

Section 7
organization and staffing needs
Retiree Medical Program

KPMG Peat Marwick
Government Services Management Consultants
for
North Carolina General Assembly
Government Performance Audit Committee
December 1992

Issue Statement

The Phase I Personnel Systems Performance Audit report identified retirees as the fastest growing and most expensive segment of the State Health Plan and recommended that the State should consider alternatives to reduce the future costs for this coverage.

This paper evaluates methods of allocating State and retiree medical insurance program contributions to reflect the actual claim costs of retired employees and their length of service.

Background

Under current State statutes, retirees of the State are eligible for medical coverage under the Comprehensive Major Medical Plan with five years of service. The cost for these retirees is paid in full by the State. Retirees with dependents under age 65 may choose to cover their eligible dependents by making a contribution equal to what an active employee must contribute. Retirees with dependents over age 65 may elect to cover their eligible dependents by making a contribution that reflects the impact of Medicare. Medicare pays for approximately 60 percent of the eligible health care costs for retirees over age 65. The cost of dependent coverage is to be borne in full by the retiree.

Retirees are an increasingly larger percentage of the individuals covered under the indemnity medical program. Exhibit 1 shows that the percentage of individuals covered that are retirees has grown from 19 percent in 1983 to 25 percent in 1991. The State's Retirement System believes that this percentage will grow to 50 percent before it stabilizes.

This growth in the retiree population is due to the aging of America. Since 1982, the percentage of the American population age 65 and over has grown from 11.5 percent to 12.6 percent. Over the same period, the percentage of the American population over age 80 has grown from 2.4 percent to 2.8 percent.

Retiree costs are increasing faster than those for active employees. Exhibit 2 shows that the costs for retirees increased 258 percent from 1983 while the cost for an active employee has increased 240 percent. It is important to note that the cost for retirees is higher than for active employees even though Medicare pays for a large portion of the cost for retirees over age 65.

In 1992, the total benefits paid from the indemnity plan to retirees were \$118 million dollars. The benefits paid to retirees were \$97 million. The benefits paid to dependents of retirees were \$21 million dollars. The State's contribution to the program was \$101 million. Retirees contributed approximately \$13 million dollars.

EXHIBIT 1

Retirees as a Percentage of Individuals Covered Under the Indemnity Medical Program

<u>Year</u>	<u>Total Number Covered</u>	<u>Number of Retirees Covered</u>	<u>Retirees as a Percentage of Total</u>
1983	240,340	45,330	19%
1984	244,135	49,850	20%
1985	250,795	52,935	21%
1986	256,331	55,746	22%
1987	218,106	56,831	26%
1988	217,201	57,526	26%
1989	250,105	61,574	25%
1990	266,956	64,767	24%
1991	275,677	67,692	25%

Source: Fiscal Research Division's State of North Carolina Comprehensive Major Medical Plan for Teachers and State Employees Summary Analysis of Claims Cost - July 1991

EXHIBIT 2

Retiree and Active Cost Under the Indemnity Medical Program

<u>Year</u>	<u>Cost Per</u> <u>Retiree</u>	<u>Annual</u> <u>%</u> <u>Increase</u>	<u>Cost Per</u> <u>Active</u>	<u>Annual</u> <u>%</u> <u>Increase</u>	<u>Cost Per</u> <u>Dependent</u> <u>Retiree</u>	<u>Annual</u> <u>%</u> <u>Increase</u>	<u>Cost Per</u> <u>Dependent</u> <u>Active</u>	<u>Annual</u> <u>%</u> <u>Increase</u>
1983	\$400	n/a	\$379	n/a	\$460	n/a	\$266	n/a
1984	657	64	556	47	638	39	410	54
1985	724	10	619	11	643	-1	409	0
1986	747	3	608	-2	648	1	408	0
1987	872	17	754	24	743	15	507	24
1988	1,000	15	776	3	925	24	597	18
1989	1,075	8	896	15	1,030	11	696	10
1990	1,275	19	1,120	25	1,244	21	753	8
1991	1,433	12	1,291	15	1,458	17	859	22
Increase								
From 1983		258		240		217		222

Source: Fiscal Research Division's State of North Carolina Comprehensive Major Medical Plan for Teachers and State Employees Summary Analysis of Claims Cost - July 1991

Findings

Finding 1: Eleven percent of current retirees retired with less than 10 years of service.

The number of retirees by length of service at retirement is summarized below using data provided by the State's Retirement System and the State Health Plan.

<u>Service at Retirement</u>	<u>Number of Retirees</u>	<u>Percentage of Total</u>
Less than 5 Years	351	.5
5 - 9 Years	6,906	10.5
10 - 19 Years	16,125	24.0
20 - 29 Years	17,449	26.0
30 or more Years	25,497	39.0

Retirees with less than five years of service are employees that retired due to disability.

Non-disabled retirees with less than 10 years of service represent a considerable cost to the State. There are several reasons for this segment of retirees comprising a disproportionate share of all claims. This group has an average age of 57. At this age, catastrophic illnesses such as treatable heart disease and cancer are more common than at either younger or older ages. Also, at this age retirees are not eligible for Medicare, which pays for approximately 60 percent of the medical costs for a retiree over age 65. In 1992 these retirees including their covered dependents received benefit payments from the plan of \$7,400,000 or 9 percent of all claims paid for retirees exclusive of their covered dependents. Non-disabled retirees with less than 10 years of service that are under age 65 comprise 2 percent of all retirees, yet receive 4.4 percent of benefits paid to retirees.

The State is providing the same benefit for a person with five years of service that it does for 30 years of service. Many employers and states are changing the eligibility provisions for retiree medical coverage. Private employers are implementing changes due to the new Financial Accounting Standards Board Statement No. 106 (FAS 106). This statement requires a private employer to book the liabilities imposed by a post-retirement medical program as they are earned by employees. An employer must reflect not only the cost of an employees immediate benefits but also the anticipated cost of retiree medical costs for that employee. The Governmental Accounting Standards Board (GASB) is expected to develop a similar statement with which North Carolina will have to comply.

Foster Higgins 1991 Retiree Health Care Survey demonstrates the changes private employers are making. The survey found that:

- 47 percent of employers have raised retiree contributions since 1990 or plan to do

so by next year.

- Increases in cost sharing provisions such as deductibles and coinsurance have been adopted by 40 percent of the respondents.
- Retirees under the age of 65 must pay the full premium of the coverage at 23 percent of the respondents. This percentage is 19 percent for retirees over age 65.

A 1991 Martin Segal study found that 32 percent of states contribute none of the cost of retiree health benefits while 38 percent of states pay the full cost of the coverage.

Finding 2: Medical claims of retirees under age 65 are approximately twice the average of active employees.

Based on the 1992 claims experience by age and sex report prepared by the State Health Plan, the cost of benefits per retiree under age 65 was \$2,689 for the 1992 plan year. The cost of coverage per active employee in 1992 was \$1,420. Retirees under age 65 received 57 percent of all benefits paid to retirees while comprising only 35 percent of all retirees.

The average age of a retiree under age 65 is 60 while the average age of an active employee is approximately 43. Based on the demographic characteristics of the State's workforce and retirees we would expect under age 65 retiree's costs to be only 65 percent higher than for the active employees instead of the actual 89 percent.

The long term implications are significant since retirees will comprise a larger segment of the State Health Plan. There will be fewer and fewer active employees supporting the retirees. The State will therefore face an inflationary component of its medical costs in addition to regular medical inflation.

Finding 3: The current contribution rates for retirees are based on the active costs.

The State's current contribution for retiree coverage is based on the combination of employee and retiree costs. Exhibit 3 shows the actual costs versus contributions for 1992. It is also important to note that all retirees eligible for Medicare must pay the premium required for Medicare Part B. Medicare Part B provides coverage for physician charges and limited other expenses. The monthly cost for this coverage is approximately \$39. As a result, retirees under age 65 pay less for their coverage since the State pays the full cost of the coverage.

EXHIBIT 3

<u>Coverage</u>	<u>Actual Annual Cost</u>	<u>State Annual Contribution</u>	<u>Employee Annual Contribution</u>
Single Coverage Retiree Less Than 65	\$2,690	\$1,735	\$0
Single Coverage Retiree 65 And Over	715	1,321	0
Additional Cost For Family Coverage Retiree Less Than 65	2,700	0	2,594
Additional Cost For Family Coverage Retiree Over 65	715	0	1,972
Additional Cost For Children Coverage Retiree Less Than 65	1,081	0	1,081
Additional Cost For Children Coverage Retiree Over 65	1,081	0	1,081

Recommendations

Recommendation 1: Require 10-years of service prior to the State making any contributions for retiree medical coverage

Implementing a 10-year threshold will prevent the State from paying a substantial cost to reward short term employees. By implementing this standard it is anticipated that the State will reduce its costs by approximately \$7,000,000 per year. Retirees that wish to have medical coverage under the state plan may be allowed to do so by paying the full cost of their coverage.

It is important to note that this recommendation can only be implemented in conjunction with Recommendation 3. As shown in Finding 3, for retirees over age 65, the State is making an excess contribution of \$606 per retiree. Eliminating this contribution for retirees with less than 10 years of service would result in the overall retiree plan having a shortfall. Recommendation 3 establishes contribution levels that prevent a shortfall.

This change will allow the State Health Plan to more closely match the age and service requirements of the State's retirement program. The State Retirement System requires the following in order to be eligible:

<u>Service</u>	<u>Earliest Retirement Age</u>
5 Years	65
25 Years	60
30 Years	Any Age

The recommendation is also closer to the requirements of private employers. A 1991 Buck survey found that the average minimum service requirement of private employers is 10 years with an age requirement of 65.

Requiring a minimum of ten years of service will move North Carolina's eligibility requirements closer to the eligibility requirements of other states. KPMG Peat Marwick's 1992 Health Benefits Survey included data for the following states:

Alabama	Mississippi
Arkansas	New York
Colorado	Oregon
Iowa	South Carolina
Kansas	Washington
Massachusetts	

The survey found the following:

<u>Criterion</u>	<u>Percentage of Surveyed States Having Provision</u>
Eligibility requirements for retiree medical coverage equal eligibility requirements for pension plan	82%
Attainment of age 55 for retiree medical benefits	18%
Attainment of age 60 for retiree medical benefits	9%
Attainment of age 62 for retiree medical benefits	9%
5 years of service required for retiree medical benefits	9%
10 years of service required for retiree medical benefits	36%
25 years of service required for retiree medical benefits	9%

As can be seen, 45 percent of the surveyed states require at least 10 years of service for a retiree to receive medical benefits.

The U.S. Department of Labor 1990 Survey of Employee Benefits in State and Local Governments shows that 39 percent of participants must meet a service requirement for eligibility for retiree medical benefits. An additional 20 percent made eligibility for the pension program as a prerequisite for coverage under the retiree medical program. The most prevalent requirement for eligibility for a normal pension benefit is 30 years of service. Retirees that wish to continue medical coverage under the State plan may be allowed to do so by paying the full cost of their coverage.

Recommendation 2: Require retirees under age 65 to make a contribution equal to Medicare Part B premiums

This requirement would create equity between retirees over and under age 65. Assuming that the average Medicare Part B premium over the next two years is \$468 per year, the savings to the State would be \$8,000,000 annually.

Recommendation 3: Require retirees with less than 30 years of service to contribute part of the cost of their coverage

Our recommendation is to adopt the contribution schedule in Exhibit 3. Implementation of this contribution plan will reduce the State's costs by \$10 million in addition to the savings shown above. The total savings from implementation of all the recommendations would be \$25 million per year. These savings assume that all retirees continue to elect coverage. If a retiree declines coverage and instead purchases an individual Medigap policy, then these savings would be greater.

Implications

The financial impact to the State is significant. Exhibit 4 projects the savings from our recommendations over the next 10 years. If all the recommendations are implemented, the State will reduce its costs by \$353 million over the next 10 years.

Implementation Consideration

State Statute (135-40.2) requires the State to pay the full cost of medical coverage under the indemnity plan for employees and certain other individuals. The same Statute requires coverage of dependents to be fully contributory. The above recommendations would require modification of this Statute.

EXHIBIT 3

Recommended Retiree Medicaid Program Contribution Schedule

<u>Years of Service</u>	<u>Percentage Paid by Employee</u>	<u>Annual Projected 1993 Employee Contribution</u>	<u>Annual Projected 1993 State Contribution</u>	<u>Annual Current Required Employee Contribution</u>
Retiree Less Than Age 65				
Less than 10 Years	100%	\$3,510	\$0	\$0
10 - 19 Years	50%	1,755	1,755	0
20 - 29 Years	25%	877	2,633	0
30 or More Years	13%	468	3,042	0
Retiree 65 and Over				
Less than 10 Years	100%	\$930	\$0	0
10 - 19 Years	50%	465	465	0
20 - 29 Years	25%	232	698	0
30 or More Years	0%	0	930	0
Cost to Cover Children	100%	1,405	0	1,081
Cost to Cover Spouse Not Eligible for Medicare	100%	3,510	0	2,594
Cost to Cover Spouse Eligible for Medicare	100%	930	0	1,972

EXHIBIT 4

Projected Savings From Recommended Contribution Schedule for the Retiree Medical Program

Projected Savings From:	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>10 Year Total</u>
Requiring 10 Years of Service For The State To Make a Contribution	7,000,000	7,092,000	7,314,000	7,608,000	8,040,000	8,515,000	9,053,000	9,609,000	10,226,000	10,923,000	85,380,000
Requiring Retirees Under 65 to Contribute an Amount Equal To Medicare Part B Premiums	8,000,000	8,392,000	8,946,000	9,692,000	10,615,000	11,731,000	13,007,000	14,435,000	16,059,000	17,927,000	118,804,000
Adopting the Recommended Contribution Schedule	10,000,000	10,490,000	11,182,000	12,115,000	13,269,000	14,663,000	16,259,000	18,043,000	20,073,000	22,409,000	148,503,000
Annual Total	25,000,000	25,974,000	27,442,000	29,415,000	31,924,000	34,909,000	38,319,000	42,087,000	46,358,000	51,259,000	352,687,000