HOW THE NEW GASB EXPOSURE DRAFT WILL AFFECT RETIREE HEALTH BENEFIT DESIGN

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1. Highlights of GASB Exposure Draft

2. Issues for Public Sector Employers

3. Retiree Health Redesign Strategies
GASB Exposure Drafts

On June 17, 2014, GASB released two Exposure Drafts related to Other Postemployment Benefits (OPEB)

- **Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions**
  - Supersedes the requirements of GASB Statements No. 45 and No. 57
  - Deals with employer reporting
  - Effective for fiscal years beginning **after December 15, 2016**

- **Financial Reporting for Postemployment Benefits Other Than Pension Plans**
  - Replaces the requirements of GASB Statement No. 43 and No. 57
  - Also includes requirements for defined contribution OPEB plans that would replace the requirements for these plans in GASB Statements No. 25, No. 43, and No. 50
  - Proposes new standards for financial reporting for OPEB benefit plans
  - Effective for fiscal years beginning **after December 15, 2015**

Deadline for submitting written comments: **August 29, 2014**

Public hearings in **September 2014**
Highlights of the GASB Exposure Draft

Financial Implications

- Focus is on OPEB obligation, changes in that obligation and attribution of expense

- Net OPEB liability is to be reported on the Financial Statement:
  - Net OPEB liability is defined as the OPEB liability less the Plan Fiduciary Net Position (market value of assets)
  - Should include “taxes of other assessments expected to be imposed on benefit payments using the rates in effect at the measurement date
    - Excise tax
  - Actuarial Standard of Practice No. 6 (ASOP 6) requires the use of age adjusted premium for plans that are not “truly” community rated
  - All plans with blended premiums must recognize an implicit subsidy
Highlights of the GASB Exposure Draft

**Blended Discount Rate for Plans with Assets**

- Based on projected benefits, current assets and projected assets for current members

- For projected benefits that are covered by projected assets
  - Discount using the long term expected rate of return on assets

- For the projected benefits that are not covered by projected assets
  - Discount using yield or index rate for 20 year, tax exempt general obligation municipal bonds with an average rating of AAA or higher

**Cost Method**

- Entry Age Normal, using a level percent of pay

**Market Value of Assets**

- No smoothing of assets
Highlights of the GASB Exposure Draft

Trust Requirements

- Contributions from employers and non-employer contributing entities to the OPEB plan and earnings on those contributions are irrevocable

- OPEB plan assets are dedicated to providing OPEB to plan members
  - Can be used for OPEB plan administrative costs

- OPEB plan assets are legally protected from:
  - Creditors of employers or plan members
  - Non-employer contributing entities
  - OPEB plan administrator
# Highlights of the GASB Exposure Draft

## Current OPEB Expense
- Based on the Annual Required Contribution (ARC)
  - Normal Cost plus
  - Amortization of the UAAL
    - Period of not greater than 30 years
    - Closed or open amortization period
    - Level dollar or level percent of payroll amortization
  - Can be based on any of six actuarial cost methods
- Annual OPEB Cost (AOC)
  - ARC plus
  - Interest on Net OPEB Obligation
  - Adjustment to the ARC

## New OPEB Expense
- Is the change in net OPEB liability each year, with deferred recognition of certain elements
- Components of new OPEB expense
  - Service Cost
  - Interest on the total OPEB liability
  - Differences between expected and actual experience (with certain deferrals)
  - Differences between actual and projected earnings over the year (5 year spread)
  - Projected investment returns over the year (if applicable)
  - Employee contributions (if applicable)
  - Other changes in plan net position

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**GASB specifically states that the new standards are for accounting purposes only and are not for the purpose of establishing funding standards.**
Highlights of the GASB Exposure Draft

Expanded Employer Disclosures

- Description of plan and assumptions
- Policy for determining contributions
- Sensitivity analysis of the impact on the OPEB liabilities under nine different scenarios:
  - Must use all nine combinations of each of the following:
    - The assumed healthcare cost trend rate, the healthcare cost trend rate plus 1%, the healthcare cost trend rate minus 1%
    - Discount rate, discount rate plus 1%, discount rate minus 1%
- Changes in the net OPEB liability for the past 10 years
- Development of long-term earnings assumption (if applicable)
- If Actuarially Determined Contribution is calculated, 10-year schedule must be disclosed
1. Highlights of GASB Exposure Draft

2. **Issues for Public Sector Employers**

3. Retiree Health Redesign Strategies
Issues for Public Sector Employers

➢ The faster—often immediate—recognition of OPEB changes will introduce greater volatility in the reported expense as will the blended discount rate if there are plan assets:
  • OPEB benefits already had a volatile nature to them, the new exposure drafts will exacerbate the issue
  • This volatility will be reflected on the income statements of plan sponsors

➢ Putting the net OPEB liability on the balance sheet will add a large and unstable element to an employer’s net financial position as presented in the basic financial statements

➢ Plan will need to determine whether the cost of reporting the financial information that employers will require for their financial statements will be charged to employers or be borne by the plan
The recognition of the net OPEB liability on the balance sheet will force employers to relook at OPEB benefits:

- Many employer’s net OPEB liability is nearly as large as their pension liability but with no accompanying assets (or very little assets compared to pension plan)
  - Plans with little or no assets will likely have a higher net OPEB liability

Will States and local governments be able to raise funds via bonds if the OPEB liability is on the balance sheet?

How will this affect bond ratings?

The sensitivity analysis required by the new Exposure Drafts will require 9 separate calculations:

- Is this cost prohibitive for employers?

Structure of trusts that cover more than OPEB will need to be reviewed:

- Trusts must be dedicated to OPEB only
1. Highlights of GASB Exposure Draft
2. Issues for Public Sector Employers
3. Retiree Health Redesign Strategies
Establish Parameters

1. What role does the retiree medical program play in recruitment and retention/total rewards?

2. Are there key late career hires? If so, what is an appropriate service requirement for retiree medical eligibility for them?

3. What promises have been made to current retired and active employees?

4. Could/should the program be different for new hires?

5. What age would a long term employee target for retirement?

6. How do you want your program to compare to your peers?

7. What aspects of the program are available to change and what are “untouchable”?  

8. Is the current program sustainable?

9. What is an acceptable cost for these types of programs  
   • For the Employer? For Retirees?

These objectives are critical to managing and have a cost consequence that must be considered in tandem.
The “Levers” for Retiree Health Design

Eligibility and/or Vesting
- Who receives the benefit (and for how long)?
- How much of a benefit do they receive based on service?

Plan Design
- Plan Platform
  - Indemnity, HMO, Medigap
  - Exchange or Group coverage
- Cost sharing
  - Coinsurance, Copays, Deductible

Employer Funding
- Level of Subsidization
- Defined Benefit vs. Defined Contribution
- Pre funded vs. Pay As You Go
Eligibility and Vesting

In many cases, Post-retirement eligibility is the same as current pension eligibility:
- This is an inclusive rule
- Should the two be the same?

Changing eligibility can have consequences:
- Could affect pension expense
- People may stay in service longer to get retiree health
- People may retire prior to eligibility change to get better benefit

Most employers want to reward the long service employee, not a mid-career hire

Four groups of participants to consider in the retiree medical plan:
- New hires
- Current Actives
- Current Actives close to retirement
- Current Retirees

Eligibility for benefits for each of these groups needs to be explored separately and in tandem.
Plan Design: Spectrum of Pre-Medicare Arrangements

**DEFINED BENEFIT RETIREE MEDICAL PROGRAM**
- Rich Benefit Design
- Employer subsidizes a set amount which increases with trend

**DEFINED CONTRIBUTION RETIREE MEDICAL PROGRAM**
- Rich Benefit Design
- Employer Caps contribution

**GROUP PRIVATE EXCHANGE**
- Employer provides an account where plans are purchased in the private marketplace
- Could be individual or group coverage

**PUBLIC MARKETPLACE**
- Employer sends retirees to the Public Marketplace with some DC type subsidy for premium reimbursement
Medicare Basics

Original Medicare

- Part A Hospital Insurance
- Part B Medical Insurance

Medicare Advantage Plan (such as an HMO or PPO)

- Combines Part A and Part B

Adding Drug Coverage

- Part D Medicare Prescription Drug Plan
- Employer Pharmacy Benefit / EGWP

MAPD Medicare Advantage + Part D Coverage

Supplemental Coverage

- Medigap Medicare Supplement Insurance
- If you join/offer a Medicare Advantage Plan, you don’t need/can’t take a Medigap Policy
### Medicare Advantage

#### Advantages

- Generally more affordable than Medicare Supplement Plans due to availability of federal subsidies
- Many offer supplemental benefits like dental and/or vision
- If retiree resides in a coverage area and the doctor is in-network, generally cost sharing will be lower than current plan
- Can be designed to mitigate any network limitation issues
- Can negotiate rate guarantees
- Experienced plans can offer increased member support
- Other benefits may be available (gym memberships)

#### Disadvantages

- If physician has opted out of Medicare, retiree pays 100% of all costs
- If retiree wants to return to a Medigap (supplement) plan, it may not be guaranteed issue
- Physician and hospital networks are generally narrower and balance billing could occur
- More care management and precertification requirements to receive care
- If CMS subsidies to MA plans are cut:
  - Premiums could increase significantly
  - Plan designs could require higher retiree cost sharing
  - Carrier could pull out of the market
Spectrum of Medicare Arrangements

**DEFINED BENEFIT RETIREE MEDICAL PROGRAM**
- Rich Benefit Design
- Employer subsidizes a set amount which increases with trend

**GROUP MEDICARE PLANS**
- Employer offers Medicare Advantage or Medigap plans
- Could be DB or DC

**DEFINED CONTRIBUTION PLAN**
- Employer provides an account where plans are purchased in the private marketplace or through Employer

**PRIVATE MEDICARE EXCHANGE**
- Employer provides an account that retiree uses to purchase an individual Medicare Supplement or Medicare Advantage plan

**CURRENT ARRANGEMENT**
# Defined Benefit vs. Defined Contribution

## Defined Benefit
- Employer pays a portion of the cost of the benefit:
  - Could be service based
- Employer and retiree share the burden of medical cost trend

## Defined Contribution
- Two Types:
  1. Defined Dollar Benefit
  2. DC accounts funded during active working lifetime
- Employer no longer has risk for increasing medical costs (but still longevity risk)
- Flexibility in actual annual dollar amounts
# Defined Contribution Plans

## Advantages

### Employer:
- Better control of budgeting—move away from unpredictable long term projections of medical inflation
- Reduce OPEB liability
- Flexibility in plan design

### Employee/Retiree
- Part A, Part B and Part D federal subsidy may now be sufficient to sustain individual retiree market
- Amount in “account” is earned during active service and will not change
- Accumulation vehicles available to build savings in conjunction with Employer contribution
- If funded in irrevocable trust, could provide a death benefit at retiree death
- Choice of plans to meet individual needs

## Disadvantages

### Employer
- Depending upon how funded, balances may not revert back to the Employer
- Depending upon how funded, there could be a significant financial outlay for past service
- Amounts granted each year are fixed

### Employee/Retiree
- Retiree will be subject to all of the cost volatility
1. Maintain the status quo

2. Begin to fund retiree health in a trust and take advantage of a higher discount rate

3. Move Medicare Eligible retirees to a Medicare Advantage Plan and Pre Medicare retirees to the Health Insurance Marketplace:
   - Future retirees would have the same option
   - Level of subsidization would be the same as current

4. Move to an account based defined contribution structure:
   - Utilize a Medicare Exchange for the Medicare eligible and the Health Insurance Marketplace for the Pre Medicare retirees or keep Pre Medicare retirees in Plan
   - Amount in account would be based on years of service
   - Assume average level of subsidization is 50% of 2014 costs, with no increase in future years.
Alternative Approaches for Retiree Health

5. Move to a Prefunded Account Structure based on years of service for current employees where contributions begin and end during employment

6. Elimination of all retiree health liability for Medicare Retirees by 2020

7. Eliminate retiree health benefits
## Alternative 1: Maintain the Status Quo

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employer</strong></td>
<td><strong>Employer</strong></td>
</tr>
<tr>
<td>• Richer benefit than most peers</td>
<td>• Subject to cost trend volatility</td>
</tr>
<tr>
<td>• Valued benefit for those near retirement</td>
<td>• Diminishes ability to fund other programs:</td>
</tr>
<tr>
<td><strong>Employee/Retiree</strong></td>
<td>– May compete with ability to increase compensation</td>
</tr>
<tr>
<td>• For long service retirees, the retiree contribution is generally low</td>
<td>• Expense of lifetime benefits</td>
</tr>
<tr>
<td>• Lifetime benefit for retiree and dependent</td>
<td>• OPEB cost will continue to increase negatively affecting the ability to borrow money</td>
</tr>
<tr>
<td></td>
<td>• Will hit the Excise Tax beginning in 2018</td>
</tr>
<tr>
<td></td>
<td>• Not an equal value to all retirees</td>
</tr>
<tr>
<td></td>
<td><strong>Employee/Retiree</strong></td>
</tr>
<tr>
<td></td>
<td>• Subject to cost trend volatility</td>
</tr>
</tbody>
</table>
## Alternative 2: Begin Funding

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Employer</strong></td>
<td><strong>Employer</strong></td>
</tr>
<tr>
<td>- Net OPEB liability will decrease due to funding and a higher discount rate</td>
<td>- Subject to cost trend volatility</td>
</tr>
<tr>
<td>- Valued benefit for those near retirement</td>
<td>- Where does the money come from?</td>
</tr>
<tr>
<td><strong>Employee/Retiree</strong></td>
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</table>
Alternative 3: Pre Medicare to Health Insurance Marketplace
Medicare Eligible to Medicare Advantage

<table>
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</tr>
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<tbody>
<tr>
<td><strong>Employer</strong></td>
<td><strong>Employer</strong></td>
</tr>
<tr>
<td>• OPEB liability is reduced</td>
<td>• Subject to volatility in medical cost trend</td>
</tr>
<tr>
<td>• Excise tax avoided</td>
<td>• Plan change will give a one-time reduction in liability, but medical increases will continue to increase liability</td>
</tr>
<tr>
<td><strong>Pre Medicare Retiree</strong></td>
<td><strong>Pre Medicare Retiree</strong></td>
</tr>
<tr>
<td>• Guaranteed issue</td>
<td>• Health insurance marketplace not yet mature</td>
</tr>
<tr>
<td>• Greater variety in plan choice</td>
<td>• Subsidization by actives goes away</td>
</tr>
<tr>
<td><strong>Medicare Retiree</strong></td>
<td><strong>Medicare Retiree</strong></td>
</tr>
<tr>
<td>• Have a meaningful benefit that could include dental and vision</td>
<td>• May not be eligible for premium tax credits in Marketplace</td>
</tr>
<tr>
<td>• Greater variety in plan choice</td>
<td>• Premium subject to medical cost increase</td>
</tr>
<tr>
<td>• Potentially lower premium for the same benefit</td>
<td><strong>Medicare Retiree</strong></td>
</tr>
<tr>
<td></td>
<td>• Perceived advantage of Employer plan</td>
</tr>
<tr>
<td></td>
<td>• Premium subject to medical cost increase</td>
</tr>
</tbody>
</table>
## Alternative 4: Move to an account based defined contribution structure

### Advantages

<table>
<thead>
<tr>
<th>Employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Not subject to cost trend volatility</td>
</tr>
<tr>
<td>• OPEB liability will decrease:</td>
</tr>
<tr>
<td>• Level of decrease will depend upon subsidy</td>
</tr>
<tr>
<td>• Can offer a subsidy that is lower than current and still give retiree same or similar benefits</td>
</tr>
<tr>
<td>• Excise tax avoided</td>
</tr>
<tr>
<td>• Simplifies retiree program administration</td>
</tr>
<tr>
<td>• May appeal to a greater number of retirees</td>
</tr>
<tr>
<td>• Cash savings every year compared to current plan</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pre Medicare Retiree</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Greater plan choice: Retiree can choose the plan that works best for them</td>
</tr>
<tr>
<td>• Guaranteed issue in Marketplace</td>
</tr>
</tbody>
</table>

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<tr>
<td>• Greater variety in plan choice</td>
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<td>• Potentially lower premium for the same benefit</td>
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</tbody>
</table>

### Disadvantages

<table>
<thead>
<tr>
<th>Employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Unclear how to offer subsidy to Pre Medicare retirees so they can take advantage of federal premium subsidies</td>
</tr>
<tr>
<td>• Participation in plan will increase (cost)</td>
</tr>
<tr>
<td>• If University pre funds, there will be an initial cash outlay</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pre Medicare Retiree</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Plan Options may not be as good as what they currently have</td>
</tr>
<tr>
<td>• Choice is in retiree’s hands, not guided by the Employer</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Medicare Retiree</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Depending upon plan choice, may be subject to medical underwriting if retiree wants to switch at a later date</td>
</tr>
<tr>
<td>• Choice is in retiree’s hands, not guided by the Employer</td>
</tr>
</tbody>
</table>
### Alternative 5: Move to a Prefunded Defined Contribution Account Structure

<table>
<thead>
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</thead>
<tbody>
<tr>
<td><strong>Employer</strong></td>
<td><strong>Employer</strong></td>
</tr>
<tr>
<td>• OPEB liability could be eliminated for actives if benefit is prefunded during their active working lifetime</td>
<td>• Currently the Employer does not fund these benefits and cash contributions to the funds will need to be made every year</td>
</tr>
<tr>
<td>• Depending upon how current retirees are handled, will reduce future increases</td>
<td>• If prefunded, monies must be in a trust that is irrevocable</td>
</tr>
<tr>
<td>• Costs are predictable</td>
<td>• If prefunded, if an active leaves employment, the funds do not revert back to the Employer</td>
</tr>
<tr>
<td><strong>Retiree</strong></td>
<td><strong>Retiree</strong></td>
</tr>
<tr>
<td>• If prefunded, funds are in a trust account, so the dollars are theirs immediately or upon vesting</td>
<td>• Participation in the plan will increase</td>
</tr>
<tr>
<td>• If prefunded with vesting, could be a death benefit</td>
<td>• Still subject to trend for current retirees</td>
</tr>
<tr>
<td>• Retiree can choose plan that works best for them</td>
<td>• Where does the money come from?</td>
</tr>
<tr>
<td>• Could appeal to more retirees</td>
<td>• Future retiree is subject to cost trend volatility</td>
</tr>
<tr>
<td></td>
<td>• Loss of Employer affiliation with plans</td>
</tr>
<tr>
<td></td>
<td>• Subject to marketplace changes</td>
</tr>
</tbody>
</table>
### Advantages

**Employer**
- Retiree medical liability will be reduced
- By 2020, with the Employer will have no OPEB liability for medical or prescription drug for Medicare retirees
- Reduced administration costs

**Medicare Retiree**
- Medicare benefits will provide a meaningful benefit in 2020
- Variety of plan offerings
- Potentially lower premium for the same medical benefit

### Disadvantages

**Employer**
- Still subject to trend risk for Medicare retirees until 2020
- Litigation risk

**Medicare Retiree**
- After 2020, no subsidized benefit from the Employer
- Transition process
- Loss of affiliation with Employer through medical plans

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**Alternative 6: Move toward elimination of retiree health for Medicare retirees by 2020**
# Alternative 7: Eliminate Retiree Health Benefits

## Advantages

**Employer**
- No OPEB liability for medical or prescription drug
- Reduced administration costs

**Pre Medicare Retiree**
- Variety of plan offerings in Marketplace
- Guaranteed issue
- Retirees can choose a plan that works best for them

**Medicare Retiree**
- Medicare benefits will provide a meaningful benefit in 2020
- Variety of plan offerings
- Potentially lower premium for the same medical benefit

## Disadvantages

**Employer**
- Litigation risk

**Pre Medicare Retiree**
- Marketplace is still immature and the benefits are not as rich as current plans
- Transition process
- Loss of affiliation with Employer through medical plans

**Medicare Retiree**
- Transition process
- Loss of affiliation with Employer through medical plans
- Prescription drug benefits will likely be reduced
Case Study

- Large Public Sector Employer that provides medical, prescription drug, dental and life insurance in retirement
- OPEB liability is $542.8M
- Trust for LTD benefits with assets of $40M, but not in an irrevocable trust
- Interest rate: 5.75%
- Current subsidy for retiree health is approximately 50% of the cost
Cost Impact

OPEB Liability (in $millions)

Alternative 1: $542.8
Alternative 2: $407.1
Alternative 3: $497.4
Alternative 4: $332.5
Alternative 5: $256.7
Alternative 6: $272.8
Alternative 7: $0.0