

Cities And Counties Feeling Pressure On Reporting Retiree Health Benefits

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The city of Duluth, Minn., population 90,000, calculates that the cost of its pledge to provide free lifetime health benefits to its retirees is \$178 million—more than double the city's current budget.

Maryland computes its unfunded liability at \$23 billion. To cover the costs, the state would have to cut into current programs and services to increase its annual payments for retiree health care from \$300 million to \$1.9 billion.

On an even larger scale, the Los Angeles Unified School District, the second largest school district in the United States, estimates that its unfunded liability for retiree health care is \$5 billion—a figure that is roughly 80% of its entire annual budget.

The promises made to retirees are about to go under a very powerful microscope, and city and county managers will not like what they see.

In December 2006, GASB 45, promulgated by the Government Accounting Standards Board, Norwalk, Conn., began requiring most large public employers to reflect the future cost of health care for retirees on their current balance sheets.

A combination of issues—retirees living longer, late-in-life health care rates increasing and the fact that the vast baby boomer population is closing in on retirement age—is running up those costs even as local and state governments are being urged to lay them on the table.

One expert made a dire prediction in a 2006 Rockefeller Institute Report on State and Local Government Finances: The total bill for public employers' retiree health care could approach an astounding \$1 trillion.

As public employers struggle to cope with their already considerable fiscal challenges, a myriad of available solutions appear attractive on the surface but carry hidden dangers that complicate their decision-making. The decision about how to handle Medicare Part D is a good place to start.

Under Medicare Part D, the federal government covers one of the largest rising health care costs: prescription drugs. The federal government provides a 28% retiree drug subsidy to encourage those that already offer this benefit to retirees to continue their coverage under this plan.

Many businesses in the corporate world quickly took the subsidy in the program's first year. But now they are discovering that the subsidy comes with expensive strings attached, including the cost of annual actuarial studies, administrative burdens and federal audit compliance.

State and local governments face even more drawbacks than corporations.

First, part of the value of the subsidy to corporations is that it's tax-free. For a business paying 35% in taxes, that increases the value of a \$600 subsidy to more than \$900. State and local governments receive no similar bump up in value because they don't pay taxes.

Second, recently issued GASB rules require the subsidy to be reflected as current income rather than as an offset for future liability. That means that while the huge cost of meeting retiree health care commitments is compounded into the future, the funding from the federal government that would cover more than one quarter of the costs for prescription drug coverage won't be reflected.

As a result, taking the 28% subsidy—what looks like a simple decision—is not always the best answer. In order to make the best decision, state and local government risk managers should familiarize themselves with all possible courses of action.

Public-sector employers can apply for the federal subsidy or decide to do nothing. By choosing the latter path, organizations do not disturb current benefits to retirees, and they avoid the cost of applying for the federal subsidy. On the other hand, doing nothing fully exposes the employer to the GASB problem of future costs reported as current liabilities.

One course government entities may consider is to apply for a federal waiver that allows them to become Medicare Part D prescription drug plan themselves.

While this decision enables employers to design their own benefit packages and share the risk with the federal government, it also carries several additional burdens. These include a complicated filing process, exposure to costly federal audits and the administrative burden of tracking employees who sign up for Medicare Part D independently.

Lastly, states, counties and municipalities can contract with a PDP to outsource the administration of Medicare Part D. While this makes them ineligible for the federal subsidy and requires that they educate their retiree population about the plan they are sponsoring, the benefits include shifting the risk to the PDP and the federal government and avoiding GASB 45 implications, thereby protecting credit ratings and the ability to sell bonds.

GASB 45 is having a striking impact on how state and local governments look at retiree health benefits. Medicare Part D adds more difficulty to the decisions that must be made about meeting the unfunded liability that threatens to overwhelm state and local government budgets.

Public employers can make a smart decision that will turn a looming crisis into a manageable challenge by understanding how GASB 45 compliance and the Medicare Part D subsidy are intertwined.

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