Retiree Healthcare Plans: Challenges and Remedies

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I. Defining OPEBs

• Other Post-Employment Benefits

• Primarily Retiree Health Care

• Government premium subsidies to Retirees
  – Received until eligible for Medicare
  – Occasionally last for lifetime of Retiree
I. OPEB Accounting Rules of GASB
(Gov. Accounting Standards Board)

• Required in Financial Statement Footnotes as of 2006

• Unfunded retiree healthcare liabilities included on public balance sheets

• Uniform discount rate of 3.3% today: interest rate on 20-year, AA municipal bonds

• But can substantially reduce liabilities by prefunding qualified trust and investing assets
II. Scope of the Problem in 2012 - States

**Highest Unfunded State OPEB (bil. $)**

- New York: 3,397
- New Jersey: 7,206
- Texas: 2,127
- Illinois: 2,586

**Unfunded OPEB per capita**

- Wyoming: 419
- North Dakota: 178
- Idaho: 53
- South Dakota: 79

Source: Standards & Poor’s Rating Services “U.S. State OPEB Liabilities Decline Slightly, But Continue To Vary Widely”
II. 2013 Scope of the Problem - Cities

- 30 Largest Cities have over $100 Billion in Unfunded Retiree Health Care and other OPEBs

<table>
<thead>
<tr>
<th>Cities with Largest Liabilities</th>
<th>Unfunded Liability (bil. $)</th>
<th>Unfunded Liability per household</th>
<th>Funding Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 New York, New York</td>
<td>70.57</td>
<td>$22,857</td>
<td>4%</td>
</tr>
<tr>
<td>2 Boston, Massachusetts</td>
<td>4.55</td>
<td>$18,962</td>
<td>0%</td>
</tr>
<tr>
<td>3 Detroit, Michigan</td>
<td>4.97</td>
<td>$15,682</td>
<td>&lt;1%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cities with Smallest Liabilities</th>
<th>(mil. $)</th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>1 Denver, Colorado</td>
<td>87.11</td>
<td>$346</td>
<td>51%</td>
</tr>
<tr>
<td>2 Minneapolis, Minnesota</td>
<td>75.90</td>
<td>$466</td>
<td>0%</td>
</tr>
<tr>
<td>3 Tampa, Florida</td>
<td>86.199</td>
<td>$613</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: The Pew Charitable Trusts: American Cities (March 2013)
III. OPEBs vs. Pensions

- Pensions require advance funding in separate trusts
- Minimal prefunding of OPEBS generally;
  - Usually financed from current tax revenues
- Pensions often protected by statute or constitution
- OPEBs are legally easier to change, but still subject to collective bargaining
III. Supreme Court Guidance (Feb. 2015)

- Collective bargaining agreement
  - language on full healthcare benefits
  - but agreement ended after 3 years
- Unanimous court said if contract not clear, need to present evidence of actual intent
- Court articulated two presumptive principles:
  - lifetime benefits need express language
  - benefits not extend beyond end of contract
III. Impact of “Cadillac Tax”

- Employer mandate applies to local governments; pay penalties if just send employees to exchange
- 40% excise tax on annual premiums (from employer and employees) above:
  - $27,500 for families/year
  - $10,700 for individuals/year
- New York City estimates that in 2023 alone, Cadillac tax will cost over $500 million
IV. Raise Property Taxes: Newton, MA in FY 2014

• $21 million was spent on total retiree health care = $747 of each household’s annual property tax bill

• Voters approved $8.4 million in property tax override
  – $8.1 million went to pay Retiree Health Care

• $8.1 million translates to 79 additional teachers; an 8% increase over the number of current teachers

• Unfunded long-term liability for retiree healthcare = $550 million

Source: Massachusetts Taxpayers Foundation
IV. Revising Eligibility Standards

• In Massachusetts, initial qualification only requires 10 years of part time work.

• In many municipalities, spouses and/or children are also covered by Retiree Health Care.

• States or cities could end subsidies when retirees become eligible for Medicare at 65.
IV. Modifying Benefits & Premium Subsidies

- Increase future deductibles and copayments
- Limit or stop COLAs (cost of living adjustments)
- Reduce the scope of Healthcare provided
  - Require retirees to pay the full cost of dental and eye care
- Reduce healthcare promises to new or recent municipal or state employees
Conclusions

• Unfunded OPEBs are rising quickly and quietly, often faster than unfunded pension liabilities

• But the new accounting rules will require unfunded OPEBs to be included on state and municipal balance sheets.

• OPEBs have much less legal protection than pension promises, though they can still be subject to collective bargaining

• So the public debate should focus on how OPEBs can be reasonably revised and properly funded