
Retiree Healthcare Plans: Challenges and Remedies

By Robert C. Pozen

Senior Lecturer, MIT Sloan

Senior Fellow, Brookings Institution

I. Defining OPEBs

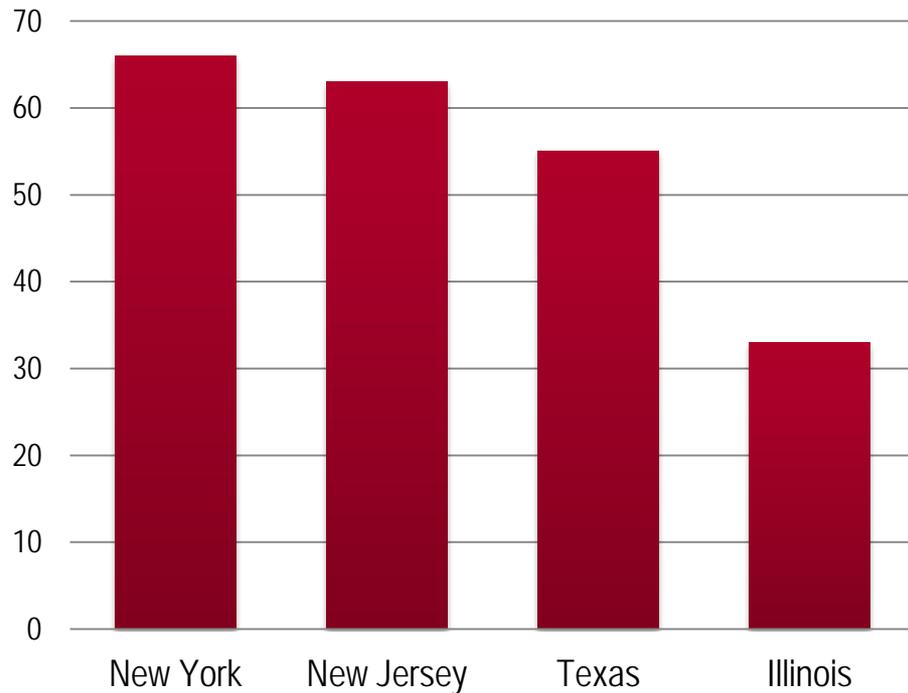
- Other Post-Employment Benefits
- Primarily Retiree Health Care
- Government premium subsidies to Retirees
 - Received until eligible for Medicare
 - Occasionally last for lifetime of Retiree

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. \$)



3,397

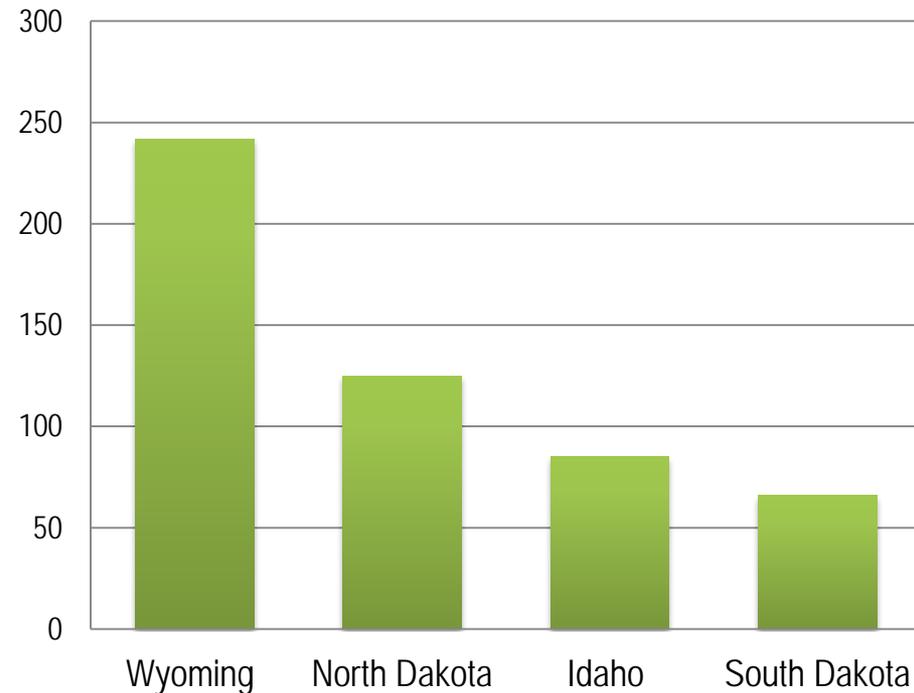
7,206

2,127

2,586

Unfunded OPEB per capita

Lowest Total Unfunded State OPEBs (mil. \$)



419

178

53

79

Unfunded OPEB per capita

II. 2013 Scope of the Problem - Cities

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

Cities with Largest Liabilities	Unfunded Liability (bil. \$)	Unfunded Liability per household	Funding Level
1 New York, New York	70.57	\$22,857	4%
2 Boston, Massachusetts	4.55	\$18,962	0%
3 Detroit, Michigan	4.97	\$15,682	<1%
Cities with Smallest Liabilities (mil. \$)			
1 Denver, Colorado	87.11	\$346	51%
2 Minneapolis, Minnesota	75.90	\$466	0%
3 Tampa, Florida	86.199	\$613	0%

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

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