

# Securing Retiree Healthcare *Keeping the Promise for American Workers*

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*Healthcare costs are soaring and the number of retirees receiving health benefits has increased, which will remain the trend as record numbers of Boomers retire.*

Consequently, governmental entities are paying more than anticipated to provide healthcare to retired employees and their dependents.

Due to changes in healthcare benefit accounting mandated by the Governmental Accounting Standards Board (GASB), the amount of liability for retiree healthcare has been measured and—for the first time—the amount is staggering. For the vast majority of governmental entities, the current method for funding these benefits is to defer payment of these costs to future generations. Now is the time to determine the appropriate funding of these benefits to secure the promise of retiree healthcare for the present and the future.

## *A Promise to be Broken*

Almost all United States governmental entities pay for retiree health benefits in the year the benefits are used by retirees and their dependents. This method of funding, commonly referred to as the “pay-as-you-go” approach, has led to the accumulation of massive financial liabilities to pay health

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benefits for future retirees. These liabilities are now being quantified under new GASB accounting rules, which have already come into effect for some large governmental entities or will become effective in the near future for remaining governmental entities.

Although retiree health benefits, like pensions, are earned during an employee’s working years, they are paid out after retirement. Unless enough funds and assumed future investment earnings are set aside to cover the accrual of these benefits while an employee is working, future taxpayers will pay all or part of the costs of the employee’s healthcare after retirement. For example, a governmental employee was hired years ago with the promise of health benefits upon retirement. However, the employer did not set aside any funds for these future health costs earned during the employee’s working years. As a result, current taxpayers must pay thousands of dollars every year for the employee’s health costs during retirement. While these benefits were earned doing work for the prior generation of taxpayers, the current generation of taxpayers bears the financial burden of paying for them. Because healthcare costs are rising and retirees are living longer than ever before, future costs could be in the tens of thousands of dollars per year, with future generations of taxpayers expected to foot the bill. At some point, the promise of healthcare during retirement could become unaffordable and require elimination of these benefits, resulting in a broken promise.

## *Pre-Funding Retiree Health Benefits*

The alternative to pay-as-you-go funding is to pre-fund retiree health benefits during an employee’s working years. This approach has many advantages over pay-as-you-go funding:

- **Same Approach is Used for Pensions.** There is virtually no dispute that pre-funding is the best way to fund a pension system. Most governmental entities sponsor some type of pension system and provide funds for the benefits during an employee’s working years. In fact, statutes commonly require pre-funding of pension benefits. Since pension benefits are earned during an employee’s working years and paid out upon retirement



(identical to health benefits), there should be no difference in funding between the two benefits.

- **More Economical.** Any funds set aside currently can be invested to generate earnings, which can then be used to pay for benefits. In some cases, funds set aside in trusts can be invested to earn a higher return than funds set aside in the government's general account. Paying or pre-funding now can dramatically reduce health costs over the long term.
- **Securing the Promised Benefits.** Pre-funding creates a pool of assets, which can be used to pay for the future benefits employees expect to receive. The assets accumulated will strengthen the governmental entity's ability to provide benefits for years to come.
- **Higher Bond Ratings.** For some governmental entities, bond rating agencies will monitor any liability associated with employee benefits, such as pensions or retiree

healthcare. These bond rating agencies do affect the interest rates paid on the governmental entity's debt. Unfunded pension and retiree health liabilities are viewed as a form of debt and can be a negative consideration when an agency compares one governmental entity's financial strength against that of another.

A retiree health benefit is one of the most underappreciated benefits given to an employee—until the employee retires and it becomes a necessity. The liability created by the retiree healthcare promise is significant for most governmental entities and will increase due to the recent rise in healthcare costs and the large number of employees soon expected to retire. It is critical to strategize a solution that will begin to address these unfunded liabilities and reduce the costs imposed on future generations of taxpayers. The promise made to America's workers must be kept.