



SNAPSHOT

Benefits in the Balance: The Uncertain Future of Public Retiree Health Coverage

2006

Introduction

The future of generous retirement health benefits for public sector workers is uncertain. In 2007, public entities in the state—including schools and government at all levels—will be required to report the cost of retiree benefits in their financial statements, in many cases revealing large unfunded liabilities. The disclosure of unfunded liabilities will lead to new scrutiny from financial planners and oversight agencies, including bond raters that influence the terms for borrowing money. As a result, trade-offs between spending on retiree health care versus other public spending priorities will come into sharper focus for public agencies, workers, local elected officials, and their constituents.

The problem is large; about 15 percent of California’s workforce is employed by the public sector. Compared to private sector workers, public employees receive a greater share of their compensation in the form of benefits. For many public sector workers, retiree health benefits are hard-won and highly valued. However, most public agencies pay for retiree benefits from current budgets, rather than saving in advance for the costs. As a greater proportion of the public sector workforce approaches retirement age, gains in life expectancy extend the period over which benefits are paid, and overall health spending continues to climb, the long-term financial viability of retiree health benefits for many public employees will be threatened.

This snapshot begins with an assessment of current and forecasted retiree health care spending by counties, cities, school districts, state government, and special districts in California. The federal sector is excluded. The snapshot concludes with data on the characteristics of public sector retirees and the benefits they receive.

Retiree Health Care Introduction

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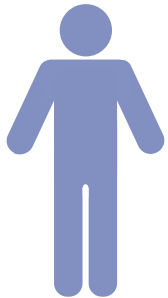
Framing the Problem

TODAY

Pay-As-You-Go

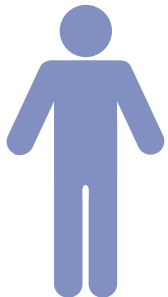
Agencies pay from current revenues the cost of benefits provided this year.

Today's Workers



Annual Invoice
for Today's
Employees' Health
Benefit Expense

Today's Retirees



Annual Invoice
for Today's
Retirees' Health
Benefit Expense

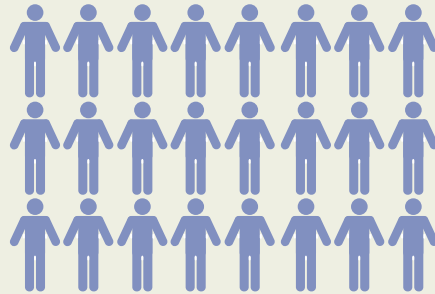
TOMORROW

Unfunded Liabilities

The costs of future coverage continuously accrue as commitments are made, but not funded, for tomorrow's retirees.



Future Retirees



Retiree Health Care

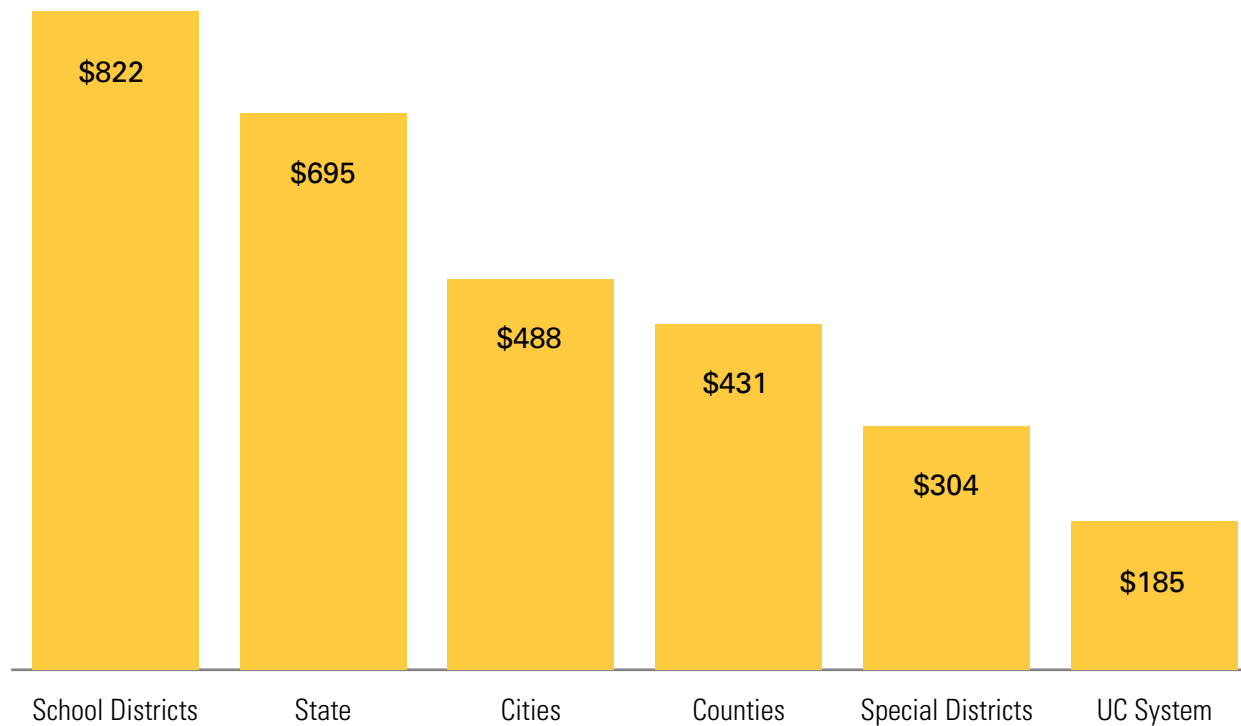
Costs

Most public agencies pay for health care only as bills come due, but do not set aside funds to finance commitments to future retirees.

Like an unpaid credit card balance that grows as interest accrues and new charges are added, the resulting financial obligations accumulate over time.

Annual Retiree Health Care Costs, by Government Type, FY 2003–04

in millions



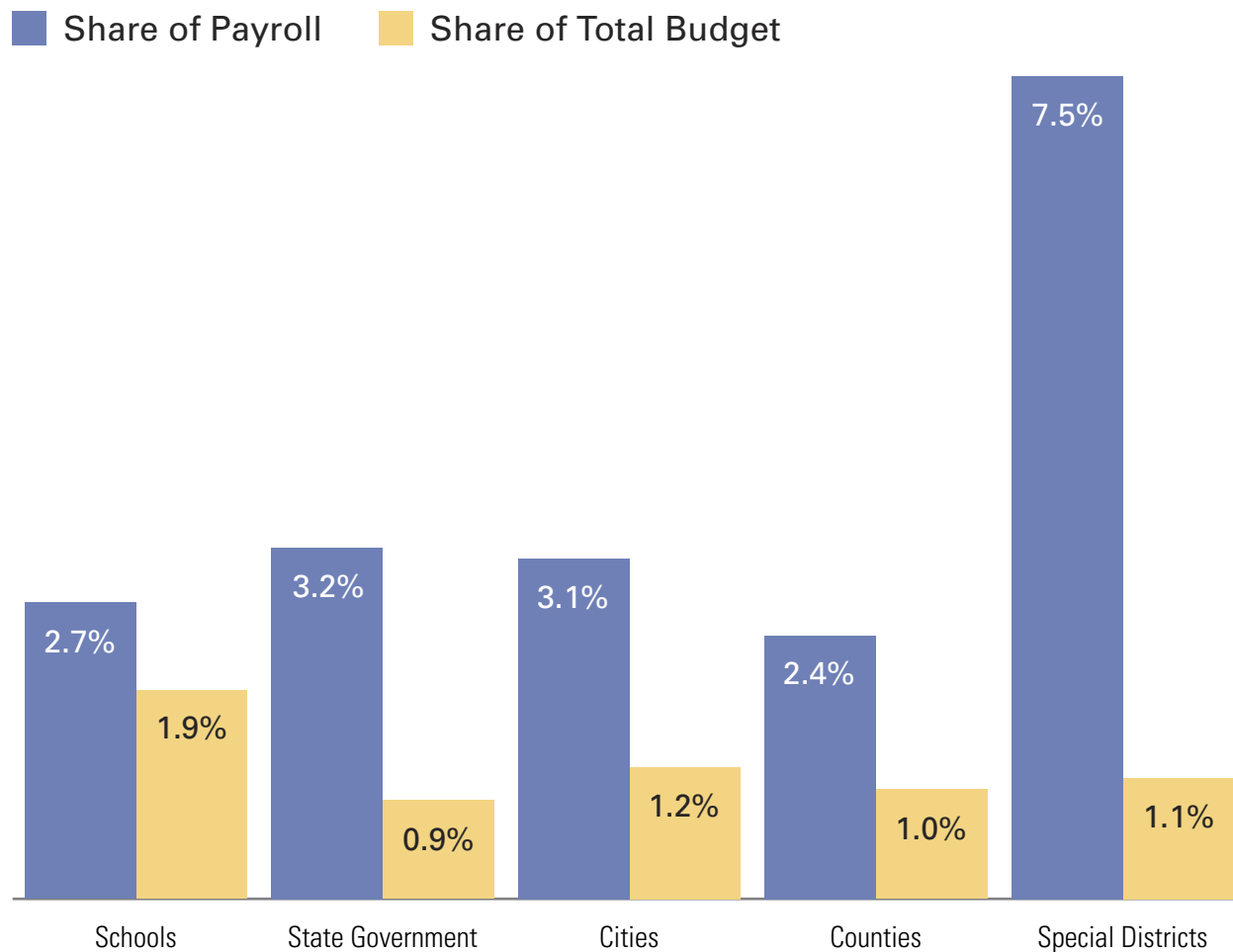
Notes: Figures represent the mid-point of an estimated range. Excludes federal retirees. Special districts include government agencies, such as water and transit districts.

Source: Center for Government Analysis, "An Analysis of Public Sector Health Care Costs in California," March 2006.

Retiree Health Care Costs

In total, California public agencies spent about \$3 billion for retiree health coverage in 2003–04.

Retiree Health Costs as a Share of Public Employer Payroll and Budget, 2003–04



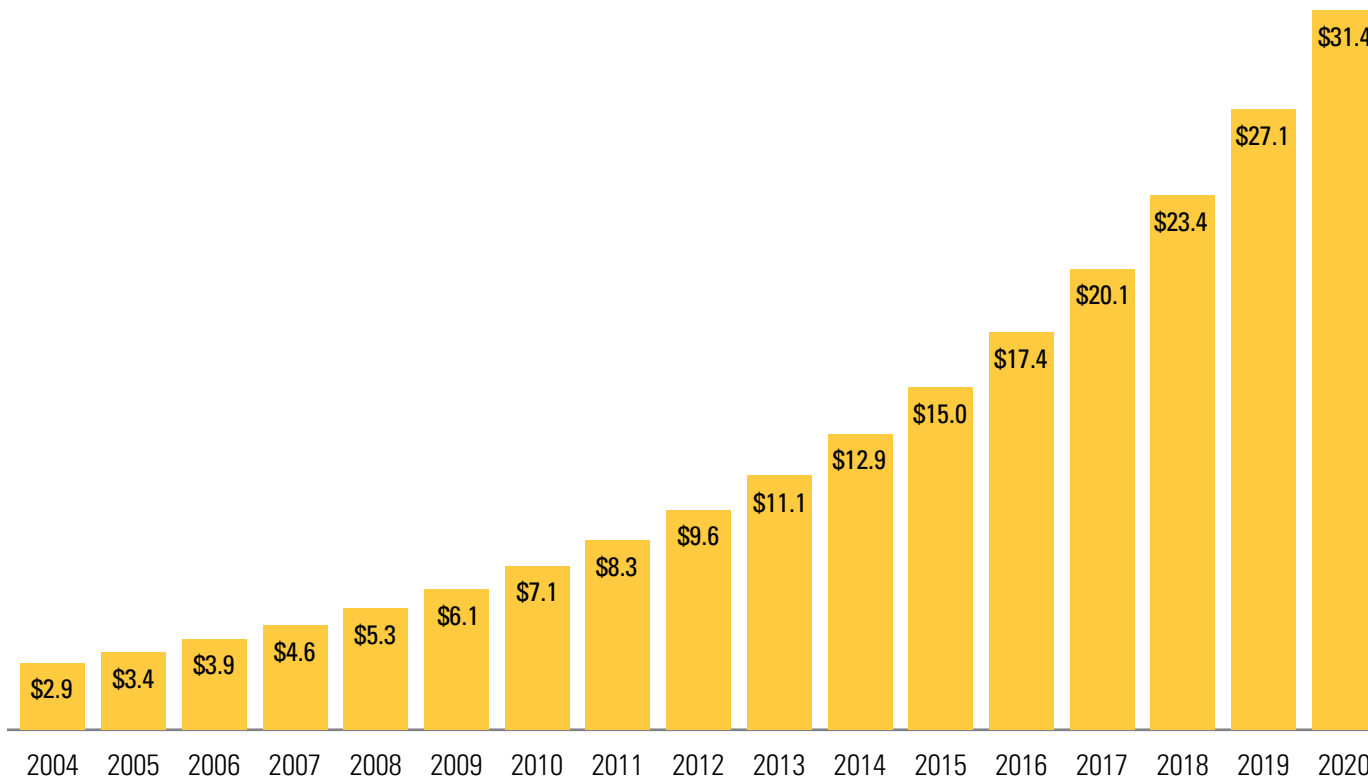
Source: Center for Government Analysis, "An Analysis of Public Sector Health Care Costs in California," March 2006.

Retiree Health Care Costs

On average, current spending on retiree health care is a small share of overall budgets. Compared to other payroll costs, however, retiree health care costs may be sufficiently large to compete with other spending priorities, such as salary increases.

Estimated Retiree Health Care Costs, Public Sector, FY 2004–20

in billions



Notes: Costs assume a pay-as-you go basis, no significant policy changes, and cost trends based on recent actuals. Reflects costs for cities, counties, schools, special districts, and the state.

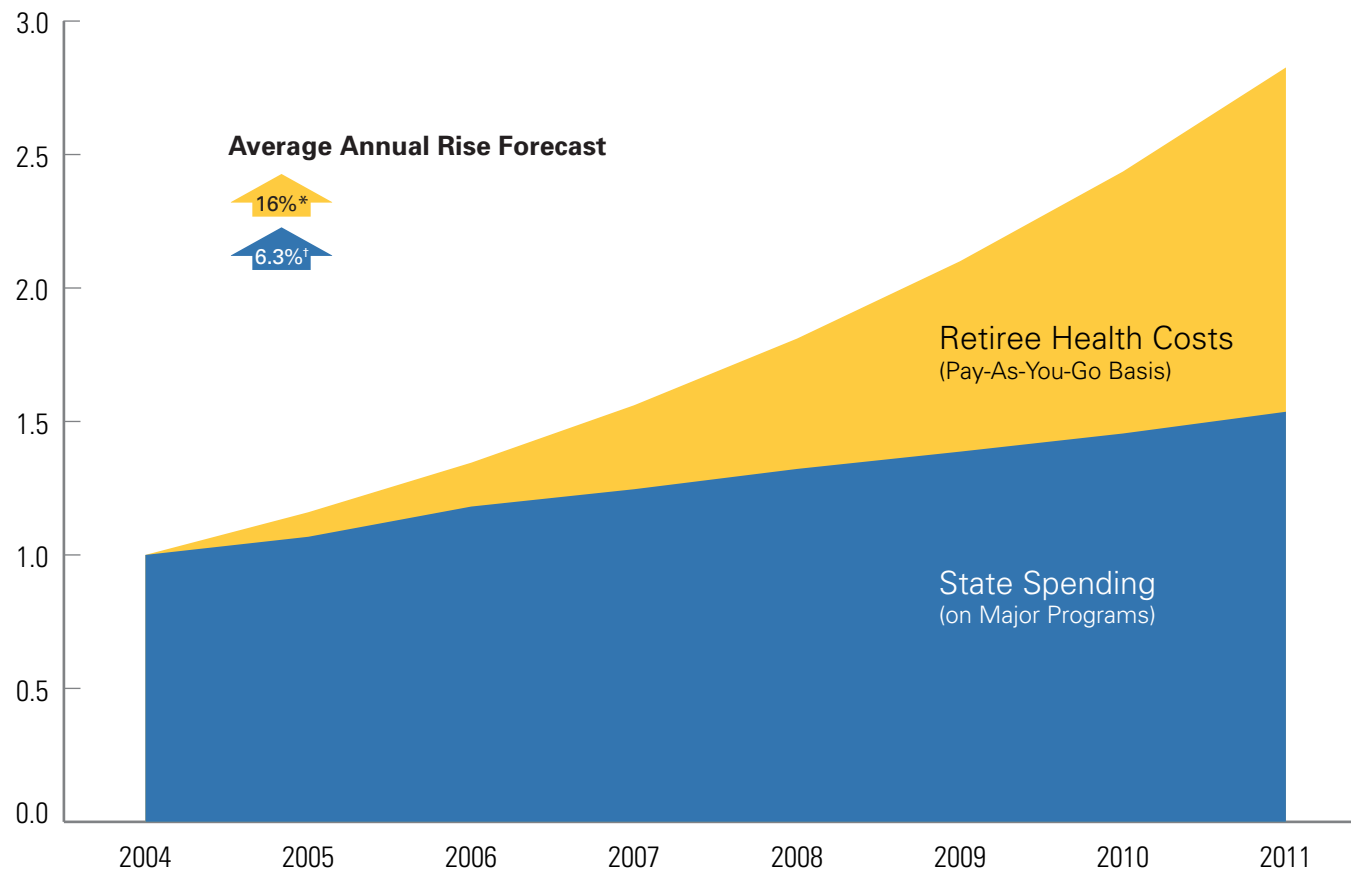
Source: Center for Government Analysis, "An Analysis of Public Sector Health Care Costs in California," March 2006.

Retiree Health Care Costs

Costs are projected to grow rapidly, reaching \$31 billion per year by 2020, a function of growing numbers of retirees and steep health care cost trends.

Cumulative Effect of Projected Increases, Retiree Health Costs vs. State Spending, FY 2004–11

Times More Expensive Than 2004



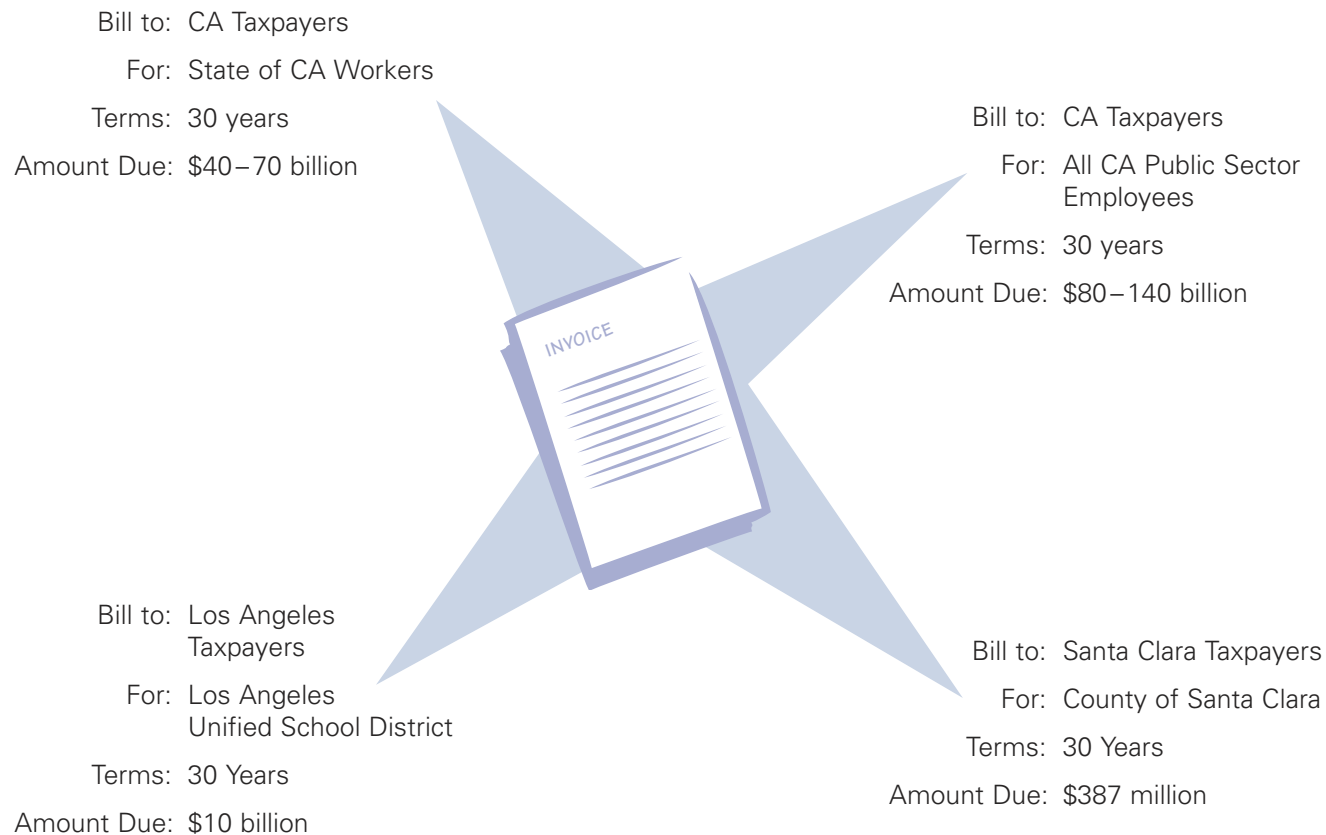
Retiree Health Care Costs

Retiree health care costs are projected to rise more rapidly than budgets, with the cumulative effect of higher growth rates mounting quickly. By 2011, retiree health costs will be 2.8 times 2004 levels, while other major state programs will be only 1.5 times 2004 levels.

Sources: *Center for Government Analysis, "An Analysis of Public Sector Health Care Costs in California," March 2006.

†California Legislative Analyst's Office, *California's Fiscal Outlook: LAO Projections, 2005–06 Through 2010–11*, November 16, 2005.

Size of Current Unfunded Liabilities for Retiree Health Care Promised



Retiree Health Care Costs

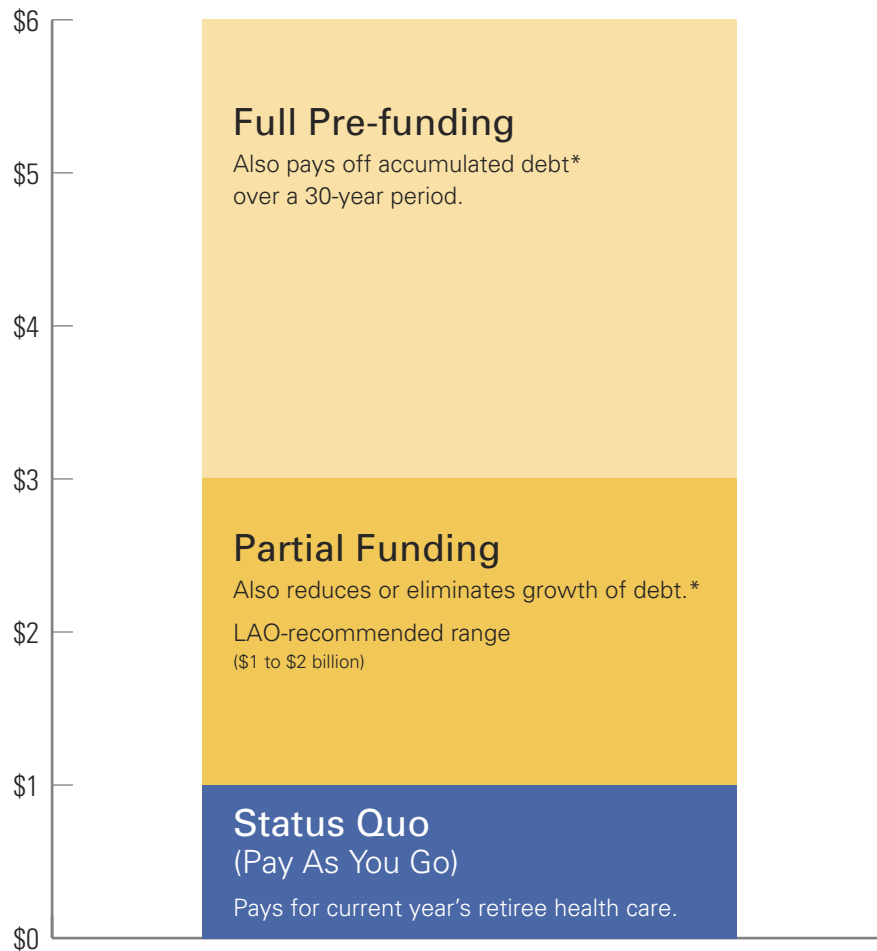
As agencies begin to evaluate their commitments, many are finding large unfunded liabilities.

Sources: Legislative Analyst's Office, *Retiree Health Care: A Growing Cost for Government*, February 17, 2006. LAUSD, July 1, 2005 valuation. Graves, Gary A. "Case Study: Santa Clara County," Presentation to the California State Association of Counties, January 25, 2006.

Future Funding Options,

EXAMPLE: State of California, 2007

in billions



*The "debt" or unfunded liability for future retiree health care for the State of California is estimated to be \$40 to \$70 billion.

Source: California Legislative Analyst's Office, February 2006.

Retiree Health Care Costs

Agencies must choose whether and to what extent they will pre-fund retiree health. As an example, in 2007, \$1 billion will be required to pay for current State of California retirees. Additional funds—up to \$6 billion per year for 30 years—would be required to fully secure benefits in the long term.

Factors Affecting Retiree Health Care Costs

Some factors are beyond the control of decision-makers at the local agency level...

DEMOGRAPHICS

- Age of Workforce
- Life Expectancy
- Mix of Early vs. Medicare-eligible Retirees

UNDERLYING HEALTH CARE INFLATION

And others are subject to change or negotiation.

BENEFIT DESIGN

- Copays, Coinsurance, and Deductibles
- Coverage for Disease Management, Prevention, and Health Promotion Activities
- Network Adjustments, including encouraging services through less-costly providers and/or non-traditional settings

ELIGIBILITY

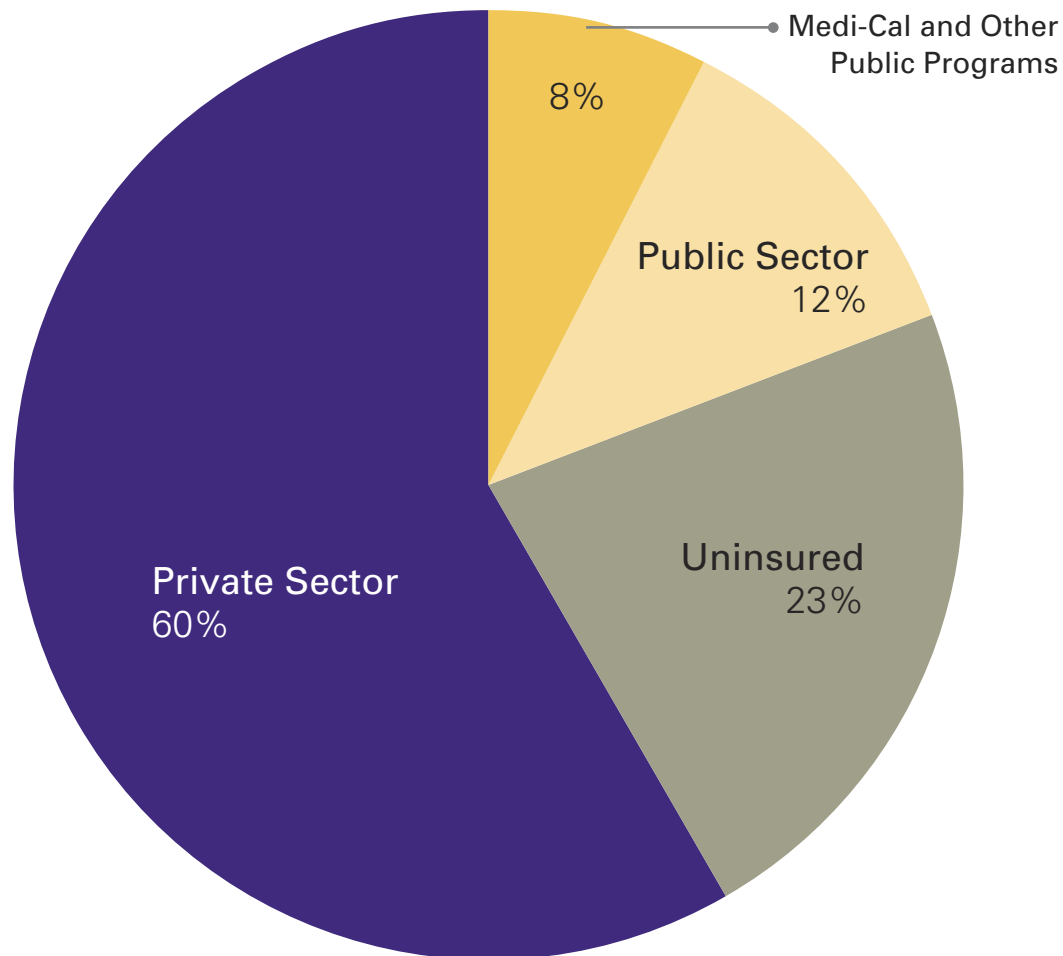
- Contribution Policies
- Coverage After Age 65
- Dependent Coverage
- Medicare Assignment Requirements
- Retirement Age
- Years of Service to Vest

Retiree Health Care Costs

Demographics, underlying health care inflation, eligibility policies, and benefit design all affect retiree health costs. Some of these elements can act as levers for adjustment; others are outside the control of agency decision-makers.

Notes: Medicare assignment refers to requirements to participate in Medicare and to assign Medicare benefits to one's health insurance, e.g. as in a Medicare HMO.

Sources of Coverage, Non-Elderly, 2004



Note: Pie does not add to 100 percent because some workers may have more than one source of insurance.

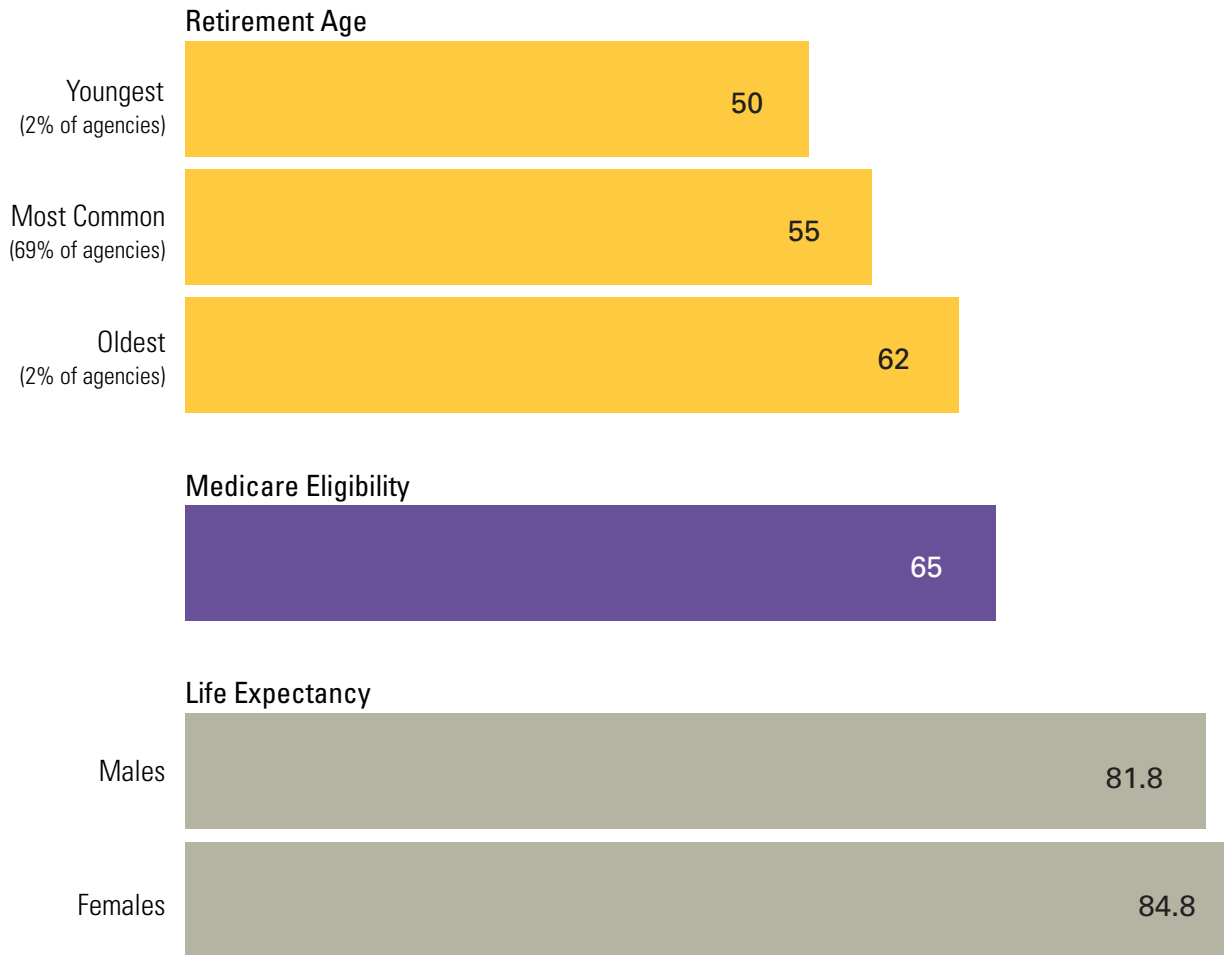
Source: Employee Benefit Research Institute estimates of the Current Population Survey, March 2005 supplement.

Retiree Health Care

Characteristics

Most Californians obtain coverage through private sector employment. Differences in public and private sector benefits, including retiree coverage, arise from different compensation approaches, collective bargaining arrangements, and levels of regulatory oversight.

Age at Selected Milestones

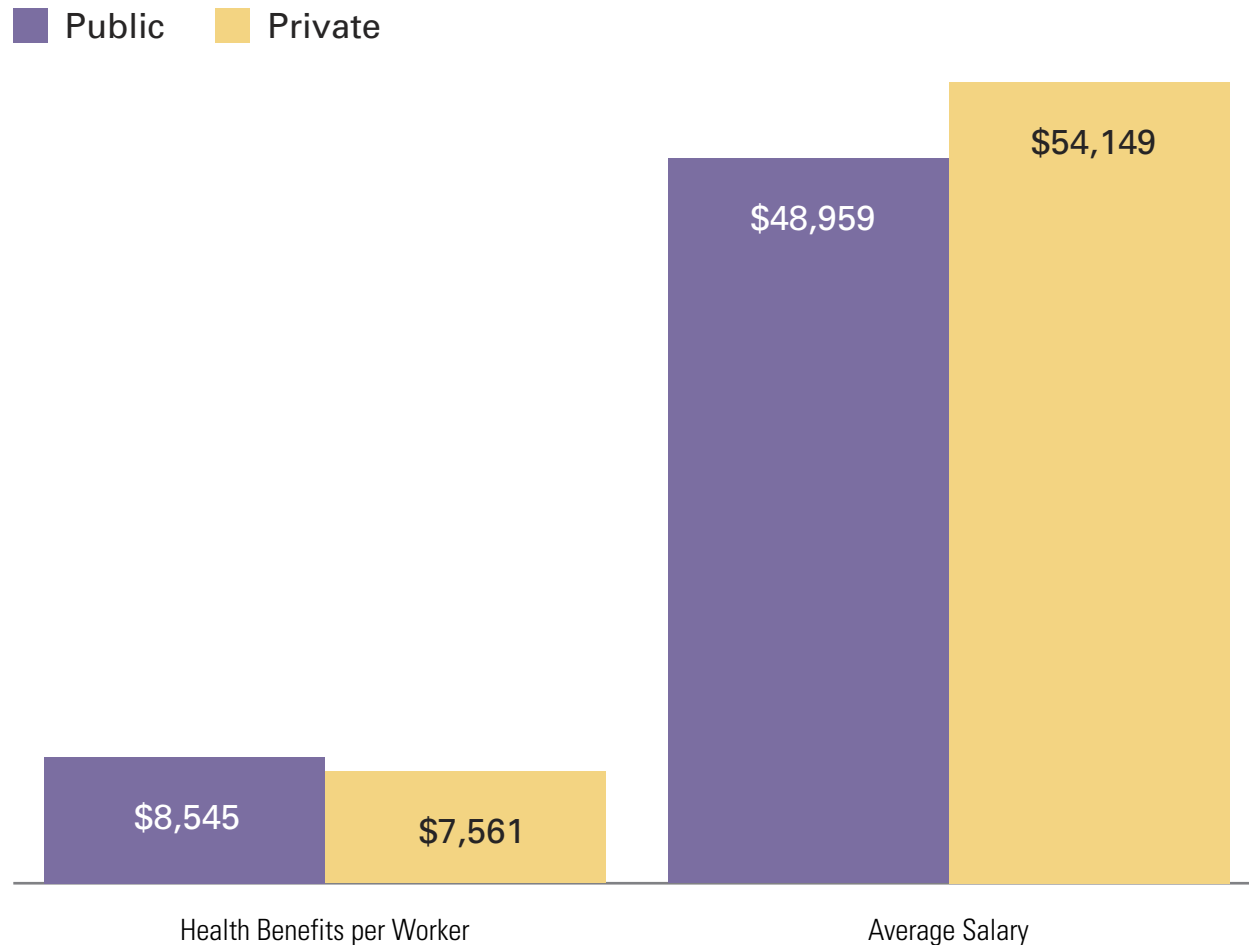


Retiree Health Care Characteristics

Most public agencies in California provide for retirement at 55 and nearly all by age 60. With Medicare eligibility not reached until age 65 and average life expectancy in the 80s for men and women, paying for retiree health coverage can extend over many years.

Sources: California Department of Personnel Administration, Total Compensation Survey, 2006. National Center for Health Statistics, Centers for Disease Control, Health United States, 2005, Table 27.

Annual Health Benefits and Salary, Public vs. Private Sector, 2005



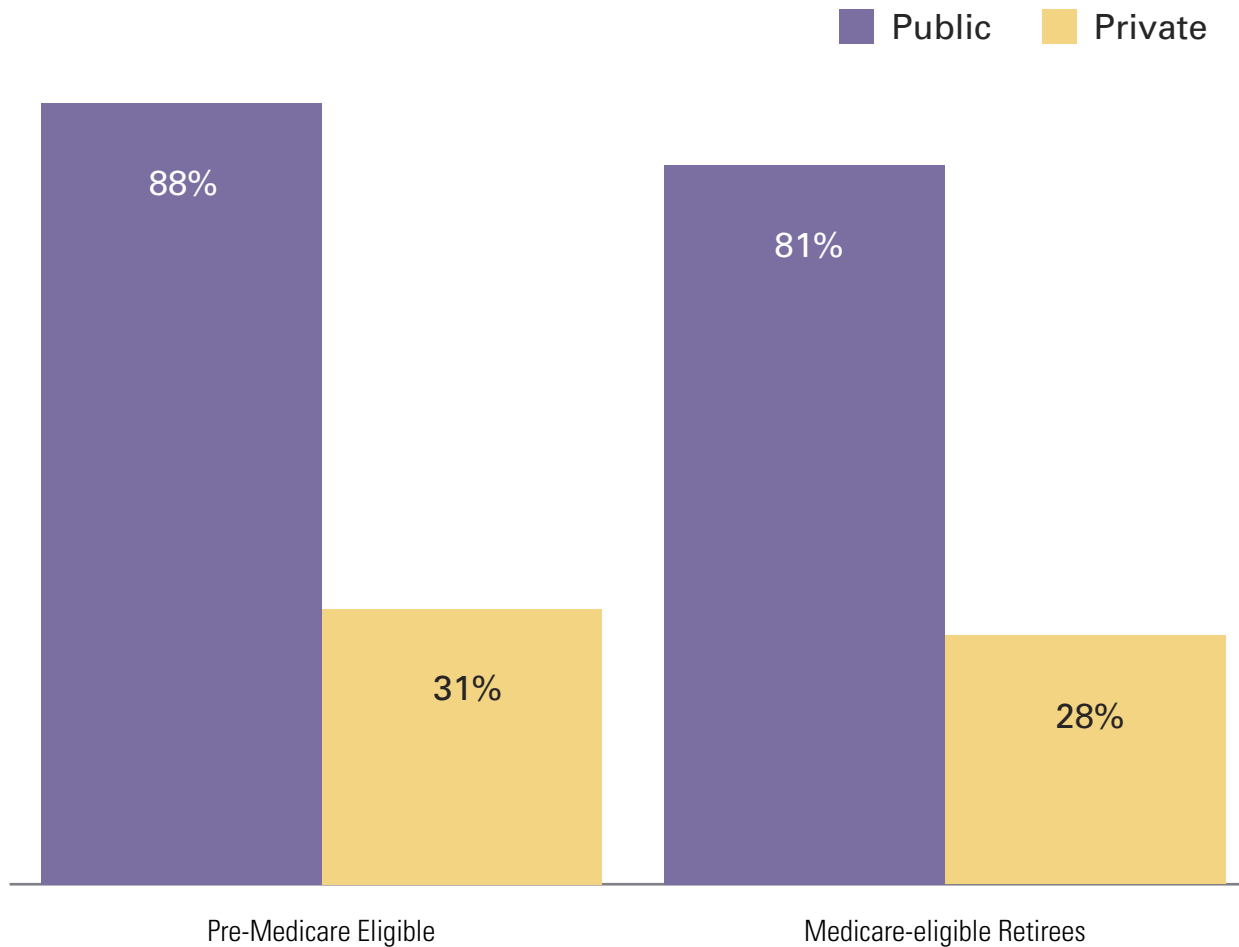
Source: Mercer National Survey of Employer-Sponsored Health Plans, 2005.

Retiree Health Care Characteristics

Compared to their private sector counterparts, public sector employees in California receive a smaller share of compensation through wages and a larger share in the form of benefits, including retiree health care.

Employers Offering Retiree Coverage, Public vs. Private Sector, 2005

Percentage Offering to...



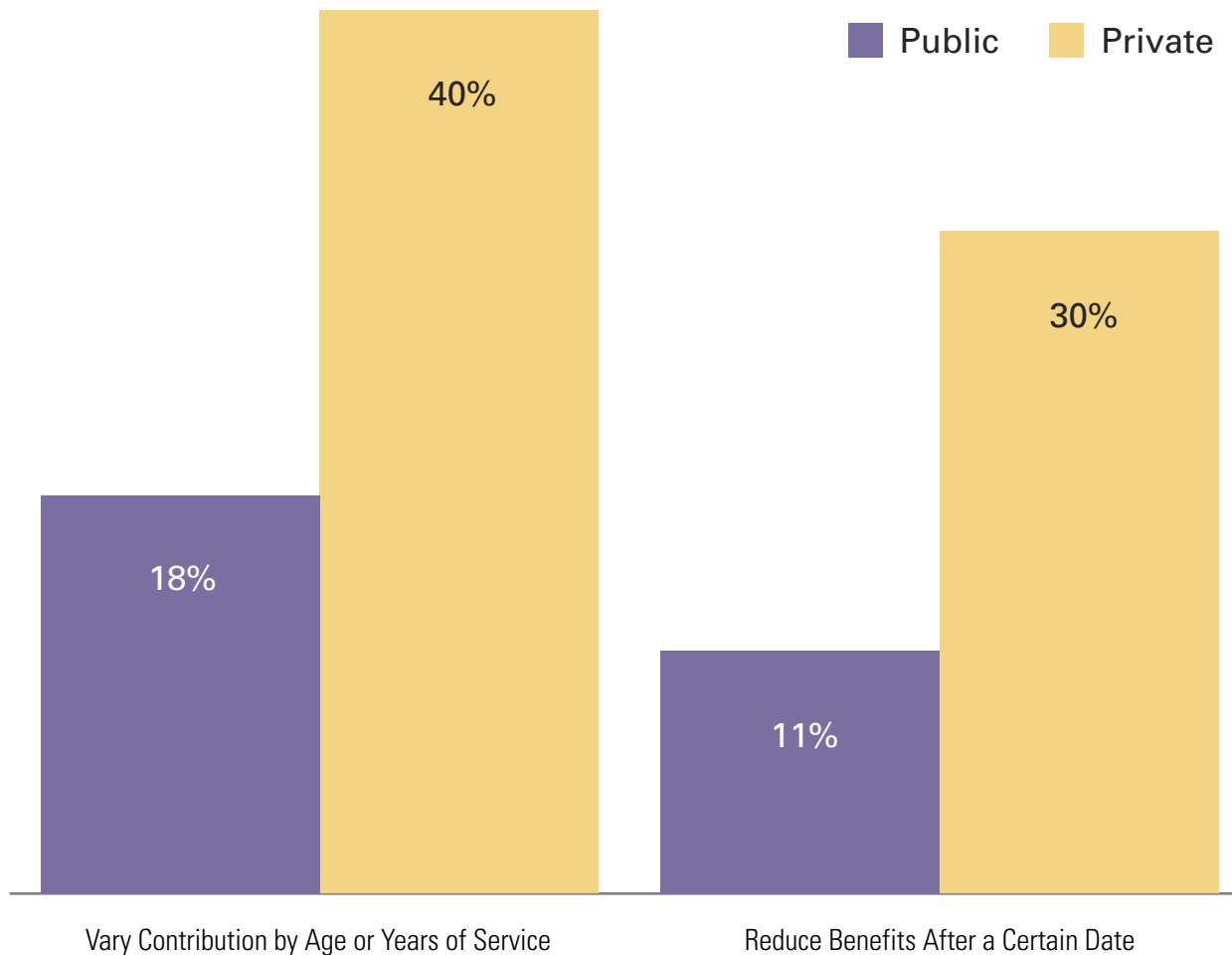
Source: Mercer National Survey of Employer-Sponsored Health Plans, 2005.

Retiree Health Care Characteristics

In California, the public sector offers retirees medical coverage at almost three times the rate in the private sector, whether or not they are eligible for Medicare.

Limits on Eligibility, Public vs. Private Sector, 2005

Percentage of Employers Who...

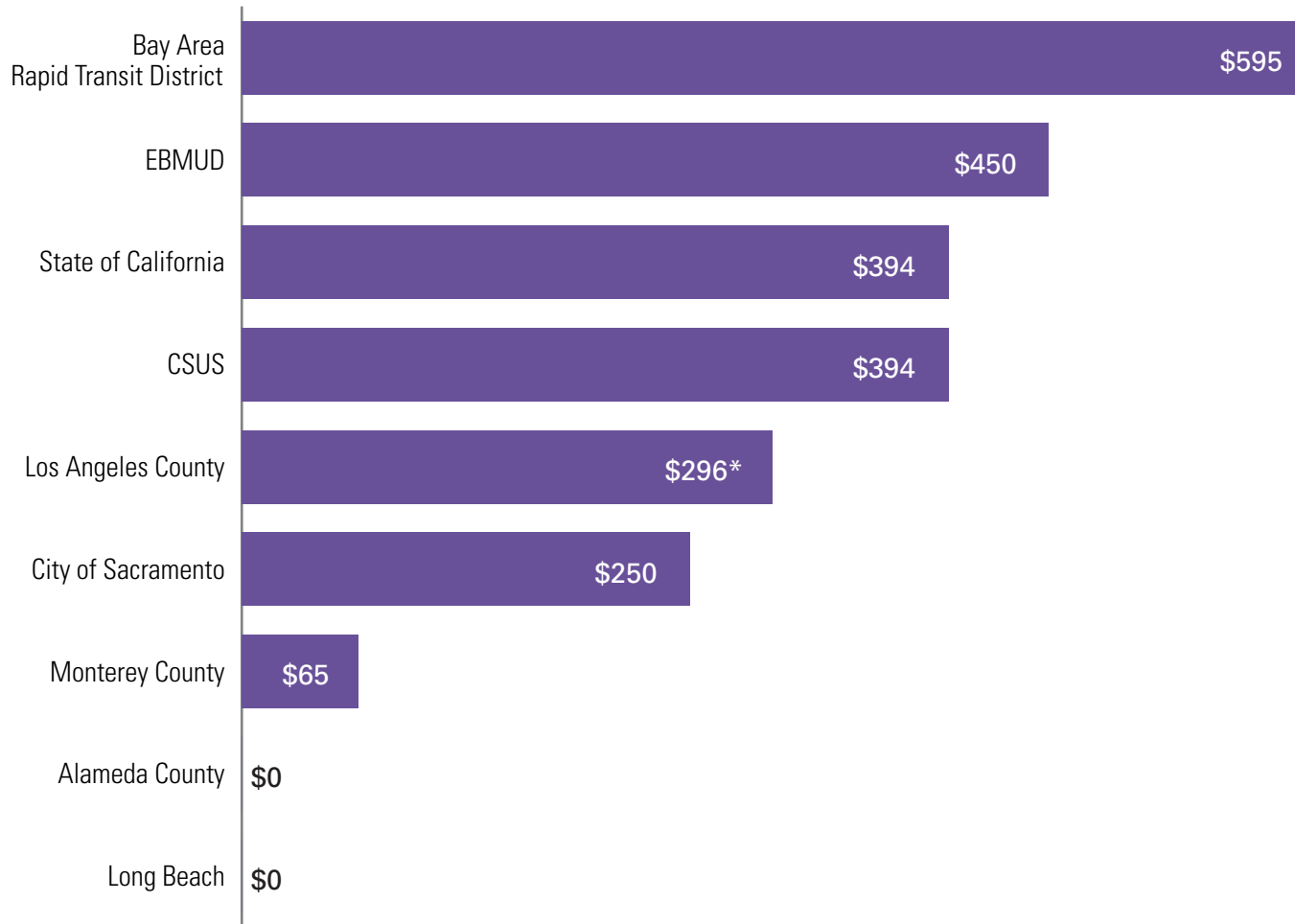


Source: Mercer National Survey of Employer-Sponsored Health Plans, 2005.

Retiree Health Care Characteristics

Where retiree health coverage is offered, private employers in California are more likely than public agencies to limit retiree benefits or contribution levels for some employees, especially younger or more recent hires.

Selected Monthly Employer Contributions, Single Enrollee, 2006



*\$296 for retirees with 10 to 24 years of service. \$740 for retirees with 25+ years of service.

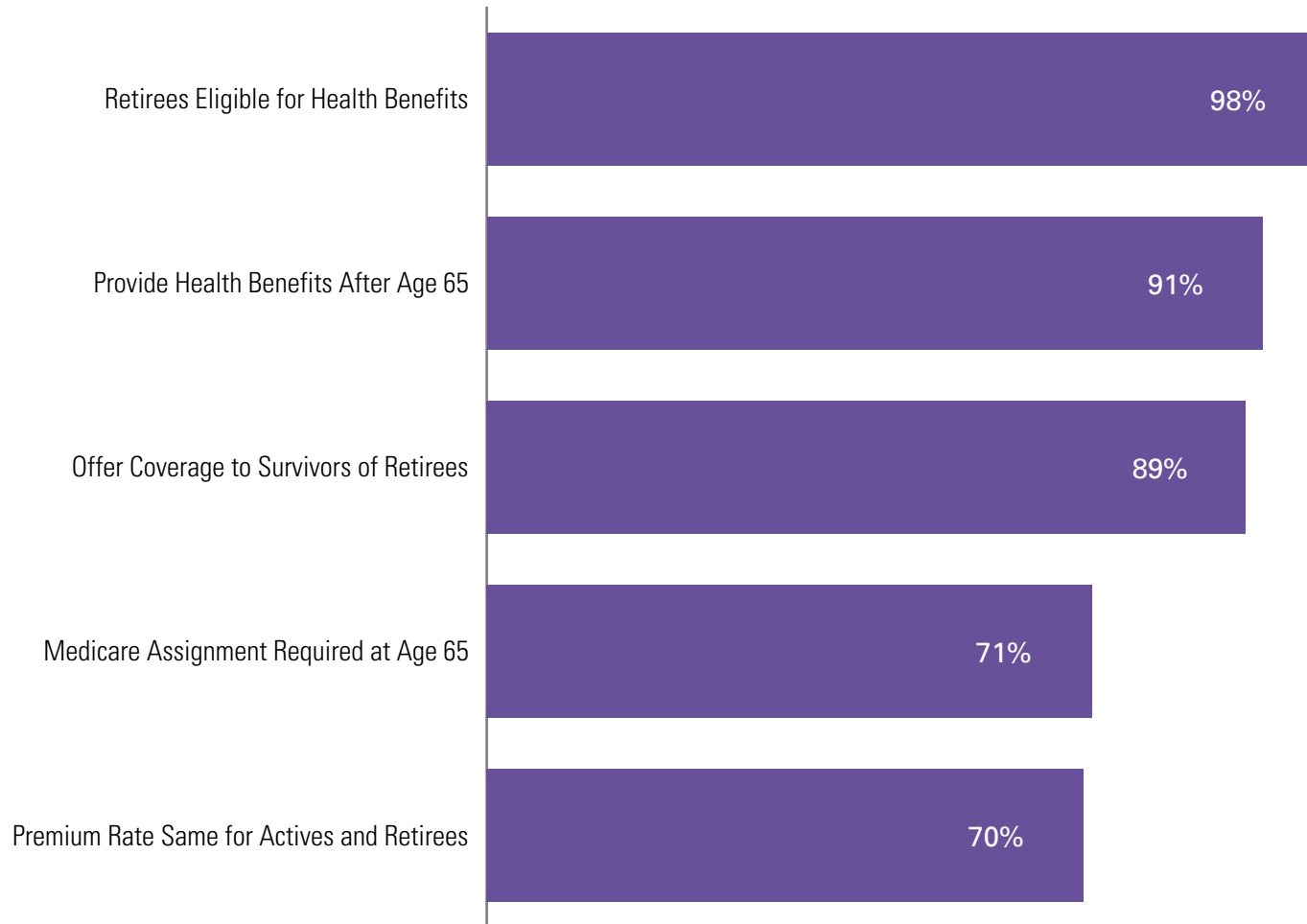
Notes: State of California and UC employees may also use the contribution to pay their Medicare Part B premium (\$88 in 2006). The variation among contributions could reflect a variety of contribution rules and the mix of early retirees and Medicare beneficiaries.

Source: California Department of Personnel Administration, Total Compensation Survey, 2006.

Retiree Health Care Characteristics

Contribution levels to retiree health care are an important cost driver and vary widely across public agencies.

County Profile of Retiree Health Benefits, 2005



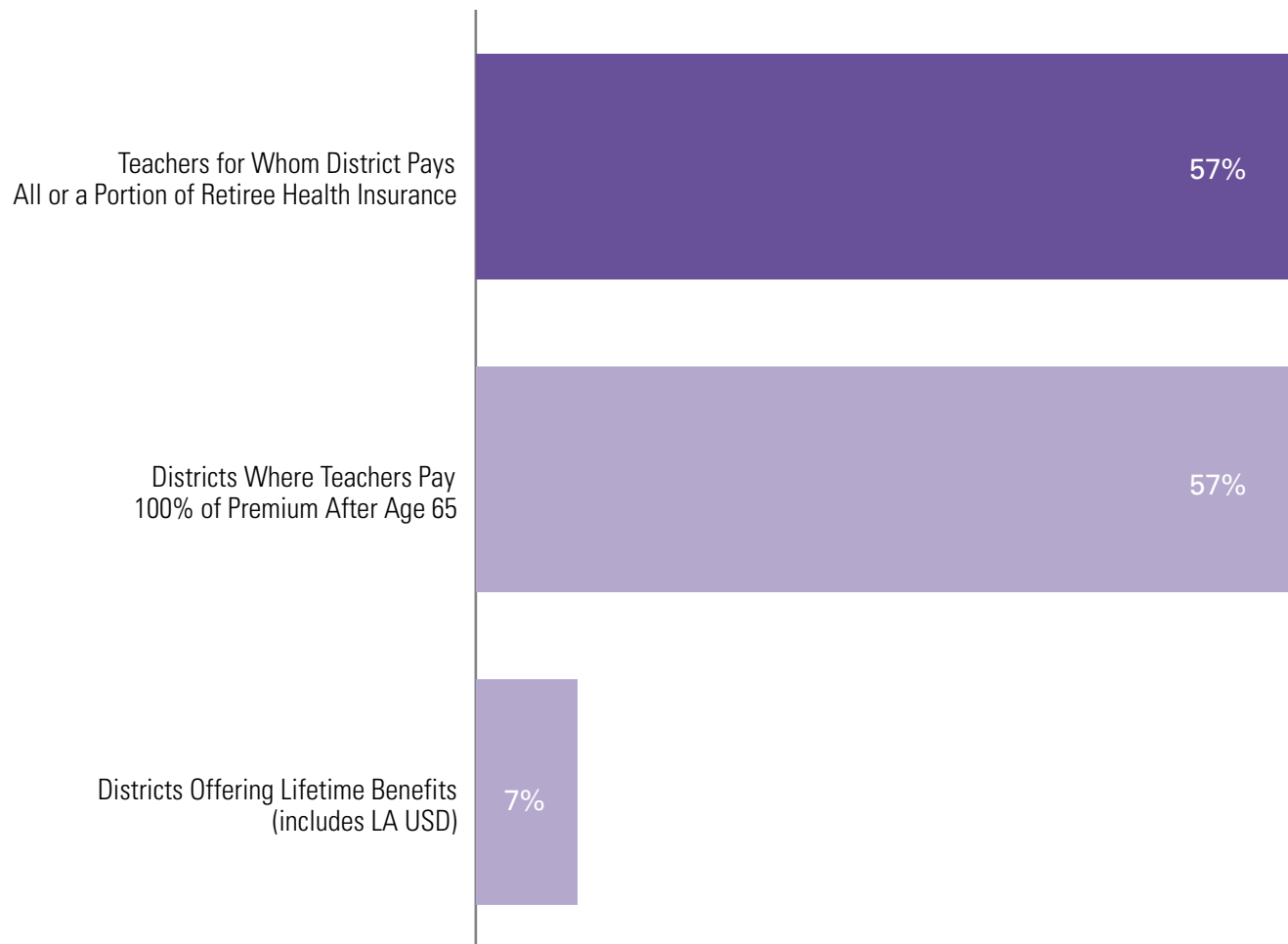
Notes: Some counties do not contribute to retiree benefits. (California DPA Total Compensation Survey, 2006.) Medicare assignment allows employer-sponsored insurance to be offset by Medicare payments and coverage.

Source: California State Association of Counties and County Administrative Officers Association of California. Retiree Health Benefit Survey, September 2005. (49 of 54 counties responding.)

Retiree Health Care Characteristics

Counties, like most government entities, generally provide health benefits to retirees and survivors, including the period after they reach the Medicare-eligible age of 65.

K-12 School Districts' and Community Colleges' Retiree Health Coverage



Source: California State Teachers' Retirement System (CalSTRS). Survey of Health Benefits, 2003.

Retiree Health Care Characteristics

Overall, retiree health coverage in schools is provided less frequently than for state and local governments workers. Contribution and eligibility policies vary widely; most notably, over half of responding school districts make no contribution to benefits once Medicare age has been reached.

GASB Basics

On August 2, 2004, the Governmental Accounting Standards Board (GASB) issued its long-awaited standard requiring accrual, rather than pay-as-you-go, accounting for retiree health benefits and other post-employment benefits (OPEB), other than pensions.

- GASB Statement No. 45 (GASB 45), *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*

GASB 45 SAYS:

- Treat OPEB “Other (than pensions) Post-Employment Benefits” in a manner similar to pension benefits.
- Recognize that OPEB constitutes compensation for employee service and, as such, should be recognized over the entire period of an employee’s active service.
- Provide relevant information regarding:
 - Actuarial accrued liabilities for promised benefits associated with past service
 - Annual OPEB cost and its contribution to the total cost of government services
 - Progress (or lack thereof) made in funding the plan

GASB EFFECTIVE DATES:

- Phase 1 governments (\$100+ million in revenues) fiscal year beginning after December 15, 2006
- Phase 2 governments (\$10–100 million in revenues) fiscal year beginning after December 15, 2007
- Phase 3 governments (<\$10 million in revenues) fiscal year beginning after December 15, 2008

Source: Mercer Health and Benefits.

New accounting standards are training a magnifying glass on retiree health costs, both present and future.

Sources

CALPERS

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Retiree Health Care Appendix

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