THE FUTURE OF RETIREE HEALTH BENEFITS

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The future of retiree health benefits appears to be bleak, due to the convergence of three powerful developments. First, the percentage of retirees from private employers receiving retiree health benefits will continue its downward decline, so that in a few years, only a small fraction will be receive these benefits. Second, due to severe budget problems of governments and the unfunded nature of the public employer promises, public sector retirees also face a severe threat to their long-term benefits. Finally, given the nation’s demographics and mounting debt, expanding Medicare to close gaps in benefits for those over age 65 and to cover early retirees under age 65 will be a daunting and difficult task.

Private Employers

The number of private employers reducing or terminating benefits has dramatically increased since the early 1990s, when the Financial Accounting Standards Board issued Financial Accounting Standard (“FAS”) 106. FAS 106 required for the first time that companies report retiree medical benefit obligations on their balance sheets, and required them to account for these benefits based on the assumption that they would remain unreduced and would last for the life of the retirees. To stave off the new debt on their balance sheets, which in many cases was enormous, many employers responded by attempting to reduce or even eliminate their retiree benefit obligations, a trend that began, albeit at a lesser rate, in the 1980s.

Some employers have even taken the unusual step of preemptively suing their own retirees simultaneously with terminating or reducing their benefits, asking the courts to declare the modifications lawful. Most often such suits have been followed by countersuits by retirees, brought sometimes in conjunction with the unions that had represented the retirees while they were employed. For the legal standards and court decisions that govern retiree health litigation, see generally Payne, W., and Ewing, P., “Union-Negotiated Lifetime Retiree Health Benefits: Promise Or Illusion,” 9 Marquette Elder’s Advisor 319 (2008); Ellen E. Schultz, “Plaintiffs Cry: When Retirees Sue An Ex-Employer,” The Wall Street Journal, November 10, 2004; Ellen E. Schultz, “End Run: Companies Sue Union Retirees To Cut Promised Health Benefits Firms

The United States, in contrast to Canada and most other industrialized countries, lacks a comprehensive national healthcare program. Accordingly, in this country, the annual cost of individual coverage for retirees can be substantial and even prohibitive. For this reason, the outcome of litigation involving employer-paid retiree health coverage has a dramatic affect on retirees’ lives. Due to preexisting medical conditions and other factors, many retirees cannot obtain affordable alternative coverage in the event they lose their employer-subsidized benefits. These retirees then must live with the prospect of a catastrophic injury or illness depleting their life savings and driving them into bankruptcy. Even worse, retirees without coverage may not have access to medical care that they need.

The Equal Employment Opportunity Commission (EEOC), after years of pondering issues and considering comments, recently issued final regulations establishing that an employer may, consistent with the Age Discrimination in Employment Act (ADEA), terminate or reduce benefits for its Medicare-eligible retirees while leaving them intact for younger non-Medicare-eligible retirees without violating the ADEA.¹ This can only result in still further cuts of retiree medical benefits.

The upshot is that employer-provided retiree health in the private sector is a rapidly diminishing and disappearing benefit. In 1988, 66% of companies offered some type of help with retiree health insurance, compared to 33% in 2007. See Kuhl, R., “Americans Need Federal Help With Retirement,” Steuben Courier, August 3, 2008 [http://www.steubencourier.com/news/2008/0803/columns/016.html]

Similarly, in a Wall Street Journal on-line article² by Paul Fronstin and Stephen Blakely of the Employee Benefit Research Institute, the authors conclude that most currently active workers will never be eligible for health insurance in retirement through a former employer, and state:

¹ In its prior interpretation of the ADEA (which it abrogated by issuing the new regulations), the EEOC had ruled that an employer that provided retiree health benefits had to do so for both Medicare and non-Medicare retirees. Likewise, an employer had to prove either that the benefits available to Medicare-eligible retirees were the same as those provided to retirees not yet eligible for Medicare or that the employer was expending the same costs for both groups of retirees. In abrogating the old policy, the EEOC expressed concern about employers that are under no legal or contractual obligation to provide benefits (having reserved a right to terminate or reduce), and noted that its former policy “created an incentive for employers to reduce or eliminate retiree health benefits,” since employers could avoid the “complex comparisons” required by the old rule “by simply eliminating retiree health benefits entirely.” It therefore “concluded the public interest is best served by an ADEA policy that permits employers greater flexibility to offer these valuable benefits.” Age Discrimination in Employment Act; Retiree Health Benefits, 72 Fed. Reg. 72938 (Dec. 26, 2007) (to be codified at 29 C.F.R. pts. 1625, 1627).

² See http://online.wsj.com/ad/employeebenefits-tipping_point_health_benefits.html
The Agency for Healthcare Research and Quality (AHRQ) reports that only 13 percent of private-sector establishments offered health benefits to early retirees in 2005, down from 22 percent in 1997. Furthermore, 13 percent of private-sector establishments offered health benefits to Medicare-eligible retirees in 2005, down from 20 percent in 1997. The trend among large employers—those most likely to offer health benefits—has been down as well.

Even at age 65, a retiree without employer-provided Medicare supplements can find himself in a desperate financial situation. With Medicare’s premiums, deductibles, copayments, and excluded benefits, an estimate by Fidelity Investments shows that a 65-year-old couple without employer-sponsored retiree healthcare coverage will likely need $225,000 to cover healthcare costs in retirement, 4.7 percent more than the 2007 estimate. This six-figure amount includes Medicare Part B premiums (which cover physician and outpatient hospital services), as well as Part D premiums (which cover drug-related expenses), Medicare copayments, co-insurance, deductibles, and excluded benefits, and out-of-pocket prescription drugs, but does not include over-the-counter medications, most dental services, or the greatest expense of all—long-term care.

Brandon, E, Retiree Benefits a Thing of the Past, US News, April 28, 2008. According to Fidelity's calculation, a 65-year-old worker earning $60,000 today and interested in retiring this year should expect to use 50 percent of pretax Social Security benefits to pay for personal healthcare expenses in the next 17 to 19 years. Similarly, a paper from the Center for Retirement Research at Boston College entitled “Health Care Costs Drive Up the National Retirement Risk Index” by Alicia H. Munnell, Mauricio Soto, Anthony Webb, Francesca Golub-Sass, and Dan Muldoon, puts the amount one should save for health expenses as slightly lower but still onerous for lower and middle income workers. These authors report that singles planning to retire in 2010 should have $102,966 earmarked for out-of-pocket healthcare costs in retirement and that couples should have $205,932.

It is likely that in the coming decades, just three categories of private-sector retirees will retain employer-subsidized health benefits.


The second group likely to retain some coverage are those in multi-employer Taft-Hartley plans where the industries are healthy enough to continue meaningful benefits.

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4 See http://crr.bc.edu/briefs/health_care_costs_drive_up_the_national_retirement_risk.html
The third group of retirees likely to maintain their medical benefits are top executives. While private employers have drastically cut retiree benefits for rank-and-file and salaried participants over the past 15 years, those moves often do not apply to top executives. See Ellen E. Schultz and Theo Francis, “The CEO Health Plan: In Era of Givebacks, Some Executives Get Free Coverage After They Retire,” The Wall Street Journal, April 13, 2006. Specifically, many companies -- even in the hard-pressed airline industry -- have promised “lifetime” free health care to retired CEOs and other senior officials:

Continental Airlines provides free health care to retired board chair Gordon Bethune and his dependents. (That’s on top of his other perks, like free flights, 10 years of free office space, and a $22 million lump-sum pension payout.)

Northwest Airlines has two sets of rules, one for top executives and another for everybody else. For everybody else, employees need 23 years to qualify for retiree coverage at age 55, which terminates with Medicare eligibility at age 65. Top execs, however, get lifetime health care for both themselves and their dependents after only three years -- and Northwest pays all out-of-pocket medical and dental expenses.

Citigroup pays not only all health care costs for Chairman Sanford Weill and his wife, but also all taxes on the imputed income; naturally, he’s the only Citigroup employee with that benefit. AT&T Inc. pays up to $100,000 per family for top execs’ out-of-pocket health care costs. Northrop Grumman Corp. requires regular retirees to pay more of their own health costs as inflation increases, but top executives can get a special plan that absorbs all increases in medical costs.

Cooper Tire & Rubber has agreed to fund a special trust to pay for top executives’ lifetime health benefits in the event of an acquisition or bankruptcy filing; meanwhile, they’ve increased the amounts all other retirees must pay for health coverage, and don’t provide any coverage at all for employees hired after January, 2003. Qwest Communications pays all costs for coverage on the company’s health plan for 18 months after departure for top executives, but not for regular employees, who have to foot the entire bill.

Public Employers

The same sort of legal fights and financial pressures are seen in the public sector, and some of this is due to the extension of FAS-106-type reporting standards to public entities. Under a new rule adopted by the Governmental Accounting Standards Board (GASB), government entities that choose to comply will have identify retiree healthcare costs in their Fiscal Year 2008 financial reports. These are expected to come out between December 2008 and March 2009.

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5 See http://online.wsj.com/article/SB11448913794892472.html?mod=todays_us_marketplace
See Ronald Kramer & Mark Casciari, “Government Accounting Standards Board (GASB) Statement No. 45 Makes Public Employers Revisit Retiree Health Insurance,” 37 Urban Lawyer 427 (Summer 2005). As Kramer and Casciari explain, public employers, like their private sector counterparts before them, will feel additional pressure to reduce or eliminate retiree health benefits under the new rules. The extent to which public employers can eliminate or reduce benefits will depend on a variety of factors involving current benefit plans, collective bargaining agreements, state laws, and state and federal constitutional standards. Kramer and Casciari note that, as in private sector cases, courts are divided over how to consider claims brought under public collective bargaining agreements providing for retiree insurance benefits.

This will be a huge issue in coming years. According to study conducted by The Pew Charitable Trusts’ Center on the States, the state and local governments have promised at least $2.73 trillion in pension, health care and other retirement benefits for public employees over the next three decades. While this study, the first 50-state analysis of its kind, finds that states have saved enough to cover about 85 percent of their long-term pension costs, states have saved only 3 percent of the funds needed for promised retiree health care and other non-pension benefits. To meet their obligations, states will need to come up with about $731 billion, a conservative figure that does not include all costs for teachers and local government employees. As one commentator has noted:

[T]he market should pay close attention because the U.S. will probably see more municipal bankruptcies in the years ahead, as local governments deal with the mountain of pension and retiree health care benefits they’ve promised but never funded


Medicare

Medicare obviously will play an essential role in the future of retiree health benefits.

Medicare is surprisingly efficient -- only 3% of total costs are attributable administrable expenses. Nonetheless, demographic shifts and rapidly rising health care costs pose daunting challenges to the system. See Dallas Salisbury, “Health Care: Can We Afford It?,” Human Resource Executive Online (August 4, 2008)6 (“The average retiree now sees 17 percent of his or her Social Security benefit pay for Medicare premiums and co-pays, and this is projected to rise to over 75 percent by the end of the actuaries’ current 75-year forecast. One assumes that none of this will be allowed to happen, yet a reduction in what the government will pay in either income (Social Security) or reimbursements (Medicare, Medicaid) will directly affect households.”).

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In recent efforts to relieve the burden on seniors as prescription costs for them grew out of control, Congress enacted limited prescription drug coverage, termed “Part D.” Under this new program, the individual retiree pays a premium for a Medicare Part D plan (e.g., $35 per month) and a $250 deductible. The government pays 75% of amounts expended for prescription drug coverage for costs between $250 and $2,250. After costs reach $2,250, the government then pays nothing for what has been termed the “doughnut” – amounts expended between $2,250 and $5,100. After the $5,100 threshold is reached, the government pays 95% of costs. This system leaves retirees liable for all amounts between $2,250 and $5,100, a large burden for individuals living on limited fixed incomes.

Since implementing the limited relief embodied in Part D, policy makers have turned their attention elsewhere. While some have proposed allowing early retirees to buy into Medicare, this idea has not had traction. None of the current major health reform proposals focus on meaningful relief for retirees (although Barack Obama proposes to close the doughnut hole—see below). Rather, Democrats speak of providing universal coverage for workers below age 65, a laudable goal but one that does not recognize the needs of retirees over the age of 65. Republicans have no serious proposals on the issue.

Another proposal involving Medicare is the extension of Health Saving Accounts, or HSAs, to Medicare recipients. Medicare enrollees cannot currently have HSAs because Medicare is not high-deductible coverage. Although the Republicans continue to push expansion of HSAs, Democrats tend to disfavor them. The evidence suggests that HSAs are used primarily by people who tend to be younger, healthier, and wealthier. Indeed, there is evidence that some wealthier retirees who typically enjoy employer coverage today support legislation to allow them to open HSAs, believing that their retiree coverage may disappear soon. These retirees (as well as insurance companies and banks that benefit from HSA arrangements) have lobbied to allow an HSA option. However, HSA savings plans may be inadequate to provide needed coverage for retirees. Florence Olsen, “Health Savings Accounts Will Be Inadequate For Covering Retirees’ Expenses, EBRI says,” 8 BNA Pension and Benefits Daily, Number 153, August 8, 2008 (stating that the maximum savings possible for people with health savings accounts could be significantly less than they will need in retirement to cover their health insurance premiums and out-of-pocket expenses for health care). But even if the Republicans prevail in November, it seems unlikely that the HSA approach will be adopted. Although Senator McCain supports elimination of employer tax benefits (and therefore the employer system), and moving to an

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7 The Medicare “Part D” subsidy applies if an employer provides actuarially equivalent drug coverage, qualifying the employer for up $1,300 per person. However, costs can run far higher than this, and it remains less expensive for the employer to simply eliminate coverage altogether.

8 For a report on advocates for eliminating tax deductibility of employer-provided benefits, see Brett Ferguson and Steve Teske, “Employer Health Care Tax Subsidies Blamed for 'Overinsurance,' Higher Costs,” 8 BNA Pension and Benefits Daily, Number 148, August 1, 2008.

9 See http://www.johnmccain.com/Informing/Issues/19ba2f1c-c03f-4ac2-8cd5-5cf2edb527cf.htm
individually-based system with HSA type accounts, it is highly unlikely that he will have sufficient support in Congress to achieve this objective.

While Senator Obama has said that health care reform will be his first priority, his proposals concerning retiree health care are fairly general. See http://www.barackobama.com/issues/socialsecurity/ which states:

Obama will allow the federal government to negotiate for lower drug prices for the Medicare program, just as it does to lower prices for our veterans. He also supports allowing seniors to import safe prescription drugs from overseas, and will prevent pharmaceutical companies from blocking cheap and safe generic drugs from the market.

Protect and Strengthen Medicare: Obama is committed to the long-term strength of the Medicare program. He will reduce waste in the Medicare system, including eliminating subsidies to the private insurance Medicare Advantage program, and tackle fundamental health care reform to improve the quality and efficiency of our healthcare system. Obama supports closing the "doughnut hole" in the Medicare Part D prescription drug program.

Provide Transparency to Medicare Prescription Drug Plans: Many seniors are enrolled in Medicare prescription drug plans that are actually more expensive for them than other available plans. Obama will require companies to send Medicare beneficiaries a full list of the drugs and fees they paid the previous year to help seniors determine which plans can better reduce their out-of-pocket costs and improve their health.

Strengthen Long-Term Care Options: As president, Obama will work to give seniors choices about their care, consistent with their needs, and not biased towards institutional care. He will work to reform the financing of long term care to protect seniors and families. He will work to improve the quality of elder care, including by training more nurses and health care workers.