

# Spotlight on

## Retiree Health Care Benefits for State Employees in Fiscal Year 2015

Alex Brown, with contributions from Joshua Franzel, PhD and Lola Oduyeru

May 2017

Other Postemployment Benefits (OPEB) is an umbrella term that characterizes retirement benefits, other than pensions, that are offered to employees of state agencies and participating political subdivisions who meet designated age and/or service related eligibility criteria. The most significant costs associated with OPEB benefits are for employer-subsidized health care for retired employees.

Nearly every state and most local governments provide access to health benefits to retired employees, and, in most cases, this coverage includes spouses and dependents. This employer-subsidized coverage typically serves as the primary health coverage until the retiree reaches age 65, when it becomes secondary to Medicare. The level of benefits, and their associated costs, depends on an assortment of factors including eligibility requirements, benefit type, and the plan's actuarial assumptions and methods.

In 2015, approximately 80 percent of state government units offered health insurance to retirees under age 65 and approximately 70 percent offered the benefit to those over age 65. These percentages are essentially the same for large local governments (over 10,000 employees), with smaller local governments less likely to offer insurance for either group<sup>1</sup>.

The agency with responsibility for administering retiree health benefits varies among states. In some states, benefits are administered by a statewide retirement system – the same agency responsible for administering pension benefits. In other states, different agencies hold this responsibility. This report focuses on OPEB finances for states and state agencies, and all relevant data are sourced from state and statewide retirement system financial reports. A list of the agencies responsible for administering retiree healthcare plans reflected in this report is found in Appendix B.

### Benefits and Liabilities

OPEB liabilities represent retiree health benefits that have been earned by public employees who meet designated eligibility requirements. As of FY 15, state OPEB actuarial accrued liabilities (AAL) are approximately \$626 billion. The size of a state's AAL is affected by factors such as actuarial assumptions and the nature of the promised benefit, and the group(s) of employees to whom benefits are offered. There are three prevailing models of retiree health benefits<sup>2</sup>:

<sup>1</sup> See: [https://meps.ahrq.gov/data\\_stats/summ\\_tables/insr/national/series\\_3/2015/tiia2h.htm](https://meps.ahrq.gov/data_stats/summ_tables/insr/national/series_3/2015/tiia2h.htm)

<sup>2</sup> Based on descriptions of benefits included in financial reports



Alex Brown is the Research Manager at the National Association of State Retirement Administrators.

Joshua Franzel, PhD, is the President/CEO of the Center for State and Local Government Excellence.



Lola Oduyeru is an MSPPM Candidate at Carnegie Mellon University's Heinz College and an International City/County Management Association Apprentice.

1. A premium-based benefit that provides a subsidy equal to an established percentage of monthly health care premiums. The cost of a benefit delivered in this fashion can rise and fall depending on the overall cost of health insurance. A premium-based benefit is the most common method of delivering retiree health care, and subsidies can range from 10 percent to 100 percent of required premiums. In most cases, the level of the premium subsidy depends on the retiree's years of service.
2. A fixed-dollar benefit is based on a dollar-certain subsidy, typically expressed as a maximum annual benefit or a fixed-rate contribution per year of service that is provided to retirees regardless of the cost of monthly premiums.
3. An implied subsidy results from an arrangement in which risk-pooling includes both active and retired members. In this arrangement, retirees generally are required to pay 100 percent of their premium, with no direct subsidy provided. However, the total premium rate is effectively subsidized by the insurance rate premiums of the active employees in the pool, resulting in a lower rate than would be available to a retiree-only pool. As such, an implied subsidy is equal to the difference between the average retiree cost and the

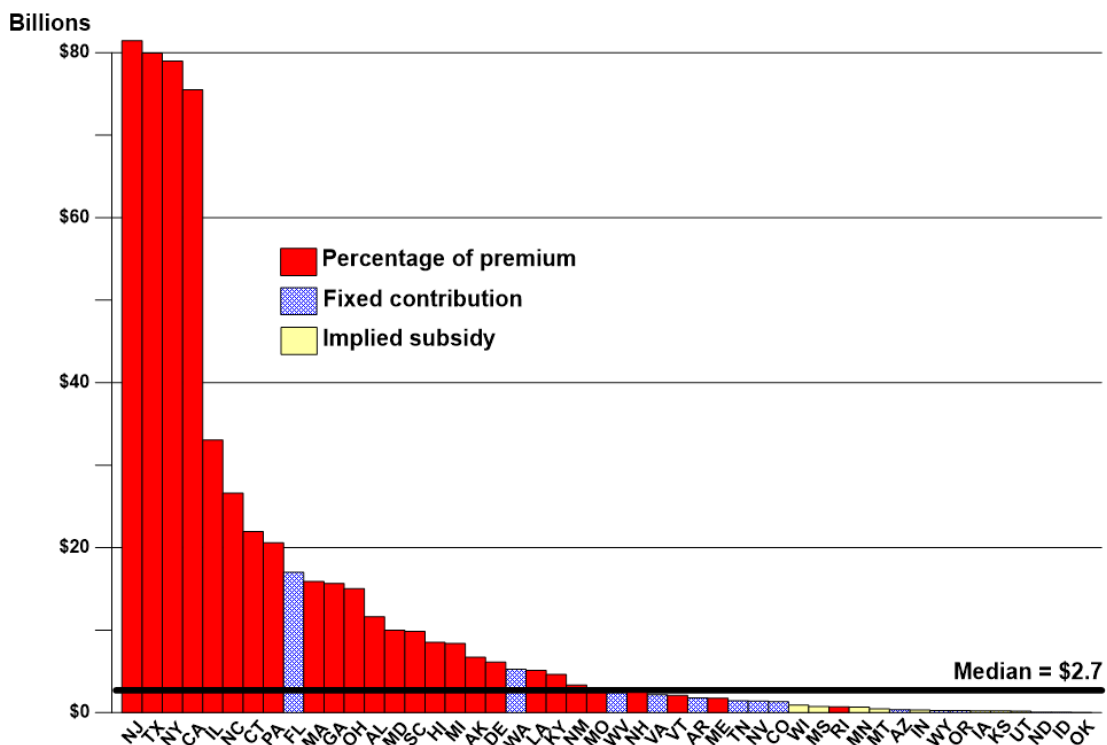
blended premium rate.

In addition to these broad plan designs, some states provide employees with an opportunity to invest their own contributions in a defined contribution account for purposes of defraying the cost of health care services.

OPEB liabilities are long-term liabilities, meaning they are expected to be paid over the lifetime of employees eligible to receive benefits, typically 30-50 years, rather than all at once. Approximately \$585 billion, or 93 percent, of state OPEB liabilities are not presently funded by assets, meaning that approximately 7 percent of these liabilities are funded.

As shown in Figure 1, the median state OPEB unfunded actuarial accrued liability (UAAL) is approximately \$2.7 billion, and the average is just over \$12 billion. This difference is indicative of the effect of several states with large UAAL exerting a disproportionate effect on the average state OPEB UAAL. Ten states – New Jersey, Texas, New York, California, Illinois, North Carolina, Connecticut, Pennsylvania, Florida, and Massachusetts – account for \$451 billion, or nearly 77 percent of the aggregate state OPEB UAAL.

Figure 1: FY15 State OPEB Liabilities by Benefit Type



Another notable trend is the variation in UAAL by benefit type. States in which retiree health benefits are tied to premiums are responsible for \$547 billion, or 93.5 percent of the total state OPEB UAAL. States that offer fixed-dollar contributions for retiree health benefits account for approximately \$34 billion, or nearly 6 percent, and states whose coverage amounts to an implied subsidy are responsible for \$3.7 billion, or 0.6 percent.

## Funding and Required Contributions

States differ with regard to funding methods for retiree health benefits. Most OPEB plans are funded on a pay-as-you-go basis, meaning the sponsoring government pays from current revenues the cost of benefits claimed in a given year. In recent years some states have established trust funds to accumulate assets to defray the cost of providing benefits in future years, in the same manner that public pensions typically are funded. As of FY 15, 31 states hold approximately \$41 billion in assets to pay future promised retiree health benefits, compared to \$32 billion held by 32 states as of FY 14. Figure 2 shows the relative distribution of OPEB assets for states with over \$1 billion in assets.

The level of OPEB assets varies significantly among states. Approximately 40 percent of all OPEB assets are held by the State of Ohio and its political subdivisions, whose public employee retirement systems administer retiree health

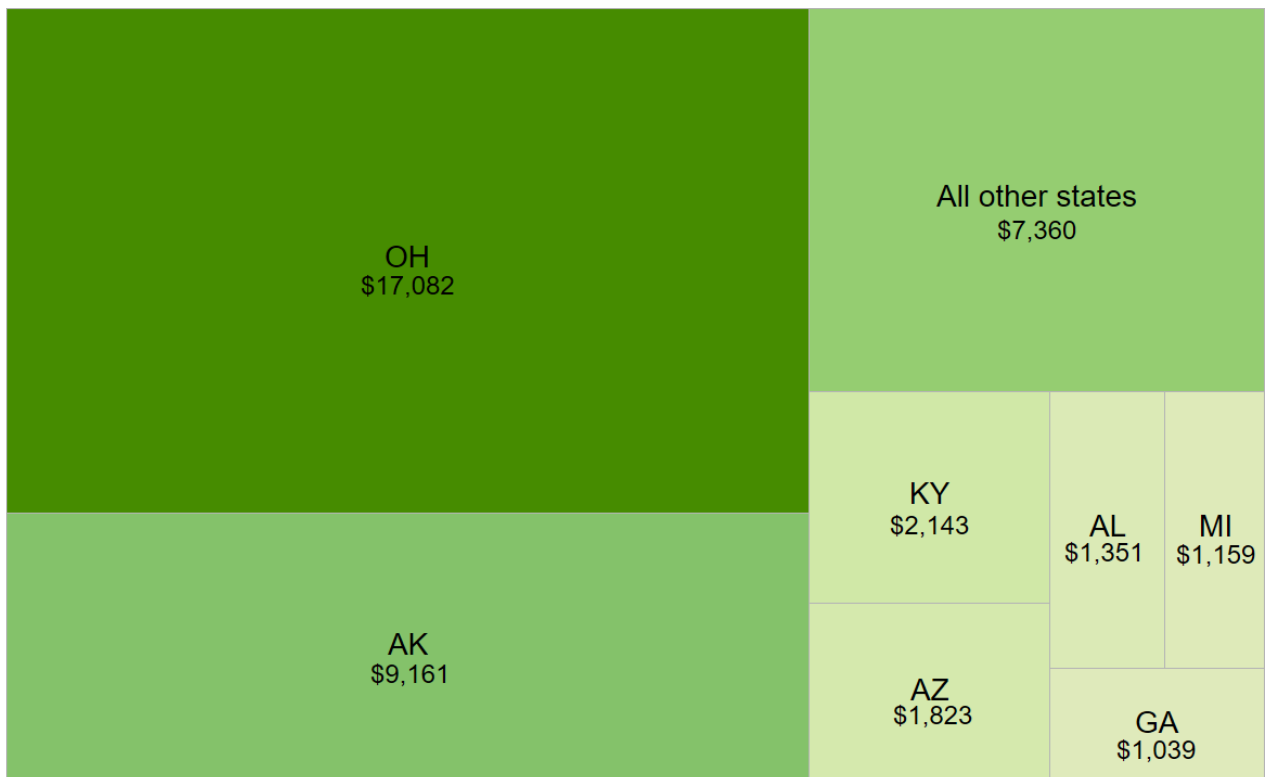
programs for nearly all public employees in the state. With over \$17 billion in assets, Ohio's retiree health plan cumulative funding ratio is nearly 54 percent, significantly higher than the median funding ratio of less than two percent.

Beginning in 2007, Governmental Accounting Standards Board (GASB) Statements 43 and 45 established accounting and reporting requirements for OPEB plans sponsored by state and local governments. The statements require that plans and their sponsoring governments calculate and disclose OPEB liabilities and an annual required contribution (ARC) which represents the sum of the normal cost (i.e., the cost of benefits accrued in the current year) and the amount needed to amortize the unfunded liability over a specified timeframe (no more than 30 years). New GASB statements, described below, succeed Statements 43 and 45 for fiscal years beginning after June 30, 2016 and 2017, respectively.

State governments contributed, in aggregate, an estimated \$18 billion to fund retiree health benefits in FY 15, a figure that represents approximately 42 percent of the aggregate ARC of \$42 billion.

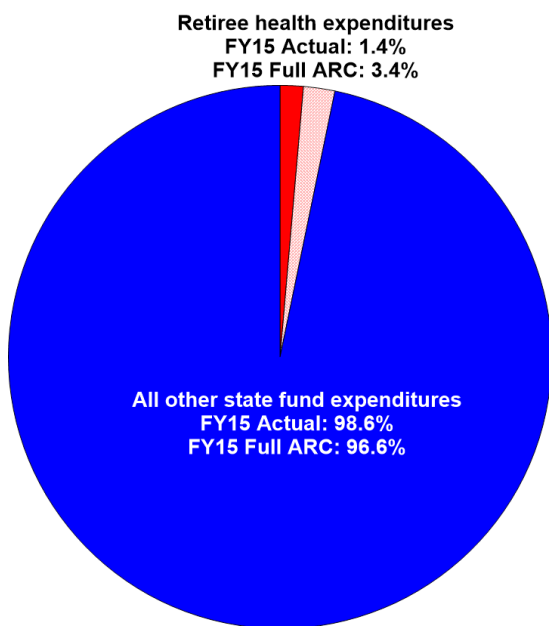
State spending on retiree health benefits varies, from nearly zero to just over 5 percent of total state fund

Figure 2: Relative Distribution of State OPEB Assets for States with Over \$1 Billion in Assets (in millions)



expenditures (a figure that excludes expenditures from the sale of bonds and funds received from the federal government). For most states, these costs remain a relatively small percentage of state spending. As Figure 3 illustrates, in FY 15, states' actual OPEB spending was approximately 1.4 percent of state fund expenditures. Payment of the full ARC would increase spending to 3.4 percent of state fund expenditures<sup>3</sup>.

Figure 3: State Spending on Retiree Healthcare Benefits (Actual and ARC) as a Percentage of Total State Fund Spending, FY15



## Key Assumptions

The determination of retiree health care liabilities is influenced by the selection and application of actuarial assumptions that form the baseline for expectations about member and economic behavior. Demographic assumptions include rates of termination, retirement, and death, as well as assumptions related to election of spousal or family coverage. Economic assumptions include monetary inflation, medical inflation, and the investment re-

turn assumption (discount rate). Assumptions are routinely measured against actual behavioral and economic experience, a process which can identify increases or decreases in a plan's liabilities. This section identifies trends in key economic assumptions.

The medical inflation assumption varies by medical plan type and Medicare coverage. The median short-term (approximately the next 5-10 years) medical inflation assumption for pre-Medicare retirees used by state OPEB plans in 2015 was 7.9 percent, and the median long-term (a period ranging from the next 10 to the next 80 years) assumption for the same group is 5.0 percent. When including Medicare-eligible cohorts, the median short term medical inflation assumption is 6.7 percent and the long-term assumption is 5.0 percent. These averages are relative to state and local government health expenditure annual growth benchmark estimates averaging 5.8 percent for the 2015-2025 timeframe<sup>4</sup>. Long-term medical inflation assumptions are subject to change, depending on changes in the overall cost of health coverage.

Monetary inflation underpins medical costs trends and investment returns. The retiree health plans in the sample use a mean and median inflation assumption of 3.0 percent, relative to the average rate of inflation for the past 30-year period of 2.7 percent<sup>5</sup>. Longer term projections for inflation are around 3 percent, a projection that informs long-term assumptions for medical inflation<sup>6</sup>. The average inflation assumptions for the health plans in the sample are about the same as the average assumption used by state and local pensions in 2013, which was 3.17 percent<sup>7</sup>. Medical cost trends are also supported by plan-specific factors such as the size and structure of the benefit, cost sharing, eligibility, and participation.

The investment return assumption, or discount rate, is the rate used to identify projected investment earnings on assets and to discount projected future cash flows to current dollars. Plans that fund OPEB benefits on a pay-as-you-go basis do not have any assets, so they are required to use a lower discount rate that, all else equal, increases the size of their liabilities. Per GASB standards, plans that hold OPEB assets are permitted to use a higher discount rate that reflects the expected rate of return on

3 Author calculations based on FY 15 actual state OPEB expenditures and OPEB ARC, and FY 15 state general fund and other state fund expenditures published by the National Association of State Budget Officers: <https://www.nasbo.org/mainsite/reports-data/state-expenditure-report>

4 See: <http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsProjected.html>

5 Author calculations based on CPI-U data published by the U.S. Bureau of Labor Statistics, <http://www.bls.gov/cpi/>

6 The Budget and Economic Outlook: 2017-2027, Congressional Budget Office

7 Author estimate of 2013 data sets from Public Plans Database; [www.publicplansdata.org](http://www.publicplansdata.org)

their assets. The median investment return assumption used by state retiree health plans in FY15 was 4.5 percent. This is lower than the median assumption used by state pension plans, which is currently 7.5 percent<sup>8</sup>, likely reflecting, among other factors, the fact that not all states have accumulated OPEB assets, and, for those with an OPEB trust, the difference in asset allocations between pension and retiree health plans.

## Accounting Changes

In June 2015, GASB approved two new statements applicable to OPEB plans and their sponsoring governmental entities. Statement 74, which applies to OPEB plans, replaced Statement 43 for plans with fiscal years commencing after June 15, 2016<sup>9</sup>. Statement 75, which applies to governments who sponsor OPEB plans, will replace Statement 45 for entities with fiscal years commencing after June 15, 2017<sup>10</sup>. Similar to the latest standards addressing public pensions (Statements 67 & 68), one principal characteristic of the new OPEB statements is that the rules, in addition to their primary objective of promulgating changes to OPEB accounting standards, will no longer provide funding guidance. One significant way in which OPEB plans and sponsoring governments will be impacted by the new standards is through changes to the calculation and reporting of OPEB liabilities. Statement 74 includes a requirement that a lower discount rate (based on a 20-year, tax-exempt municipal bond) be used to value the portion of a plan's liabilities for which assets are projected to be insufficient to pay projected benefits to current plan members (or, in the case of plans with no OPEB assets, to value all OPEB liabilities). To the extent that most OPEB plans are projected to exhaust their assets, this requirement will increase OPEB liabilities relative to existing levels.

Among other changes, the new standards eliminate the ARC as a required funding accounting disclosure. The ARC, as required by outgoing statements 43 and 45, is recognized as a benchmark for funding progress. In contrast, Statements 74 and 75, while requiring calculation and disclosure of the so-called actuarially determined contribution (ADC) in cases where one is calculated, are silent regarding funding.

Statements 43 and 45 established the first requirements to report state OPEB liabilities, which informed stakeholders of the presence and size of state and local government OPEB obligations. Similarly, the changes emanating from the implementation of Statements 74 and 75 are expected to instigate a renewed focus on OPEB plan liabilities, costs, and funding strategies.

## Outlook & Conclusion

While OPEB liabilities in some states are quite large in dollar terms, annual costs remain, at 1.5 percent, which is a relatively small percentage of aggregate state expenditures. Most states contribute far less each year than the amount required to adequately fund benefits accrued each year and to service unfunded liabilities; increasing their annual OPEB outlay to match the required amount is estimated to require 3.4 percent of total spending.

Because of changes to accounting and reporting standards, state leaders are likely to focus more attention on contribution rates, prefunding retiree health benefits, or finding other ways to reduce their OPEB liabilities. Some state governments have flexibility to address retiree health benefit costs by reducing benefit levels, eligibility, or access. Such changes may be limited by law, which varies from state to state.

8 See: <http://www.nasra.org/returnassumptionsbrief>

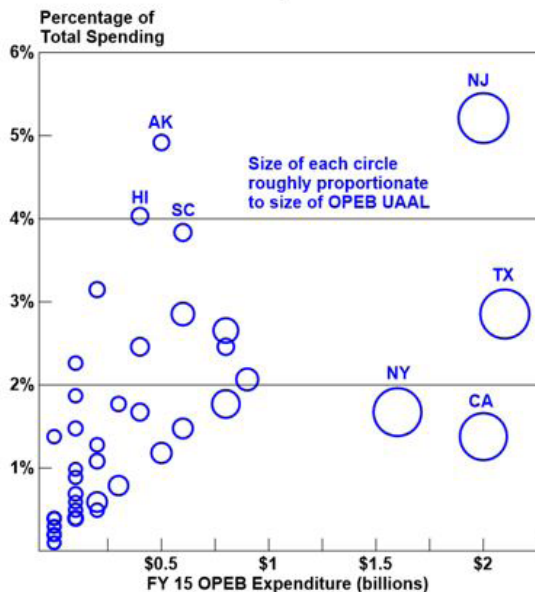
9 GASB Statement 74 summary: [http://www.gasb.org/cs/ContentServer?c=Pronouncement\\_C&pagename=GASB%2FPronouncement\\_C%2FGASBSummary-Page&cid=1176166370715](http://www.gasb.org/cs/ContentServer?c=Pronouncement_C&pagename=GASB%2FPronouncement_C%2FGASBSummary-Page&cid=1176166370715)

10 GASB Statement 75 summary: [http://gasb.org/cs/ContentServer?c=Pronouncement\\_C&pagename=GASB%2FPronouncement\\_C%2FGASBSummary-Page&cid=1176166370763](http://gasb.org/cs/ContentServer?c=Pronouncement_C&pagename=GASB%2FPronouncement_C%2FGASBSummary-Page&cid=1176166370763)

## Appendix A: UAAL and OPEB Expenditure by State, FY 2015

State	Unfunded Liabilities (\$millions)	OPEB Expenditure (\$millions)	Percentage of State Expenditures (%)	State	Unfunded Liabilities (\$millions)	OPEB Expenditure (\$millions)	Percentage of State Expenditures (%)
AL	11,638	360.0	2.4	MT	467	13.9	0.3
AK	6,712	503.9	4.9	NE	0	0.0	0.0
AZ	355	106.0	0.5	NV	1,428	60.9	0.8
AR	1,795	49.3	0.3	NH	2,454	76.07	2.2
CA	75,494	2,028.2	1.3	NJ	81,456	2,044.3	5.2
CO	1,328	84.6	0.3	NM	3,363	149.4	1.4
CT	21,966	571.5	2.8	NY	77,359	1,550.8	1.6
DE	6,111	227.8	3.1	NC	26,615	800.3	2.6
FL	17,023	487.2	1.1	ND	69	11.5	0.2
GA	15,662	158.0	0.5	OH	15,046	336.4	0.7
HI	8,530	393.6	4.0	OK	5	0.2	0.0
ID	56	3.8	0.1	OR	241	6.2	0.0
IL	33,051	809.8	1.7	PA	20,589	920.7	2.0
IN	331	31.5	0.2	RI	714	61.9	0.9
IA	218	10.6	0.1	SC	9,860	571.8	3.8
KS	214	16.0	0.1	SD	0	0.0	0.0
KY	4,612	332.0	1.7	TN	1,441	76.4	0.4
LA	5,128	191.4	1.0	TX	79,936	2,108.8	2.8
ME	1,765	93.8	1.8	UT	185	31.6	0.3
MD	10,008	438.5	1.6	VT	2,096	43.4	1.3
MA	15,893	636.9	1.4	VA	2,172	151.0	0.4
MI	8,386	766.0	2.4	WA	5,274	73.8	0.3
MN	667	32.4	0.1	WV	2,712	153.0	1.2
MS	732	32.4	0.3	WI	893	42.1	0.1
MO	2,732	94.3	0.6	WY	244	10.8	0.1

Figure 4: FY15 State OPEB Expenditure (dollars and percentage)



A moderate correlation is observed between the size of a state's FY 15 OPEB expenditure and the size of the outlay as a percentage of total state spending. However, the percentage of FY 15 state spending on OPEB varies, with some states reporting a higher FY 15 expense that represents a higher percentage of spending than states reporting a comparatively lower expense.

For example, FY 15 spending on OPEB in New York and California was below 2 percent, despite both states reporting relatively high UAAL and annual expenditures. By contrast, FY 15 spending on OPEB in Alaska and Hawaii was above 4 percent of spending, despite comparatively lower UAAL and annual expenditures in both states.

## Appendix B: UAAL and OPEB Expenditure by State, FY 2015

State	Agency
AL	Alabama State Employees Insurance Board
	Public Education Employees' Health Insurance Plan
AK	Alaska Department of Administration
AR	Arkansas Department of Finance & Administration
AZ	Arizona Department of Administration
	Arizona Public Safety Personnel Retirement System <sup>A</sup>
	Arizona State Retirement System <sup>B</sup>
CA	California Public Employees' Retirement System
	California Department of Human Resources
CO	Colorado Public Employees' Retirement Association
CT	State Comptroller's Office
	Connecticut State Teachers' Retirement Board
DE	State of Delaware Office of Pensions
FL	Florida Office of Management Services <sup>C</sup>
GA	Georgia Department of Community Health, State Employee Health Benefits Division
	University System of Georgia Board of Regents
HI	Employer-Union Health Benefits Trust Fund
	University of Hawaii
IA	Iowa Department of Administrative Services
ID	Idaho Department of Administration
	University of Idaho
IL	Illinois Department of Central Management Services
IN	Indiana State Personnel Department
	Indiana State Police
	Indiana State Excise Police
	Indiana Conservation Officers Health Committee
KS	Kansas Division of Health Care Finance
KY	Kentucky Retirement Systems
	Kentucky Teachers' Retirement System
LA	Louisiana Office of Group Benefits
	Louisiana State University
MA	Commonwealth of Massachusetts Group Insurance Commission
MD	Maryland State Employee and Retiree Health and Welfare Benefits Program
ME	Maine Division of Employee Health and Benefits
MI	Michigan Office of Retirement Services
MN	Minnesota Department of Employee Relations
MO	Missouri Consolidated Health Care Plan
	MoDOT and MSHP Medical and Life Insurance Plan
	Conservation Employees' Insurance Plan

	Agency
MS	State and School Employees' Health Insurance Management Board
MT	Montana, Department of Administration, Health Care & Benefits Division
	Montana University System
NC	North Carolina Department of State Treasurer
ND	North Dakota Public Employees' Retirement System
NH	New Hampshire Department of Administrative Services
	New Hampshire Retirement System <sup>D</sup>
NJ	Division of Pensions & Benefits
NM	New Mexico Retiree Health Care Authority
NV	Board of the Public Employees' Benefit Program
NY	New York State Health Insurance Program
	State University of New York
OH	Ohio Police & Fire Pension Fund
	Ohio Public Employees' Retirement System
	Ohio School Employees' Retirement System
	Ohio State Highway Employees' Retirement System
	Ohio State Teachers' Retirement System
OK	Oklahoma Office of Management and Enterprise Services, Employees Group Insurance Division
OR	Oregon Public Employees' Retirement System
	Oregon Public Employees Benefit Board
PA	Pennsylvania Employee Benefits Trust Fund
RI	Rhode Island State Employees' and Electing Teachers OPEB System
SC	South Carolina Public Employee Benefit Authority, Insurance Benefits Division
TN	Tennessee Department of Finance & Administration
TX	Employees' Retirement System of Texas
	Teacher Retirement System of Texas
	Texas A&M
	University of Texas
UT	Utah Retirement Systems
VA	Virginia Department of Human Resource Management
	Virginia Retirement System <sup>E</sup>
VT	Vermont Office of the State Treasurer
WA	Washington State Health Care Authority, Public Employees' Benefits Board
WI	Department of Employee Trust Funds
	Wisconsin Group Insurance Board
WV	West Virginia Public Employees Insurance Agency
WY	Wyoming Department of Administration and Information

- A. Eligible retirees of plans for public safety officers, corrections officers, and elected officials receive a retiree health insurance premium subsidy, equal to a fixed dollar contribution set by statute.
- B. In addition to sponsoring health insurance coverage for all eligible Arizona public employees and their dependents, the Arizona State Retirement System provides a retiree health insurance premium supplement to all retired and disabled ASRS members with at least 5 years of service credit.
- C. Eligible retirees of the Florida Retirement System (an agency within the Office of Management Services) receive a formula based health insurance subsidy based on years of creditable service at retirement multiplied by \$5 (with a minimum of \$30 and a maximum of \$150 per month).
- D. The New Hampshire Retirement System provides a medical insurance subsidy to qualified retirees of closed plans for state employees, teachers, public safety officers, and members of participating political subdivisions.
- E. The Virginia Retirement System provides a tax-free reimbursement for the portion of health insurance premiums eligible retirees pay for single coverage under qualified health insurance plans.



## Contacts:

Alex Brown, Research Manager, National Association of State Retirement Administrators; [alex@nasra.org](mailto:alex@nasra.org); [www.nasra.org](http://www.nasra.org)

Joshua Franzel, PhD, President/CEO, Center for State and Local Government Excellence; [jfranzel@slge.org](mailto:jfranzel@slge.org); [www.slge.org](http://www.slge.org)