Retiree Healthcare Costs

✓ Actuarial valuation is a modeling calculation process to estimate the present value costs associated with future retiree coverage. The scope of the valuation may involve funding and/or accounting standards compliance (i.e., GASB 74/75)

✓ The employer cost is the “retiree benefit” or “employer contribution” or “employer cost” that forms the basis for the valuation.

✓ For Self Funded = Claims + Admin Fees + Stop-loss Premiums – Retiree Contribution Premiums

✓ For Fully Insured = Age-Based Premiums – Retiree Contribution Premiums (Age-Based Premium \(\rightarrow\) credible size group of like-age retirees rated/measured)

✓ On average costs increase as we age. (2% to 5% per year)

✓ A group at age 60 to 62 may cost on average 1.5 to 2.0 times the cost of a group at age 35 to 40.
Retiree Healthcare Costs

✓ Medicare retirees (no Part D) → ER plan costs are 70% to 80% Rx / 20% to 30% Medical (Medicare is primary for Medical)

✓ Pre-Medicare Retirees → ER Plan costs are 25% to 30% Rx / 70% to 75% Medical

✓ The employer cost may consist of direct and indirect components.

❑ The direct component is the portion of the plan premium directly paid by the employer.

❑ The indirect cost is the excess of the age-based cost over the plan premium. All else equal the plan premium will be lower over time if retirees are removed from the pool.
Retiree Healthcare Costs

✓ $X + Y = \text{Plan Premium}$ and $X$ is the direct ER cost component
✓ $X + Y + Z = \text{Total Age Based Cost}$ and $Z$ is the indirect ER cost component

$X = \text{Premium Paid by Employer}$

$Y = \text{Retiree Contribution}$

$Z = \text{Excess Retiree Cost over Plan Premium}$

$\text{Plan Premium}$

$\text{Total Retiree Cost}$
Cost Curve

![Cost Curve Diagram]

- **Age-Adjusted Cost**
- **Cobra Rate**
Client Example

Per Capita Costs

- Age 55: $8,000 (73%) Plan Premium, $6,000 (27%) Benefit
- Age 57: $8,800 (68%) Plan Premium, $5,200 (32%) Benefit
- Age 60: $9,600 (61%) Plan Premium, $4,400 (39%) Benefit
- Age 62: $10,800 (56%) Plan Premium, $4,800 (44%) Benefit
- Age 64: $12,000 (52%) Plan Premium, $4,800 (48%) Benefit

Legend: Plan Premium, Benefit
GASB 74/75

- Goal → Accrue for future retiree costs as benefits are earned instead of recognize on a pay-as-you go basis during retirement (similar to pension accounting)
- Consistency with pension accounting
- GASB 74 applies to plan (asset trust) reporting (replaced GASB 43) though no pre-funding is required
- GASB 75 applies to employer reporting (replaced GASB 45)
- OPEB or Other Post Employment benefits [Medical, Dental & Life]
- Present value of benefits is determined via an actuarial valuation
Who has to comply with GASB OPEB Standards?

- Offers more than COBRA coverage
- Does not charge retirees the full age-based cost
- Fully insured versus self-funded is not the issue. Are retirees charged a retiree only rate based on a credible size group of retirees?
- Follows Accrual accounting (not strictly required if cash basis though bond rating agencies could inquire)
- A benefit may also apply regarding retiree life insurance if retirees are not charged a separate “retiree” rate

Non-compliance may be an important factor for bond issuance and/or the audit.
Active Plan vs. Retiree Plan

ACTIVE PLAN → GASB 10

Benefits During Active Employment

Recognize costs as incurred

RETIREE PLAN → GASB 74/75

Benefits During Retirement

Estimate all future incurred costs during Retirement

Projected Future Retirees (Based on Current Employee Group)

Current Retirees Electing Coverage
Terms

- Actuarial Present Value (Past, Present, Future)
- Actuarial Accrued Liability (AAL) – Past
- Service Cost – Present
- Interest Cost (change in present value due to passage of time)
- Total OPEB Liability
- Fiduciary Net Position (but no funding required)
- Net OPEB Liability
- OPEB Expense
- Reporting Date
- Valuation Date
- Measurement Date
Terms

- GASB 75 – Total OPEB Liability = Actuarial Accrued Liability (AAL)
  Net OPEB Liability = Total OPEB Liability minus Plan Assets

- Detail of changes in Total OPEB Liability from one period to the next must be calculated and tracked
  - Changes in Benefit Provisions (fully recognized currently in expense)
  - Changes in Actuarial Assumptions
  - Differences between expected and actual experience

- OPEB Expense = Components of change in the AAL with deferral and amortization over average remaining service lives for certain items. (must track amortization bases until fully amortized)
  - Amortization over average remaining service life
Date Definitions

- **Reporting Date** equals the fiscal year end (FYE).

- **Actuarial Valuation Date** equals the census data collection date generally coinciding with the date as of which an actuarial valuation is performed. Must be performed as of a date no more than 30 months and one day prior to the employer’s current FYE.

- **Measurement Date** equals the date as of which the Net OPEB liability is measured. May be selected from a range starting no earlier than the end of the employer’s prior FYE and ending no later than the reporting date. When the actuarial valuation date does not equal the measurement date actuarial calculations are used to project results to the measurement date.

- When measurement date does not equal valuation date, must report deferred outflows = employer contributions from measurement date to reporting date.
Other Items

- Full update valuations every 2 years regardless of size
- Interim years – No “full update” but re-measurement required
- Must complete a full valuation for an otherwise interim year if material changes in the census or benefit arrangement (Some examples are an early retirement offer, enrollment shift in medical options, significant layoffs, change in retiree contribution policy)
- For unfunded plans discount rate is based on published bond rate as of the measurement rate. Report can’t be completed until after the measurement date.
- Benefit changes enacted and made public as of the year-end measurement date are valued/projected even though changes may not come into effect until future periods.
- Spouse coverage provisions can have a material impact. What spouse coverage is available upon retiree death or retiree attainment of age 65?
Information for Valuation

- Census data (actives and covered retirees) as of the valuation date
- Retiree Benefit Eligibility and Spouse coverage provisions
- Plan premium rates and Retiree premium rates
- Schedule of Benefits for each plan option
- Admin Fee Rates and Stop-loss premium rates if self-funded
- Monthly paid claims experience and enrollment
- Plan renewal detail if fully insured
- Plan document and/or policy provision document
- Participation Experience (How many that retired elected coverage?)
- Projected average salary growth per employee (may be a flat number such as 3%, or differ by service or some other variable)
Assumptions for Actuarial Valuation

- Decrement (Retirement, Turnover, Disability, Mortality)
- Discount Rate – The expected yield on 20-year, tax-exempt, municipal bonds of quality rating AA or higher; otherwise, the expected return on assets in an irrevocable trust to the extent that benefits may be paid from such assets.
- We use S&P Municipal Bond 20 Year High Grade and Fidelity Municipal General Obligation (20 Year) Indexes
- Expected Costs by Age (involves claim analysis)
- Healthcare Cost Trends function of usage, technological developments and unit prices
- Participation Rates (retiree and dependent)
- Proportion of retirees dropping upon attaining age 65
- Salary Scale
An Example – Pre-65 Retiree Health Plan

Plan Specifics
- Actives pay 20% of the blended rate ($1,200 = $6,000 x 20%)
- Retirees pay 100% of the blended rate ($6,000)
- Plan has 500 Actives (age 40) and 40 Retirees (age 60)

Retiree rates based on blended premium rates:

<table>
<thead>
<tr>
<th></th>
<th>Actives</th>
<th>Retirees</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blended Premiums-$6,000 PMPY</td>
<td>$3,000,000</td>
<td>$240,000</td>
<td>$3,240,000</td>
</tr>
<tr>
<td>Less: Participant Contributions</td>
<td>600,000</td>
<td>240,000</td>
<td>840,000</td>
</tr>
<tr>
<td>Employer Cost</td>
<td>$2,400,000</td>
<td>-0-</td>
<td>$2,400,000</td>
</tr>
</tbody>
</table>
An Example – Pre-65 Retiree Health Plan

- Projected average age-adjusted cost is split as follows:
  - Retirees = $10,196
  - Actives = $5,664

Employer Contributions based on age-based costs:

<table>
<thead>
<tr>
<th></th>
<th>Actives</th>
<th>Retirees</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age-adjusted Costs</td>
<td>$2,832,160</td>
<td>$407,840</td>
<td>$3,240,000</td>
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<tr>
<td>Less: Participant Premiums</td>
<td>600,000</td>
<td>240,000</td>
<td>840,000</td>
</tr>
<tr>
<td>Employer Contributions</td>
<td>$2,232,160</td>
<td>$167,840</td>
<td>$2,400,000</td>
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The expected cost (PMPY) of retiree coverage is $10,196 of which the retiree contributes $6,000. The difference of $4,196 equals the benefit that forms the basis for valuation.
Accounting Entries for GASB 75:

- **OPEB Expense** $xxx
  - OPEB Liability $xxx
  To accrue for OPEB Expense

- **Change in Def Inflows/Outflows** $xxx
  - OPEB Liability $xxx
  To record Change in Def Inflows/Outflows

- **OPEB Liability** $167,840
  - Cash (or Group Health Expense) $167,840
  To record amount of Employer Contributions

Key – Active and Retiree costs must be analyzed separately to comply with GASB
An Example – Pre-65 Retiree Health Plan

- An actuarial valuation is performed.

**Present Value of Future Retiree Costs (future ER Contributions)**

<table>
<thead>
<tr>
<th>Period</th>
<th>Actives</th>
<th>Inactives</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service Cost</td>
<td>300,000</td>
<td>0</td>
<td>300,000</td>
</tr>
<tr>
<td>Past-AAL</td>
<td>7,800,000</td>
<td>700,000</td>
<td>8,500,000</td>
</tr>
<tr>
<td>Future-All Other</td>
<td>6,000,000</td>
<td>0</td>
<td>6,000,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$14,100,000</strong></td>
<td><strong>$700,000</strong></td>
<td><strong>$14,800,000</strong></td>
</tr>
</tbody>
</table>

Service Cost ($.3 million) is part of Expense.
The AAL is the Total OPEB Liability. ($8.5 million)
These are based on the PV of Benefits ($14.8 million)
Questions ? ?

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