the administrative savings associated with consolidating welfare funds in their annual Budget Options report for the past several years. To estimate savings, they apply the per-member administrative cost for DC37's welfare fund, which has one of the largest memberships, to all welfare funds.[21] Using this methodology, with the updated 2007 numbers, the estimated administrative savings would be $12.7 million annually.

Even greater savings would be possible in benefits spending. Savings accrue from the increased buying power of a larger member base, which is enhanced by the standardization of purchasing contracts and the use of well designed formularies for pharmaceutical benefits. Studies have shown that the use of formularies can reduce pharmaceutical costs between 15 and 58 percent.[22] Applying a conservative savings of 20 percent to an estimate of pharmaceutical spending yields a savings of nearly $90 million.[23] Assuming an additional 10 percent savings in the remaining health related benefits brings the total benefits savings to about $135 million annually. Combined with administrative savings the total gain is about $146 million annually.

Consolidating some benefits under the City's health insurance plan could yield savings of almost $150 million

How should these substantial savings be used? In the current difficult fiscal times, a strong case can be made for applying any and all savings to closing the City's large budget gaps. However, some fraction of the savings arguably could be made available to cover the growing cost of benefits to workers; this would be an incentive for union cooperation in implementing the recommended changes.

2. Provide Non-health Related Benefits through a Centralized Cafeteria Plan

About 8 to 16 percent of the current welfare fund expenditures go toward non-health related benefits. (Refer to Table 5.) This is a diverse set of benefits, and there likely is considerable variability in the benefits individual members might want. For these benefits, a new centralized plan should be developed. It could be administered by the City through the existing benefit offices in the Office of Labor Relations or by a coalition of unions. In either case, meaningful economies of scale should be achieved.

The new centralized entity should offer benefits in a “cafeteria plan” model. This approach offers a range of benefits and allows individuals to select the benefit they use in a given year based on their needs with a limit on the dollar value of the benefits. For example, one worker might select to spend available benefit dollars on legal services while another opts for life insurance. In each case, the available benefit would have been negotiated in advance by the centralized plan with all the economies of large scale purchasing.

3. Improve Accountability for any Remaining Union Welfare Fund Expenditures

Shifting responsibility for health related benefits to the City will remove much of the current spending from the auspices of union welfare funds. In addition, a new arrangement for other types of benefits could fully eliminate the need for union welfare funds to administer benefits in the future. However, these funds may remain with some residual responsibilities, and relying on a union coalition to manage non-health benefits would create a new entity that ought to be highly accountable. Accordingly, new standards should be set for accountability of existing and any new union welfare benefit funds.

The new standards should improve upon the requirements in Comptroller’s Directive #12. Limits should be placed on allowable administrative expenditures and reserve requirements established. In addition, new enforcement powers should be given to the Comptroller. That office should be able to sanction entities that fail to meet standards in an adequate or timely fashion, and repeated violations should result in removal of fund officials.

ENDNOTES

[1] New York City Office of Management and Budget, *Message of the Mayor for the Executive Budget, Fiscal Year 2011*, May 6, 2010, p. 5 and p. 229.

[2] CBC staff analysis of data from New York City Office of the Comptroller, *Analysis of the Financial and Operating Practices of Union-Administered Benefit Funds with Fiscal Years Ending in Calendar Year 2007,* December 30, 2009.

[3] Active members have a choice among 12 plans; retired members have a choice among 13 plans.

[4] Employees and retirees who receive benefits through their welfare funds are ineligible for optional riders. See New York City Office of Labor Relations, *New York City Summary Program Description: Health Benefits Program*. Accessed on May 1, 2010 and available at http://www.nyc.gov/html/olr/downloads/pdf/healthb/full_spd.pdf.

[5] Directive #12 does not mandate that the Comptroller produce an annual report based on the submissions of the welfare funds, only that the welfare funds' managers submit an independent auditor's report and other financial details to the Comptroller annually. The directive also does not require that the auditor's report be unqualified.

[6] New York City Office of the Comptroller, *Analysis of the Financial and Operating Practices of Union-Administered Benefit Funds with Fiscal Years Ending in Calendar Year 2007,* December 30, 2009, p. 2 and pp. 39-41.

[7] New York City Office of the Comptroller, *Analysis of the Financial and Operating Practices of Union-Administered Benefit Funds with Fiscal Years Ending in Calendar Year 2007,* December 30, 2009, Appendix C.

[8] New York City Office of the Comptroller, *Audit Report on the Financial and Operating Practices of the United Probation Officers Association Welfare Fund*, June 30, 2009.

[9] Russ Buettner, "Audit Raised Concerns About a Union Administrator Before Charges Were Filed," *The New York Times,* February 10, 2010. Accessed on April 9, 2010 and available at http://www.nytimes.com/2010/02/11/nyregion/11unions.html?ref=nyregion.

[10] New York City Office of the Comptroller, *Audit Report on the Financial and Operating Practices of the United Probation Officers Association Welfare Fund,* June 30, 2009.

[11] CBC staff analysis of audits of union welfare funds by the New York City Office of the Comptroller from 2002 to 2009. A complete list of audits is available at http://www.comptroller.nyc.gov/bureaus/audit/current.asp.

[12] New York City Office of the Comptroller, *Audit Report on the Financial and Operating Practices of the Detectives Endowment Association Health Benefits Fund – Active Employees,* June 24, 2002, and *Audit Report on the Financial and Operating Practices of the Detectives Endowment Association Health Benefits Fund – Retirees*, June 24, 2002.

[13] New York City Office of the Comptroller, *Audit Report on the Financial and Operating Practices of the United Probation Officers Association Welfare Fund,* June 30, 2009, and *Audit Report on the Financial and Operating Practices of the United Probation Officers Association Retirement Welfare Fund,* June 30, 2009.

[14] New York City Office of the Comptroller, *Audit Report on the Financial and Operating Practices of the Local 333 Insurance Fund for the New York City Employees,* June 26, 2007.

[15] New York City Office of the Comptroller, *Audit Report on the Financial and Operating Practice of the Superior Officers Council Health and Welfare Fund of the New York City Police Department,* September 30, 2009.

[16] New York City Office of the Comptroller, *Audit Report on the Financial and Operating Practice of the Local 300 S.E.I.U. Civil Service Forum Employees Welfare Fund,* June 10, 2003.

[17] The higher reserve level for self-insured funds is to protect against unusually high claims in a single year. Insured funds generally have more predictable expenditures, and their insurers usually maintain reserves as well.

[18] Local 832 has since merged with Local 237, and Local 832's active and retiree welfare funds have been merged with Local 237's funds.

[19] New York City Office of the Comptroller, *Analysis of the Financial and Operating Practices of Union-Administered Benefit Funds with Fiscal Years Ending in Calendar Year 2007,* December 30, 2009, p. 32.

[20] CBC staff analysis of data from New York City Office of the Comptroller, *Analysis of the Financial and Operating Practices of Union-Administered Benefit Funds,* annual editions for 2001 – 2007.

[21] Independent Budget Office, *Budget Options for New York City,* February 2010, p. 32. Accessed on May 13, 2010 and available at http://www.ibo.nyc.ny.us/iboreports/options2010.pdf.

[22] In 1995 the Veterans Administration consolidated their pharmaceutical purchasing by creating a national formulary. Studies analyzing the savings from this program find savings from 15 to 58 percent. See United States General Accounting Office, *Contract Management: Further Efforts Needed to Sustain VA's Progress in Purchasing Medical Products and Services,* June 2004, Accessed on May 14, 2010 and available at http://www.gao.gov/new.items/d04718.pdf; Mariscelle M. Sales, Francesca E. Cunningham, Peter A. Glassman, Michael A. Valentino, and Chester B. Good, "Pharmacy Benefits Management in the Veterans Health Administration: 1995 to 2003," *American Journal of Managed Care,* February 2005, pp. 104-112, Accessed on May 14, 2010 and available at http://www.ajmc.com/media/pdf/AJMC_05feb_Sales_104to112.pdf; David Blumenthal and Roger Herdman, eds, VA Pharmacy Formulary Analysis Committee, Division of Health Care Services, Institute of Medicine, *Description and Analysis of the VA National Formulary, (*Washington, DC: National Academy Press, January 2000), Accessed on May 13, 2010 and available at http://www.nap.edu/catalog.php?record_id=9879.

[23] Pharmaceutical spending is estimated to be about $445 million in 2007 by assuming 50 percent of all benefits expenditures are for pharmaceuticals. This assumption is based on the review of benefits claims documentation from several of the major welfare funds and discussions with experts in health benefits purchasing.

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