State Retiree Health Care Liabilities: An Update

Increased obligations in 2014 mirrored rise in overall health care costs

Overview

States paid a total of $19.4 billion in 2014 for non-pension worker retirement benefits, known as other post-employment benefits (OPEB). Almost all of this money was spent on retiree health care. The aggregate figure for 2014, the most recent year for which complete data are available, represents an increase of $1 billion, or 5.7 percent, over the previous year. The 2014 payments covered the cost of current-year benefits and in some states included funding to address OPEB liabilities. These liabilities—the cost of benefits, in today's dollars, to be paid in future years—totaled $659 billion in 2014, a 5 percent increase over 2013.

This brief provides an update to a 50-state analysis by The Pew Charitable Trusts detailing state OPEB assets and liabilities, "State Retiree Health Care Liabilities: Multiple Factors Contribute to Improving Picture in Many States," released in 2016 and based on 2013 data. The update explores the varied structures of state OPEB programs and the cost of benefits across states. It also reviews the methods that they use to manage OPEB costs. Future analyses will examine the effectiveness of those efforts, including the impact of states' pre-funding strategies and the potential legal issues facing those considering OPEB reforms.

OPEB funded ratios

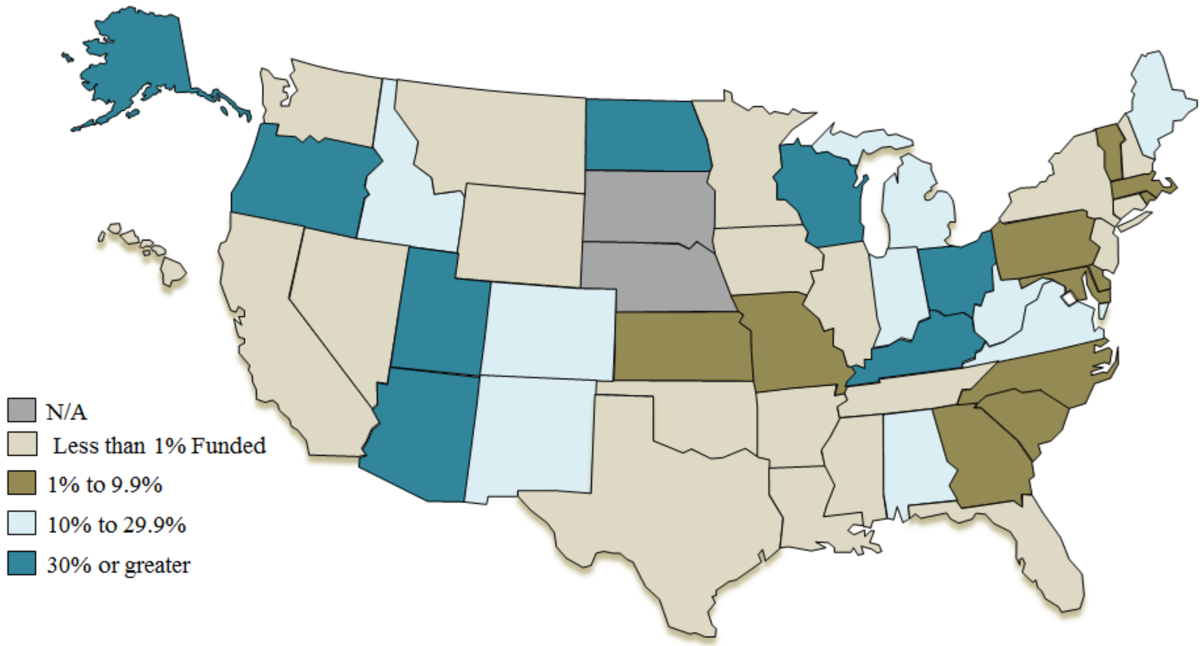
In 2014, states had $45 billion in assets to meet $659 billion in OPEB liabilities, yielding a funded ratio of 6.9 percent. These figures are slightly higher than the reported $40 billion in assets and 6 percent funded ratio reported in 2013. The average state OPEB funded ratio is low because most states pay for retiree health care benefits on a pay-as-you-go basis, appropriating revenue annually to pay retiree health care costs for that year rather than pre-funding liabilities by setting aside assets to cover the state's share of future retiree health benefit costs.

State OPEB funded ratios vary widely, from less than 1 percent in 22 states to 94 percent in Arizona. As Figure 1 shows, only eight have funded ratios over 30 percent. These states typically follow pre-funding policies spelled out in state law. Many of them also make use of the expertise of staff from the state pension system to invest and manage plan assets.

Figure 1

HED: State OPEB Funded Ratios, 2014

DEK: Wide range across the country



Variation in OPEB liabilities

Pew compared states' 2014 OPEB liabilities with 2014 state personal income to show these liabilities in relation to the potential resources that states could draw on to cover the liabilities. The major ratings agencies and other financial research organizations commonly use personal income as a metric to illustrate untapped revenue sources and as an indicator of how flexible states can be in meeting their obligations under changing budget conditions. The research shows significant overall reported OPEB liabilities, but the relative size varies widely. (See Figure 2).

The primary driver for the variation in OPEB liabilities is the difference in how states structure health care benefits for retirees. As a percentage of personal income, the liabilities range from less than 1 percent in 16 states to over 15 percent in New Jersey. Alaska, which has the highest ratio of liabilities to personal income at 42 percent, is a clear outlier among the 50 states because of generous benefit levels that can reach up to 90 percent of premiums for some retired workers. States that provide eligible retirees a monthly contribution equal to a flat percentage of the health insurance coverage premium report the largest liabilities—and could face the greatest fiscal challenges because their costs automatically increase as plan premiums do.

Conversely, those states with fixed-dollar premium subsidies provide a smaller benefit and report lower liabilities. Their exposure to health care cost inflation is also lower, because a fixed-dollar subsidy does not rise with the plan premium. Lastly, the states that only provide access to a retiree health plan, with no subsidy, have the lowest liabilities as a percentage of personal income. Although these plans do not make an explicit monthly premium contribution to retirees, many offer retirees a reduced premium through a group rate, which is an implicit subsidy. The Governmental Accounting Standards Board (GASB), the private, independent organization that sets accounting and financial reporting standards for U.S. state and local governments, requires plans to recognize these implicit subsidies in plan financial reporting.

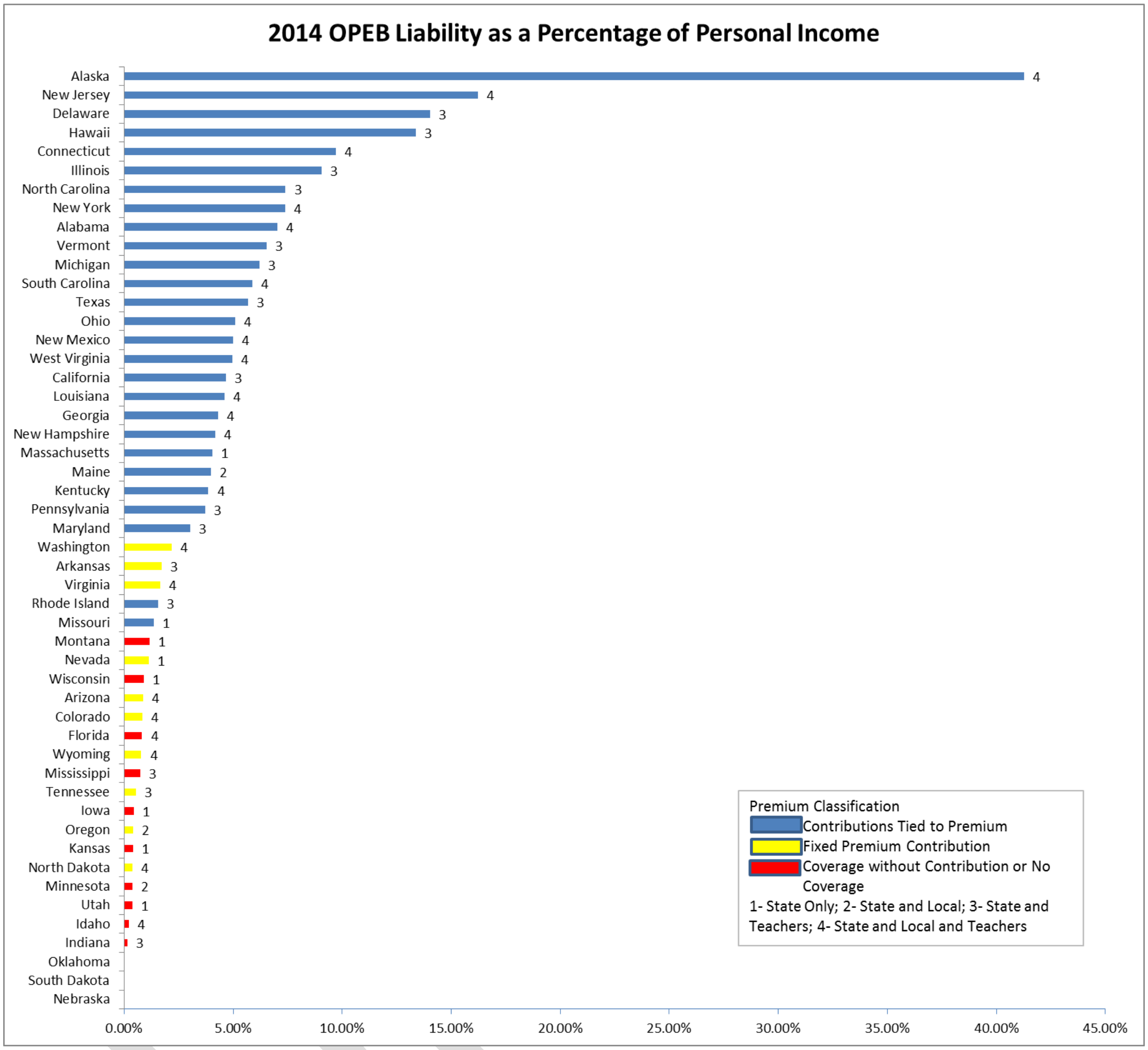
The number of employee groups covered by state OPEB plans also affects the size of retiree health liabilities reported in state comprehensive annual financial reports (CAFRs). For example, while some states may cover only employees working for state-level agencies, others also include municipal or school district employees in state-funded plans (workers who are typically covered at the local level). However, variations in employee eligibility do not appear to be the primary cause for differences in OPEB liability size.

As Figure 2 shows, states that provide retirees with a monthly contribution set at a flat percentage of the insurance premium rank highest in a comparison of OPEB liabilities as a percentage of state personal income, regardless of the number of employees covered. Fixed-dollar states that provide a small cash subsidy to be applied toward monthly plan premiums generally fall in the middle, and states that provide coverage without contributions rank at the low end of the scale. So although some of the variation in the funded ratio may be attributed to the number of retirees covered by OPEB benefits, most of the difference appears to be linked to the level of benefits provided.

Figure 2

HED: 2014 States' Total OPEB Liability as a Percentage of Personal Income

DEK: Benefits tied to premiums lead to higher obligations



Cost trends

The National Health Expenditure Accounts, the official estimate of health care spending produced by the Centers for Medicare & Medicaid Services, reported an increase of 5.3 percent in health expenditures nationwide as a percentage of gross domestic product in 2014 over 2013. That is roughly in line with the overall increase in reported costs and liabilities. This increase in national health expenditures closely mirrors state actuaries' common assumption of a long-term health care cost trend rate of 5 percent increases per year.

Year-over-year changes in reported liabilities vary by state, however, with 38 reporting liability increases of less than 5 percent. Several states with declines or smaller increases, including Hawaii, Illinois, and Louisiana, attributed this to lower-than-expected claims values, as opposed to lower health care costs.[1]

In contrast, a number of states with higher premium contributions—including California and New Jersey—reported significantly greater liabilities in 2014, reflecting increases in assumed future costs.[2] California's plan actuary attributed $7.1 billion of the state's $7.9 billion liability increase to changing demographic assumptions to account for longer retiree life expectancy. New Jersey's hike included a 5 percent increase in liabilities caused by changes in its mortality assumptions and a 9 percent jump linked to changes in health care cost assumptions. For states with the largest year-over-year change in OPEB liabilities, changes in assumptions were the largest driver in increasing costs.

While changes in long-term assumed investment return rates—often used to discount the cost of future liabilities into present value—did not play a significant role in annual liability fluctuations in 2014, Hawaii was a notable exception. Hawaii reported a 37 percent decline in its total liability, in part because of an increase in its plan discount rate from 4 percent to 7 percent.

Conclusion

Although overall OPEB liabilities increased in 2014, some individual state plans experienced lower projected liabilities, which were attributable to lower-than-expected claims values or changes in demographic assumptions. Still, for many states, the gap remains significant between the retiree health care benefits that these governments have promised workers and the funding to pay for them.

Multiple factors could affect reported liabilities in coming years, including future changes to benefits or funding policies, as well as health care inflation or demographic changes that differ from expectations. Policymakers should closely monitor future retiree health care liabilities, and many should consider ways to better manage these costs. Future analyses will examine state approaches to managing OPEB costs while maintaining the ability to pay for promised benefits, the impacts of pre-funding strategies, and the potential legal issues facing states seeking reforms.

Glossary

Discount rate. The discount rate is the assumed interest rate used to account for the fact that money invested now will accumulate interest and be worth more in the future.

Other post-employment benefits. In addition to pension benefits, state governments offer other post-employment benefits. Expenditures for these benefits consist primarily of retiree health insurance expenses but may also include a small percentage of expenditures for other insurance coverage such as dental, vision, life, or disability.

OPEB liabilities. OPEB liabilities reflect the expected cost of these benefits for current workers and retirees over the course of their lives. These liabilities are self-reported and calculated by each state's actuary according to the standards set forth by the GASB.

Appendix A: Methodology

Data sources

Most of the OPEB data comes from the 2014 CAFRs from each state. States are required to include in the financial statements' notes a description of OPEB plans, the benefits provided, actuarial assumptions, and breakdowns of each plan's actuarial required contribution and employer contributions. The required supplementary information for each CAFR includes a schedule of funding progress that details plan assets and liabilities. Often this section will also include a schedule of employer contributions. When the information was available, Pew used the actuarial valuations released by the states for their OPEB plans because these reports provide more detailed information on plan actuarial assumptions.

Accuracy and comprehensiveness

To ensure the accuracy of the information presented, Pew used several quality control measures. Researchers identified and double-checked all instances where data changed significantly over time in OPEB finance documents. Retirement and finance officials in each state were given the opportunity to review OPEB data for accuracy and, in many cases, offered useful feedback that was incorporated into the analysis. The combined approach ensures that this research is based on vetted, accurate numbers.

Data analyses

Pew collected data on 166 OPEB plans, including multiple plans in many states. The total is one less than the previous year's review because South Dakota eliminated its OPEB liability. Each state's plans were aggregated to provide one set of OPEB numbers.

Funded ratios by state

Pew aggregated data to get one value for each state's OPEB liabilities and assets. By dividing the value of plan assets by the total liability, Pew arrived at each state's OPEB funded ratio.

OPEB liabilities to personal income

To calculate each state's aggregate OPEB liabilities as a percentage of state personal income, Pew compared the total actuarial accrued liabilities for all of a state's OPEB plans in fiscal 2014 with the personal income data available online through the U.S. Bureau of Economic Analysis, adjusted to match each state's fiscal year.

Percentage of annual required contribution paid

The annual required contribution (ARC) is an accounting metric and disclosure requirement defined by the GASB and calculated by each state's actuary. Using the economic and demographic assumptions of the plans, the ARC calculation includes the expected cost of benefits earned for the current year and an amount to reduce some of the unfunded liability, called an amortization payment. The amortization payment is calculated based on the number of years—the amortization period—assumed to fully pay for the unfunded liability.

Although most states pay only for current benefit costs each year, some of the states that pre-fund their other OPEB liabilities include amortization payments based on ARC calculations. Pew used states' aggregate actual expenditures to OPEB and the annual required contributions to OPEB reported in state and plan documents to calculate each state's actual expenditures as a percentage of the annual required contribution.

HED: State OPEB Liabilities and Funded Ratios, 2013-14

State OPEB liabilities and funded ratios							
State	2014 liability	2014 assets	2014 funded ratio	2014 actual contributions	2014 % ARC paid	% change liability '13 to '14	% change contributions '13 to '14
Alabama	$12,596	$1,365	10.8%	$423	46.4%	1.1%	-7.6%
Alaska	$15,972	$9,240	57.9%	$512	46.0%	-8.2%	-4.3%
Arizona	$2,202	$2,073	94.2%	$153	100.0%	0.0%	-1.9%
Arkansas	$1,896	$0	0.0%	$63	26.4%	-11.7%	7.2%
California	$88,301	$137	0.2%	$2,326	33.6%	9.9%	5.9%
Colorado	$2,116	$376	17.8%	$167	87.5%	-0.9%	76.6%
Connecticut	$22,109	$144	0.7%	$541	31.6%	-2.7%	-5.1%
Delaware	$5,946	$290	4.9%	$204	48.1%	-0.7%	-2.5%
Florida	$6,825	$0	0.0%	$121	22.3%	-8.9%	-6.2%
Georgia	$16,489	$1,273	7.7%	$706	42.3%	-14.4%	12.6%
Hawaii	$8,530	$0	0.0%	$380	54.9%	-37.6%	36.8%
Idaho	$135	$28	20.9%	$9	70.6%	0.0%	-16.2%
Illinois	$54,910	-$106	-0.2%	$1,000	25.9%	-2.5%	16.9%
Indiana	$381	$91	23.9%	$31	101.2%	-1.8%	60.6%
Iowa	$617	$0	0.0%	$26	43.4%	17.2%	-0.4%
Kansas	$519	$40	7.7%	$72	83.8%	-5.1%	9.6%
Kentucky	$6,231	$1,885	30.3%	$369	90.8%	-3.1%	-3.7%
Louisiana	$8,815	$0	0.0%	$236	41.5%	3.2%	-12.8%
Maine	$2,119	$259	12.2%	$97	62.5%	3.1%	-3.8%
Maryland	$9,635	$250	2.6%	$421	65.1%	6.9%	3.4%
Massachusetts	$15,670	$511	3.3%	$608	48.6%	-0.7%	4.0%
Michigan	$24,772	$4,141	16.7%	$1,834	108.5%	0.9%	3.2%
Minnesota	$989	$0	0.0%	$53	45.7%	-2.1%	-11.9%
Mississippi	$762	$0	0.0%	$31	69.4%	10.4%	3.4%
Missouri	$3,344	$152	4.5%	$113	44.9%	1.2%	5.4%
Montana	$467	$0	0.0%	$9	19.4%	4.4%	N/A
Nebraska	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Nevada	$1,272	$1	0.1%	$59	41.9%	0.0%	7.0%
New Hampshire	$2,852	$21	0.7%	$102	54.0%	10.2%	0.5%
New Jersey	$81,455	$0	0.0%	$2,042	25.6%	21.9%	11.1%
New Mexico	$3,740	$377	10.1%	$149	51.0%	-4.5%	10.3%
New York	$78,727	$0	0.0%	$1,500	47.7%	13.3%	3.7%
North Carolina	$28,063	$1,396	5.0%	$866	37.8%	4.2%	-5.1%
North Dakota	$156	$78	49.9%	$17	161.9%	1.6%	26.4%
Ohio	$24,458	$15,620	63.9%	$350	41.8%	-1.7%	6.3%
Oklahoma	$5	$0	0.0%	$0	60.1%	3.0%	8.6%
Oregon	$644	$403	62.6%	$27	81.0%	0.6%	-56.3%
Pennsylvania	$22,178	$337	1.5%	$927	69.9%	17.5%	11.4%
Rhode Island	$778	$64	8.2%	$63	100.0%	0.0%	7.9%
South Carolina	$10,156	$821	8.1%	$480	61.0%	0.5%	15.3%
South Dakota	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Tennessee	$1,442	$0	0.0%	$74	55.9%	0.0%	5.6%
Texas	$68,698	$458	0.7%	$1,616	32.5%	11.3%	27.1%
Utah	$405	$220	54.5%	$32	102.2%	-5.7%	-19.8%
Vermont	$1,860	$19	1.0%	$24	23.5%	12.0%	-5.0%
Virginia	$6,843	$1,542	22.5%	$410	66.2%	4.6%	8.0%
Washington	$7,381	$0	0.0%	$136	19.9%	0.0%	0.0%
West Virginia	$3,263	$590	18.1%	$165	65.0%	0.0%	-3.9%
Wisconsin	$2,225	$1,199	53.9%	$54	38.0%	-0.7%	-43.3%
Wyoming	$244	$0	0.0%	$11	63.9%	0.2%	19.4%
Total	$659,191	$45,298	6.9%	$19,611	41.0%	5.1%	6.5%

[1] Gabriel Roeder Smith & Co., "State of Hawaii Retiree Health Care Plan: Actuarial Valuation Report as of July 1, 2013," 5, http://eutf.hawaii.gov/wp-content/uploads/2015/04/StateOfHawaiiOPEBFY15-rh.pdf; Gabriel Roeder

Smith & Co., “Illinois State Employees Group Insurance Program: GASB No. 45 Actuarial Valuation Report as of June 30, 2014,” 2, http://cgfa.ilga.gov/Upload/c2916ValSEGIP2015_FINAL_03082016.pdf; Buck Consultants, “GASB 45 Actuarial Valuation at 7/1/2013 of the State of Louisiana Post-Retirement Benefit Plan for the Office of Group Benefits” (July 2014), http://www.doa.la.gov/osrap/library/afr_packetts/2014OGB_OPEBValuationReport.pdf; Aon Hewitt, “Commonwealth of Massachusetts Postemployment Benefit Other Than Pensions Actuarial Valuation Fiscal Year Ending June 30, 2014” (Jan. 1, 2014), 5, http://www.mass.gov/comptroller/docs/reports-audits/opeb/2014-mass-gasb-45-report-final.pdf.

[2] Gabriel Roeder Smith & Co., “State of California Retiree Health Benefits Program: GASB Nos. 43 and 45 Actuarial Valuation Report as of June 30, 2014,” 15 and 16, http://www.sco.ca.gov/Files-EO/CalSCO_GASB45_OPEB.pdf; Aon Hewitt, “State of New Jersey Postemployment Benefits Other than Pension Actuarial Valuation for the Fiscal Year Ending June 30, 2015,” 14, http://www.state.nj.us/treasury/pensions/pdf/financial/gasb-43-july2014.pdf.