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Position Paper – Long Term Retiree Benefits Changes

The purpose of this paper is to review issues relevant to long-term retiree health care benefits and provide a recommendation to the Retiree Benefits Study Committee for long-term changes in retiree health care benefits. This paper will discuss the following:

- Why are changes necessary?
- Basic principles
- What is the financial status of the present retiree health care program?
- What is OPEB and how does it work at present?
- How much would it cost to adequately fund OPEB?
- Possible changes to reduce future liability
- What is DRSPA's position regarding the OPEB liability funding?
- What actions has DRSPA considered?
- DRSPA Proposal

Why are changes necessary? The Retiree Benefits Study Committee was formed by Governor John Carney in August 2019 in response to accounting rule changes that were made by the Government Accounting Standards Board (GASB). These rule changes require that government entities like states, counties and cities, must include future health care obligations in their balance sheets. In other words, Delaware must include the future health care costs of present retirees plus the anticipated health care costs of active employees from when they retire until their surviving spouse (if there is one) passes away.

The present annual cost to the state for retiree health care this fiscal year (FY2020) is estimated to be $242.8 million[1]. But the future health care obligation for retirees is estimated to be $8.7 billion (or $8,700 million). The OPEB fund presently has a balance of $0.4 billion, so the unfunded liability is $8.3 billion[2]. The Retiree Benefits Study Committee has a choice: either recommend that the state begin paying off this future obligation or recommend that the state reduce the future cost of retiree health care. If they don't do anything bond rating agencies may/will lower Delaware's bond rating (presently AAA). Each year Delaware issues about $860 million in bonds[3] for highway, school and other types of long-term projects so a lower bond rating would mean that the state would have to pay a higher rate of interest on bonds that it issues.

Basic Principles: Before continuing, we will lay out our basic beliefs and understandings:

- DRSPA members are financially conservative. They pay off their mortgage ahead of schedule. They don't carry any credit card debt. They often pay cash for their cars.
- DRSPA members are opposed to government deficit spending because it means our children and grandchildren will have to pay for our greed. They are also opposed to large government "rainy day funds" because citizens may die before they can enjoy the benefit of the taxes they paid.
- DRSPA members recognize that it would be politically unwise to oppose changes that are designed to maintain the current AAA bond rating.

- DRSPA members realize that pensions and health care costs are linked together for individual pensioners. An increase in health care costs effectively reduces the purchasing power of the pension received.
- DRSPA members realize that pensions and health care costs are linked together for the State. Increased retiree health care costs mean less funds are available for a pension increase, and *vice versa*.
- DRSPA has a greater obligation to advocate for older retirees, less of an obligation for younger retirees, and even less for presently active employees who will retire in the future.

What is the financial status of the present retiree health care program? At present, pension recipients' health care costs are managed by the State Employee Benefits Committee (SEBC). The plan receives premium revenue funded from the state operating budget, active employees, non-Medicare pensioners and Medicare pensioners who retired after 2012. It also receives a variety of other revenues such as prescription drug rebates, federal coverage gap payments, reinsurance payments and negotiated financial and performance guarantees. Premium and other revenues are used to pay health and prescription claims, administrative fees and consulting and operational expenses. The state is self-insured, so if income is greater than medical claims and other expenses the fund's balance increases. If income is less than claims and expenses the fund's balance decreases. In order to be financially responsible, the SEBC seeks to keep a minimum balance on hand, called the Minimum Reserve. It also estimates and seeks to keep on hand funds to pay unprocessed claims, called the Claim Liability. Surplus funds are excess monies available for use as determined by the SEBC. Surplus funds have been historically used as one-time funds by the SEBC to offset premium increases. Table A summarizes the plan's balance for the last five years, using November (the most recent data available) balances. Note that the fund balance and surplus increased significantly during this period. This occurred due to premium increases as well as a number of cost saving initiatives adopted by the SEBC and implemented by both active employees and retirees.

Table A
State of Delaware Health Fund
Summary of November Balances, 2015 – 2019[4]

	2015	2016	2017	2018	2019
Fund Balance	$17,813,652	$47,786,882	$133,555,728	$165,033,666	$169,087,404
Claim Liability	$45,000,000	$47,786,882	$59,526,000	$61,300,000	$59,500,000
Minimum Reserve	$79,000,000	$79,000,000	$24,000,000	$24,300,000	$24,300,000
Surplus	$0	$0	$74,029,728	$79,433,666	$85,287,404

What is OPEB and how does it work at present? OPEB stands for Other Post-Employment Benefits Fund. The OPEB fund was created by the legislature in 2001. It was planned that contributions would be made to the fund well above the current expenses and that this surplus

would become large enough to pay future retiree health care costs. While this was the plan (or perhaps hope) twenty years ago, in reality the OPEB fund is essentially a "pay-as-you-go" system.

Most years the state's budget includes contributions to the OPEB fund (there was no contribution made in FY04, FY05, FY06, FY10 and FY11). The fund also receives premium payments from non-Medicare pensioners and those Medicare pensioners who retired after 2012. The excess funds are also invested, and the income from these investments is plowed back into the fund as well. There are two costs to the fund each year: health care premiums for retirees (which are paid to the State Group Health Fund to pay health and prescription claims and administrative and operational costs attributed to the pensioners enrolled in coverage through Highmark or Aetna. The table (next page) summarizes the fund activity for the most recent five fiscal years:

Table B
OPEB Fund
Reconciliation of Assets FY 2015 to 2019[5]
(Expressed in Millions)

Fiscal Year	2015	2016	2017	2018	2019
Opening Balance	$290.2	$312.4	$310.0	$355.2	$381.8
Additions					
Contributions - state	226.3	217.9	237.4	224.8	222.6
Contributions – retirees	8.0	9.6	12.0	13.1	13.0
Investment Earnings	6.7	4.4	32.3	23.8	18.8
Deductions					
Benefit Payments	218.8	234.3	236.3	235.0	242.0
Admin Costs	0.0	0.0	0.1	0.1	0.2
Closing Balance	$312.4	$310.0	$355.2	$381.8	$411.3

As Table B demonstrates, the OPEB fund has increased for the past four fiscal years. However the increase in fund value is nowhere near the $8.7 billion needed to fund future health care costs.

How much would it cost to adequately fund OPEB? The FY2019 payment for benefits for those already retired totaled $227.8 million, and the state contributed an additional $7.8 million in prefunding (.36% of the payroll of $2.08 billion) for a total of $235.6 million. The State's OPEB actuarial valuation calculates an Annual Required Contribution (ARC) of $565.1 million is actually required, so the State is "short" $329.5 million for the year[6]. Each year that the state fails to meet the Annual Required Contribution means that the ARC amount gets larger.

Possible changes to reduce future liability: The Retiree Benefits Study Committee looked at five possible cost saving scenarios at their December 10 meeting:

Scenario A: Benchmark - Delaware adopts a Medicare Supplement plan design aligned with Virginia's medical design, which includes a $100 deductible, and similarly increases the deductible by $100 for all pre-65 retiree plans.

Scenario B: Active Spouses - Delaware reduces spousal "State Share" subsidy by 50% for future retirees; no impact to current spouses of retirees.

Scenario C: All Spouses - Delaware reduces spousal "State Share" subsidy by 50% for all current and future retirees.

Scenario D: Health Reimbursement Arrangement (No Increase) - Delaware eliminates direct contracting and self-insuring supplemental and prescription coverage for Medicare pensioners and moves to an individual marketplace structure – retirees receive annual HRA to purchase individual coverage comparable to the value of "State Share" subsidy received from the State of Delaware currently, with no increase to HRA amount provided in future years. Health Reimbursement Arrangement (HRA) is a tax-free account that can be used to pay premiums for Medicare Parts A, B and D, Medicare Advantage plan and/or supplemental plan, as well as qualified out-of-pocket expenses (deductibles, copays, etc.).

Scenario E: Health Reimbursement Arrangement (2% Increase) - Delaware eliminates direct contracting and self-insuring supplemental and prescription coverage for Medicare pensioners and moves to an individual marketplace structure – retirees receive annual HRA to purchase individual coverage comparable to the value of "State Share" subsidy received from the State of Delaware currently, with 2% annual increase to HRA amount provided in future years.

The following table summarizes the reduction in liability of each of these scenarios:

Table C
Scenarios to Reduce OPEB Liability[7]
(Amounts in Billions)

	Actuarial Liability as of		Reduction	
	2019	2049	2019	2049
No Change	$8.730	$35.994	--	--
A. Benchmark	$8.718	$35.949	$0.012	$0.045
B. Active Spouses	$7.787	$30.102	$0.943	$5.892
C. All Spouses	$7.117	$29.931	$1.613	$6.063
D. HRA – no increase	$5.244	$10.584	$3.486	$25.410
E. HRA – 2% increase	$6.369	$13.978	$2.361	$22.016

The RBSC considered additional liability saving measures at their January 7, 2020 meeting. Before discussing these measures, we need to review the availability of health coverage as it presently exists.

1. Health insurance is available with 100% of the "State Share" being paid by the State of Delaware for members first hired prior to July 1, 1991

2. For members first hired on or after July 1, 1991, the following portion of the "State Share" is paid by the State of Delaware:

Less than 10 years	0%
10 years - 14 years 11 months	50%
15 years - 19 years 11 months	75%
20 years or more	100%

3. For members first hired on or after January 1, 2007, the following portion of the "State Share" is paid by the State of Delaware:

Less than 15 years	0%
15 years -17 years 5 months	50%
17 yrs 6 mo - 19 yrs 11 mo	75%
20 years or more	100%

Scenarios F, G and H below would change the percentage paid by the state, effectively reducing the state's cost, while increasing the cost to the pensioner:

Scenario F: Change #2 above for those hired since 1991:
Liability savings: $0.2 billion

Less than 15 years	0%
15 years - 20 Years	50%
20 years – 25 years	75%
25 years or more	100%

Scenario G: Change #2 above for those hired since 1991:
Liability savings: $0.8 billion

Less than 20 years	0%
20 years – 25 years	50%
25 years – 30 years	75%
30 years or more	100%

Scenario H: Change #3 above for those hired since 2007:
Liability savings: $0.5 billion

Less than 20 years	0%
20 years – 25 years	50%
25 years – 30 years	75%
30 years or more	100%

At present an employee can work for a few years, terminate his/her state employment then return later, accumulating his/her total time of employment for both pension and health care coverage. Scenarios I and J below would effectively erase the prior service time for determining the portion of "State Share" that would be paid.

Scenario I: Effective 7/1/2019 all current and future terminated vested participants would not have access to any state health benefits if they left State employment prior to being eligible for retirement benefits through the State of Delaware. Liability savings: $0.4 billion

Scenario J: Effective 7/1/2020 future terminated vested participants would not have access to any state health benefits if they left State employment prior to being eligible for retirement benefits through the State of Delaware, those that are already terminated could still come back and have access to healthcare upon becoming eligible for pension benefits through the State of Delaware. Liability savings: $0.0 billion

At present an employee can retire after 25 years of service and immediately begin collecting a pension and recieve100% of the "State Share" of health care costs. The RBSC looked at the feasibility of setting a minimum age for healthcare:

Scenario K: This scenario would set the minimum age to receive healthcare at age 60 for State (and school) Employees and Judges; Public Safety would be age 55 Liability savings: $0.7 billion

The RBSC also looked at scenario L, a combination of a number of scenarios described above. If recommended, this combination of changes would become effective starting 1/1/2021.

Scenario L has a liability savings of $3.75 billion and includes:

Scenario E - $5,100 HRA for Medicare retirees with 2% inflation
Scenario B - Future Spouses would receive 50% of benefit
Scenario J - Eliminate vested health care benefits for future terminated vested employees
Scenario K: Minimum age for healthcare (60 and 55 for public safety)
Scenario H: Increase years required for percentage paid by the State for health care for those hired after 2007

What is DRSPA's position regarding the OPEB liability funding? The Executive Director of DRSPA presented DRSPA's position during the public comment portion of the November 23 Retiree Benefits Study Committee meeting. He stated:

- The OPEB liability needs to be looked at from a long term perspective, rather than assuming payment must be completed immediately
- It seems unreasonable to exclusively look at retiree benefits since other state costs will also increase over time.
- Each month present Medicare retirees pay $83 more than employees for health care, while the state contributes $242 less.
- At present the State Health Fund is well in the black.
- "Recommend changes to the health care program if you feel you must, but allow our health benefit costs and coverage to remain at their present levels."

What actions has DRSPA considered?

1. DRSPA do nothing more than has already been done

   DRSPA has already stated our case, which is basically "leave us alone." Our organization wasn't invited to be on the committee, so let's stay out of the fight.

2. DRSPA can recommend that the RBSC continue to study the issue and not submit recommendations at their March meeting.

3. DRSPA can recommend changes to retiree benefits for future retirees, but no changes or additional costs to present retirees.

   The RBSC has studied 12 cost-cutting scenarios. Scenarios B, F, G, H, I, J and K would not change the costs or coverage for present retirees. However some of these scenarios are variations of the same cost cutting strategy (e.g. Scenario B-Active Spouses and Scenario C-All Spouses). If we select the variations that have the least impact on present retirees we have the following scenarios:

B	*Active Spouses*	*$0.9*
D	*HRA-2% Increase*	*$2.4*
G	*%age Coverage*	*$0.8*
I	*Reduced Access*	*$0.4*
K	*Age 60 Coverage*	*$0.7*
	Total	*$5.2*

   These cost savings would significantly reduce the liability, from $8.3 billion to $3.1 billion. It would however, place a possible additional cost on retirees, since they would be responsible in covering any increase in premiums beyond the 2% provided by the state.

4. DRPSA can recommend – or not recommend – that specific scenarios be approved by the RBSC.

   If the Board decides to select this option, it should consider the merits of each scenario. Scenario A (Benchmark Plan) would introduce a new $100 deductible for retirees. Scenario C (All Spouses) would reduce the spousal benefit by 50% ($2,756) for approximately 8,900 retiree families. Scenario D (Health Reimbursement Arrangement – No Increase) would provide adequate funding to purchase individual Medicare supplemental coverage initially, but the reimbursement would not increase, meaning that over time, retirees would be responsible for a larger and larger payment gap. Scenario E (Health Reimbursement Arrangement – 2% Increase) would provide a 2% increase in the annual reimbursement, providing some level of state funding for the payment gap. As noted above, scenarios B, F, G, H, I, J and K would not change the costs or coverage for present retirees.

5. DRSPA can develop our own recommendations that would change the OPEB liability.

DRSPA Proposal

After reviewing this position paper as well as other related information, the DRSPA Executive Board voted to propose that two of the scenarios be recommended by the Retiree Benefits Study Committee.

Before starting DRSPA's proposal, we need to first affirm the following:

- We believe current retirees are entitled, through years of service and commitment, to continuing our existing health benefits, with no changes. We planned, saved and sacrificed, before retirement for all the foreseeable expenses in our futures. After retirement, most of our previously unseen health issues and related decisions have had a negative impact financially. The medical treatments we committed to were based on the belief of our continued participation in the State's current health benefits package. Changes that reduce or leave us gambling on sufficient benefit resources, add great risk to our continued health and possibly our longevity.
- As Table A demonstrates, the Delaware Health Fund – the fund that pays our health benefits today - is healthy, with a balance of $169 million dollars.
- Most retirees – specifically those on Medicare - are already paying more than active employees for their health care coverage – $136 v. $53 per month, and the state is contributing less - $460 v. $702. Not only are we paying more in our older years, most of us paid more when we were young. Retirees are paying a higher premium than active employees and doing so on a pension that is less than half an average active employee's salary. So from our perspective, we're already sacrificing more than enough.

And so DRSPA proposes:

1. **Scenario B:** Active Spouses – Beginning July 1, 2020, Delaware reduces spousal "State Share" subsidy by 50% for future retirees; no impact to current spouses of retirees. Liability savings: $0.95 billion

4. **Scenario E: Health Reimbursement Arrangement (2% Increase**) **–** Delaware eliminates direct contracting and self-insuring supplemental and prescription coverage for Medicare pensioners and moves to an individual marketplace structure – retirees receive annual HRA to purchase individual coverage comparable to the value of "State Share" subsidy received from

the State of Delaware currently (initially $5,512 for Medicare recipients), with 2% annual increase to HRA amount provided in future years.

Beneficiaries who retired prior to July 1, 2020 would be grandfathered so that their health care cost would not increase during their or their covered spouse's lifetime.

Beneficiaries who retired prior to July 1, 2020 would default to having the State act as the purchasing agent for their health insurance and prescription drug coverage.

Unused funds in the HRA would be carried over from year to year. Upon the death of the retiree, the unused HRA funds would be added to the existing death benefit. Liability savings: $2.3 billion.

Footnotes:

[1] Presentation to Retiree Benefits Study Committee, September 26, 2019 by Willis Tower Watson, page 13.

[2] The OPEB unfunded liability amount varies significantly if different assumptions are used. For example, differing estimates of general, medical care and prescription drug cost inflation will result in a higher or lower OPEB liability. At the September 26, 2019 presentation Willis Tower Watson presented an OPEB liability of $7.6 billion as of June 30, 2018 (page 11). The Office of Pensions has published the $8.7 billion figure as an updated figure.

[3] State of Delaware Bond Bill: FY2019 ($816 million); FY2020 ($863 million) FY2021 (proposed $891 million)

[4] State Employee Benefits Committee, State of Delaware Health Fund, Monthly Statements for November 2015, 2016, 2017, 2018 and 2019

[5] Years 2015 to 2018 are from "Postretirement Health Plan Actuarial Valuation" reports, typically page 6. The report of 2019 is not yet available. 2019 values were estimated from "State of Delaware Other Postemployment Benefits (OPEB) Fund Trust Financial Statement – June 30, 2019". The Closing Balance of $411.2 million is essentially the same figure as provided by Willis Tower Watson in its "Presentation to Retiree Benefits Study Committee, September 26, 2019", page 29 ($410.1 million).

[6] Presentation to Retiree Benefits Study Committee, September 26, 2019 by Willis Tower Watson, page 12.

[7] Presentation to Retiree Benefits Study Committee, December 10, 2019 by Willis Tower Watson, pages 12 - 20.

Questions or additional Information:

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