

A retiree health care solution for today's economy

By Kevin House, FSA, EA, FCA

As a result of GASB Statement 75, retiree health care liabilities are now measured in a more marked-to-market fashion, making them more visible — as they are required to be prominently displayed in financial reports.

As GASB pressures combine with rising health care costs, a growing number of public entities and retirement systems are cutting costs and reducing OPEB liabilities by shifting retirees from a traditional group health care insurance model to an individual Medicare marketplace.

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It's a problem that spans the nation — affecting cities, counties and states — from school board offices to police and fire departments: How do public entities efficiently and effectively provide retiree health care benefits?

According to a recent S&P Global Ratings report, U.S. state unfunded retiree health care liabilities nationwide are nearly \$700 billion.¹ Similarly, Truth in Accounting reports about 40% of the 75 largest cities' total unfunded debt — some \$139.2 billion — comes from other post-employment benefits (OPEBs), a liability that is comprised mainly of retiree health care.² The bulk of this liability is attributed to Medicare-eligible retirees, due to the longevity of the benefit.

In response, public entities find themselves seeking ways to address these liabilities, sometimes in dramatic fashion. The city of Houston, for instance, is considering eliminating spousal subsidies as well as retiree health coverage for new employees to address their projected \$9 billion OPEB liability shortfall.³ Dearborn, Michigan, has taken the dramatic step of issuing \$35 million in bonds, hoping the interest it earns investing the proceeds will chip away at the \$161 million it needs to cover the medical bills of retiring workers — a move that failed in Wisconsin a decade ago.⁴ Many other cities have terminated health care benefits for Medicare-eligible retirees entirely.

However, these moves are risky and often painful — and many times, unneeded.

The billion dollar solution hiding in plain sight

Historically, public entities have provided retiree health care through traditional group plans, offered by private insurance companies and administered by the plan sponsor. Retirees are offered one-size-fits-all coverage with a standard premium often reduced by subsidies provided by the plan sponsor. It's a structure that has led to significant costs for retirees and large OPEB liabilities for these organizations.

Today, a growing number of public entities and retirement systems are finding substantial savings by moving away from the traditional group health care insurance model to a significantly more affordable solution: *an individual Medicare marketplace*. It's a move that has saved public sector organizations billions in OPEB liabilities while offering retirees access to a more personalized health care experience often with lower premiums and less out-of-pocket cost.

Not to be confused with the exchanges/marketplaces created under the Affordable Care Act, individual Medicare marketplaces are run by private vendors, specifically service Medicare-eligible retirees and have been successfully used for more than a decade. A financial win-win for plan sponsors and retirees, more than 1,000 major employers have moved millions of retirees from group plans to the individual Medicare marketplace.

¹ Liz Farmer, "As Retiree Health-Care Costs Soar, Public Employers Turn to Private Insurers," *Governing*, January 9, 2019, <https://www.governing.com/topics/finance/gov-retiree-health-care-costs-soar-government-solutions.html>

² Mayra Rodriguez Valladares, "Americas Largest Cities Are Practically Broke," *Forbes*, January 29, 2019, <https://www.forbes.com/sites/mayrarodriguezvalladares/2019/01/29/americas-largest-cities-are-practically-broke/#3780cf702ebb>

³ Andrew Schneider, "Governments Struggle To Find A Way To Pay Retirement Pension Bills," *NPR*, March 3, 2019, <https://www.npr.org/2019/03/03/699892067/governments-struggle-to-find-a-way-to-pay-retirement-pension-bills>

⁴ Amanda Albright, "This 'Insanity' May Be the Muni-Bond Market's Next Big Thing," *Bloomberg*, December 13, 2018, <https://www.bloomberg.com/news/articles/2018-12-13/this-insanity-may-be-the-muni-bond-market-s-next-big-thing>

Individual Medicare marketplace vendors:

- Offer core products of Medigap, Medicare Advantage and Part D (prescription drug) plans. Other products available can include dental, vision, life, senior critical illness, short-term medical and hospital indemnity insurance.
- Offer “personal shopper” guidance from a licensed benefit advisor. Retirees can purchase health insurance plans from hundreds of private insurers and thousands of plans, enabling retirees to customize their coverage to meet their needs and budgets.
- Provide retiree communications, evaluation of options and enrollment support while also managing plan sponsor subsidies (if provided) in the form of a Health Reimbursement Arrangement (HRA).
- Serve as the primary point of contact (and lifetime advocate) for retirees regarding benefit issues they may encounter.
- Administer the plan sponsor subsidy through an HRA.

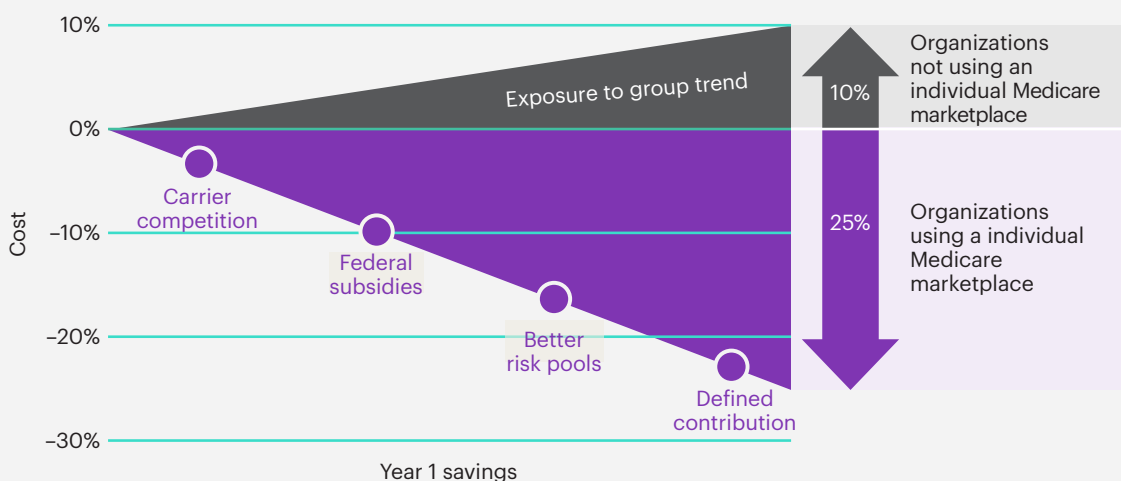
Five ways the individual Medicare marketplace improves your bottom line

In 2017, when the city of Memphis moved to an individual Medicare marketplace, it reduced its OPEB liability by hundreds of millions — a typical Memphis retiree could save about \$2,000 a year in out-of-pocket costs.^{5,6} However, happier retirees and reduced OPEB liabilities are just the beginning of the financial benefits of an individual Medicare marketplace. It’s a win-win that addresses a number of large public sector challenges.

1. An individual Medicare marketplace can reduce OPEB liabilities and health plan costs by millions — maybe billions

Individual Medicare marketplace plans generally cost much less than group health care insurance plans. For instance, often an individual Medigap Plan G with prescription drug coverage will cost between \$160 to \$200* per month versus a comparable group Medicare plan of \$250 to \$400-plus per month.

Figure 1. How a Medicare marketplace drives value



- Medicare supplement plans are all standardized, so carriers compete on price.
- Insurance carriers receive federal subsidies to offset the cost of Medicare Advantage and Part D plans.
- Premiums are kept low and stable by the influx of retiring baby boomers, who are relatively young and healthy.

⁵ Farmer, “Retiree Health Care Costs Soar,” <https://www.governing.com/topics/finance/gov-retiree-health-care-costs-soar-government-solutions.html>

⁶ “Making Retiree Health Benefits Sustainable,” webinar sponsored by WTW, aired May 22, 2019, <https://www.governing.com/events/webinars/Making-Retiree-Health-Benefits-Sustainable-99845.html>

*Note: Average premium reflects those enrolled in plans available on WTW’s Individual Marketplace in all jurisdictions as of March 2019. Individual rates can vary based on age, geography, gender and smoking status.

Individual Medicare marketplaces provide superior financial outcomes through the following:

- **Carrier competition**

The individual Medicare marketplace allows retirees to pick from a variety of carriers and plans, putting downward pressure on premiums.

- **Better federal subsidies**

Although an employer can take advantage of federal subsidies in a group plan, they aren't at the same level of subsidies that carriers receive from the federal government for individual Medicare plans.

- **Larger risk pools**

A group plan is often limited to former employees, so a limited number of younger, healthier retirees age into the plan to offset the higher-cost claims of aging retirees. Often these plans are closed to new entrants, resulting in even quicker cost acceleration. Medicare has 60 million beneficiaries — about half are in the individual market, which makes up the largest risk pool in the nation. In addition, more than 10,000 people turn 65 every day.

- **Individualized coverage**

Departing from the broad-brush approach of a group plan that offers the same plans to retirees with diverse needs, individual Medicare marketplaces reduce over- and under-insurance issues by allowing retirees to select plans that fit their specific health and budget needs.

- **Defined costs**

When transitioning to an individual Medicare marketplace, plan sponsors often provide subsidies to retirees through health reimbursement accounts (HRA's) to help defray some or all of the retirees' premium costs. It's a way to provide health care, which is unpredictable and inconsistent, through a predefined stipend. This gives the plan sponsor control of the cost and the ability to project their future health care expenses. This financing structure is what enables the plan sponsor to reduce the OPEB liability.

2. An individual Medicare marketplace can substantially lower administrative costs

Once a plan sponsor implements an individual Medicare marketplace, outsourcing and overhead are greatly reduced. There's no need to go to procurement with a request for proposal every three-to-five years. Complex and costly medical claim audits go away, and the need to keep up with ever-changing health care regulations is also eliminated. Carrier negotiations, annual plan redesign, fiduciary oversight and market benchmarking no longer need to be done. Once transitioned to an individual Medicare marketplace, the HRA element becomes as simple as the individual Medicare marketplace vendor sending a bill for claims paid (for premiums or out-of-pocket costs) and the plan sponsor wiring the funds.

By moving to an individual Medicare marketplace, one large state retirement system reduced the staff required to administer their health care program by two-thirds.

3. An individual Medicare marketplace can

Figure 2. **Moving from a group plan to the individual Medicare marketplace: impact on plan sponsor activities**

Activity	Individual Medicare marketplace vendor responsibility	Plan sponsor responsibility
Plan design	All	None
Vendor management	All	None
Premium rate renewal	All	None
Summary plan description (SPD)	Most	Reduced
Communications	Most	Reduced
Eligibility administration	Partial	Reduced
Billing administration	All	None

reduce or eliminate risk

Risk is inherent in any health care plan, from rising costs to the health level of the insured population, to regulatory and legal risks. Moving from a group Medicare plan to the individual Medicare marketplace, however, can help mitigate or even eliminate some of those risks.

4. An individual Medicare marketplace can

Figure 3. Reducing plan-related risk by moving to an individual Medicare marketplace

Cost and risk area	Impact to the plan sponsor when moving to an individual Medicare marketplace
Overall health risk factors of the insured population	Eliminated. The benefit is a fixed stipend in an HRA, so the plan sponsor is no longer exposed to this risk.
Regulatory risk	Mitigated. Although the individual market is subject to regulatory risk, it's relatively low compared to group plans. Also, responsibility for compliance shifts from the plan sponsors to individual health plans chosen by retirees.
Rising health cost trends	Greatly reduced or eliminated. The plan sponsor sets the HRA level. Because the employer controls the stipend level and rules, this risk can be managed or eliminated altogether.
Richness of the inherent plan design, carrier network discounts, etc. (i.e., over or under insuring the population)	Reduced. There are a wide variety of plans available allowing the retirees' specific needs to be met.
Discount rate for determining liability	Reduced volatility. The duration of the liability is shortened, reducing exposure to long bond price fluctuation.

support stronger bond ratings

If you think a large OPEB liability can't affect the overall financial health of a public entity, think again. Large OPEB liabilities negatively affect government bond ratings. And lower bond ratings, of course, mean higher interest rates and stricter debt covenants. In its annual report to the city, an Alameda County Grand Jury warned the city of Oakland, California, in 2018 that its \$860 million retiree health care cost crisis, could risk "worsening Oakland's bond ratings, imperiling its borrower power."⁷

Recent news and rating reports confirm the underfunding of pensions and other strains on governments could influence credit profile factors.⁸ Bond rating agency S&P notes demographics and health care as "social factors to watch" in 2019.⁹ And it warns against issuing OPEB obligation bonds to jump-start underfunded situations like Dearborn, Michigan, did stating: "Issuing debt for OPEB obligations could have a compound effect of increasing debt ratios to shift assets to the OPEB plan and delay a projected GASB crossover date in order to mitigate growth in the reported unfunded OPEB liability."⁹

Taking advantage of the financial benefits, an individual Medicare marketplace can allow public plan sponsors to meet the competing interests of retirees, bondholders and taxpayers.

5. An individual Medicare marketplace can help with recruitment and retention

Many individuals choose to work in the public sector in part because of the promise of post-employment benefits. Retiree health care benefits are powerful recruitment and retention tools for often-hard-to-fill public safety positions. But today, only 68% of state and local governments still provide retiree health care, down from 73% five years ago, despite employees believing they were promised the benefit when hired.

These broken promises can further damage already suffering recruiting and retention rates and can cost public entities a bundle in hiring and training costs. The average cost to hire

⁷ "Grand Jury: Oakland Facing \$860M Retiree Health Care Cost Crisis," CBS SF BayArea, June 29, 2018, <https://sanfrancisco.cbslocal.com/2018/06/29/oakland-facing-860m-retiree-healthcare-cost-crisis/>

⁸ Brian Tumulty, "Why GASB rules might spur governments to change retirement benefits," The Bond Buyer, October 19, 2018, <https://www.bondbuyer.com/news/why-gasb-rules-might-spur-governments-to-change-retirement-benefits>

⁹ "New GASB Statements 74 And 75 Provide Transparency For Assessing Budgetary Stress On U.S. State & Local Government OPEBs," S&P Global, March 14, 2018, https://www.capitaliq.com/CIQDotNet/CreditResearch/RenderArticle.aspx?articleId=2006821&SctArtId=450190&from=CM&ns_code=LIME&sourceObjectId=10462202&sourceRevId=1&fee_ind=N&exp_date

and train a new employee is more than \$4,000, according to the Institute for Research on Labor and Employment, and the Society for Human Resources Management.^{10,11} Law enforcement, for example, illustrates just one area of steeply declining recruitment rates: There was a 63% drop in applications from 2015 to 2017, according to the National Association of State Chief Administrators.¹²

An individual Medicare marketplace is a way for public sector plan sponsors to keep the promise of retiree health care coverage and help reverse sagging recruitment and retention numbers. When the city of Memphis eliminated its 70% health insurance premium subsidy for most of its retirees in 2015, it soon found it could not fill public safety positions; the uniformed police attrition that year was 185. Under a new administration, the retirement health cost benefit was restored via an HRA and a move to an individual Medicare marketplace. Together with other human resources changes, the move is credited with a reduction in police attrition to 141 in 2016 and in the hiring of 487 non-public safety employees in 2017 — not to mention a reduction in the city's OPEB obligation by \$319 million.

Switching from a group plan to an individual Medicare marketplace to save retiree health care doesn't just look good on paper. It works in the real world.

Case study: The results of a midwestern retirement system's financial impact analysis (FIA).

Consider one Midwestern public retirement system that examined whether to move its 30,000 eligible members to an individual Medicare marketplace. This retirement system's inquiry began with a financial impact analysis (FIA), comparing current group plan costs against the value of an HRA provided through the individual Medicare marketplace. This particular system also considered another popular alternative — Group Medicare Advantage plans. In these plans, a carrier develops a Medicare Advantage plan for the group that closely replicates the current Medigap structure, but enables lower costs due to government subsidies. As can be seen in Figure 4., this alternative didn't achieve the results of the individual Medicare marketplace.

The FIA allowed the plan sponsor to assess which retirees would find equivalent or better health care plans at the same or lower costs — in this case 95% — and which would not. The FIA also helped the plan sponsor determine the appropriate HRA funding level.

In this case, the retirement system set an HRA funding level that would result in **\$21 million savings** the first year — and a **38% reduction in OPEB liability** from \$1.2 billion to \$750 million. At the same time, **95% of the system's retirees would save an average of \$925** in health care costs in year one and would have equal or better health coverage than with their current traditional group plan. The FIA also revealed that the **plan sponsor could reduce its contribution by 30% while allowing the average retiree to save up to \$800 per year on a Medicare Supplement plus Part D plan and \$1,700 per year on a Medicare Advantage plus Part D plan.**

¹⁰ Arindrajit Dube, Eric Freeman and Michael Reich, "Employee Replacement Costs," Working Paper Series, Institute for Research on Labor and Employment, UC Berkeley, March 4, 2019, <http://irle.berkeley.edu/files/2010/Employee-Replacement-Costs.pdf>

¹¹ "Average Cost-per-Hire for Companies Is \$4,129, SHRM Survey Finds," SHRM, August 3, 2016, <https://www.shrm.org/about-shrm/press-room/press-releases/pages/human-capital-benchmarking-report.aspx>

¹² Kayla Leslie, "Job One: Reimagine Today's State Government Workforce," NASCA, March 25, 2019, <https://www.nasca.org/research/ArtMID/9272/ArticleID/2284>

Figure 4. Midwestern retirement system: Average retiree savings with 70% plan sponsor subsidy



Conclusion

An individual Medicare marketplace can sound too good to be true, with its promise of cost savings for both plan sponsors and retirees along with better health plan options for retirees. But actuarial analyses prove the argument, and the hundreds of public sector entities that have already made the move, like the city of Memphis, reinforce this assertion: Plan sponsors, retirees, public sector financial stakeholders, elected officials and taxpayers can all benefit.

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