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Strategies for Managing Long-Term Retiree Benefit Costs



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Public agencies offering retiree health benefits are now required to tabulate and disclose the long-term costs of providing those benefits. Agencies are now coming to grips with the staggering long-term costs these benefit plans impose.

To address these costs, many agencies have terminated the benefit and implemented defined contribution plans, while others have developed long-term financial strategies for meeting their obligations under GASB #45.

The *good news* is that strategies exist for agencies to reduce their long-term financial obligation while continuing to provide their retirees with this valuable benefit.

Some of those strategies are discussed below.

Get to Know Your Actuary

GASB #45 requires a biannual actuarial valuation to determine the long-term financial obligations. It is essential to understand the key actuarial assumptions used in conducting the valuation and how making simple adjustments to your benefit may influence those assumptions.

Your actuary is an excellent source of critical information in helping you develop a comprehensive strategy to address costs. Talk with your actuary.

Promise to Pay

For some agencies, the amount of the agency's premium payment toward the monthly premium for a retiree is tied to an external benchmark such as the "two-party" premium rate. When the amount of premium payment paid by the agency for the retiree is linked to a health insurance premium rate that increases annually, you can be assured that the long-term cost to provide the benefit will be huge.

Benchmarking an agency's contributions to a more stable external index will help reduce the long-term liability.

Benefit Plan

There are two main points to consider regarding your current bene-

fit plan. The first point deals with the benefit plan design for both active and retired employees. Carefully review your plan's experience data with your broker or consultant. Look to see how your employees and retirees are consuming health care. Some areas to look at include the number of doctor's visits per year per covered employee, emergency room utilization, in-patient hospitalizations, prescription drug utilization, and outpatient procedures.

In particular, it is useful to correlate utilization data and trends in those areas to the required co-payment in place for those services. Lower co-payments tend to result in higher than expected plan utilization; slight adjustments in co-payments will result in a reduction of plan utilization by subscribers.

You need to be careful how this point is communicated to employees and retirees. You never want to tell employees and retirees not to seek medical care when necessary, but you want to ensure that they seek medical care when necessary.

Helping employees and retirees become better-educated consumers is essential for plan management.

The second point is the "implied subsidy" provision of GASB #45. When a group medical plan includes both active and retired employees in the same pool, everyone in the pool pays the same premium

– even though active employees consume fewer benefits than retirees do. Those consuming fewer benefits are subsidizing the “real” premium cost for the higher consuming members. GASB #45 requires the actuarial study tabulate the value of the “implied subsidy.” One strategy to consider is separating active and retired employees into two pools (with the same or similar benefit levels) for premium purposes. This reduces the implied subsidy and lowers the long-term cost.

Pre-Funding the Long-Term Obligation

Nothing in GASB #45 requires an agency to pre-fund the long-term obligation. Nonetheless, there are several compelling reasons to pre-fund the cost of the benefit. First, negative consequences may accrue on an agency’s financial statement if benefits are not pre-funded. Using the “pay as you go” approach increases the long-term obligation and may adversely affect an agency’s debt rating.

Second, pre-funding using a 115 Trust allows the actuary to use a higher actuarial assumption regarding investment returns on funds placed in the Trust. Using a higher rate of return results in a reduction of long-term costs, but significantly increases the annual budget allocation for funding the retirement health benefit. A 115 Trust may not be appropriate for all agencies, as there are issues of trust governance and operation that must be considered.

Also, when using a 115 Trust, deciding on a funding policy to pay the Annual Required Contribution is important. GASB #45 does not require full funding of the ARC (many agencies do not have the

resources to fully fund the ARC in the first few years of a 115 Trust), and agencies using this approach must develop a funding policy and disclose the policy as part of their compliance with GASB #45.

VEBA’s or Health Savings Accounts

Both Voluntary Employee Beneficiary Associations (VEBA) and Health Savings Accounts (HSA) provide an alternative approach to paying for retirement health benefits. Generally, agencies providing their employee with VEBAs or HSAs are not making a “promise to pay” for retiree health insurance and may not be subject to the provisions of GASB #45. In both VEBAs and HSAs, funds are deposited into interest-bearing employee accounts on a pre-tax basis and upon retirement, can be used to pay for a range of medical expenses, including premiums for health insurance.

VEBAs can be used by active employees as well. The risk associated with this approach is that the funds accumulated in the employee accounts are subject to market volatility and upon retirement may not be adequate to cover the cost of health insurance for the remainder of the retiree’s life.

Citygate’s next article on this topic will address managing pension cost issues.

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