Straining public higher education finances:

GASB* 75 and retiree health liabilities

Balancing financial challenges while striving to make a difference and fulfill their institution's mission is part of a typical day for public higher education leaders. Many institutions are battling rising costs, declining public funding and a challenging enrollment environment. Retiree healthcare benefits is one additional area that public institutions may want to explore as a way to improve their financial health.

Most public institutions offer a defined benefit (DB) retiree health benefit either directly or as part of a state health benefit program, and most finance these benefits on a pay-as-you-go basis. Until recently, public institutions were only required to account for these significant liabilities as a footnote on their balance sheets. This has changed now that GASB 75 reporting requirements are in effect. With GASB 75, unfunded liabilities pose a greater risk.

State retiree healthcare liabilities exceed half a trillion dollars and few states have set aside significant assets to cover these liabilities.[1]

A defined contribution (DC) approach to retiree health benefits could help you manage these significant liabilities and risk without having to eliminate a popular benefit.

Unfunded state retiree health liabilities are a burden

2017 Unfunded OPEB Liability**[2]

$678 billion

$63 billion increase

10% increase

** Other post-employment benefits other than pensions
Note: State unfunded OPEB liabilities are indicators of similar trends of public higher education OPEB liabilities.

* Governmental Accounting Standards Board.

GASB 75: Retiree healthcare liabilities are no longer hiding in plain sight

GASB Statement 75 requires state and local governments to recognize and disclose their obligations for OPEB—primarily retiree health benefits—on the balance sheet. In addition, an OPEB retiree health expense will need to be recognized in the income statement of the participating employers. Although passed in 2015, GASB 75 went into effect the fiscal year following June 15, 2017, and has significant implications for public institutions.

- **Credit implications:** Full actuarial OPEB liabilities—not just annual OPEB expenses—are now recognized on the balance sheet. The change in liabilities could affect your institution's credit quality and possibly increase borrowing costs or your ability to secure future funding.
- **Liability calculation:** A new actuarial methodology and discount rate guidance could result in greater OPEB liabilities than in the past.

Unfunded OPEB liabilities are a growing concern

Public pension plan liabilities in the trillions of dollars get a lot more attention than retiree health liabilities. OPEB liabilities aren't as large, but they are substantial. A recent S&P Global Ratings state survey reported close to $700 billion in unfunded OPEB liabilities. Equally troublesome, the 2017 fiscal year liability increased significantly faster than inflation, continuing an upward trend.

Directionally, liabilities are likely to trend upward or, at the very least, experience significant volatility. A number of factors are driving this trend, including:

Demographics

An aging population results in greater benefits usage.

Medical inflation

Healthcare costs have been rising at a rapid pace. There are positive signs that medical inflation is slowing down, but it's still outpacing overall inflation.

Employer contribution levels

Beyond funding their current benefits, few employers make additional contributions to pre-fund their OPEB obligations.

Best intentions, but unintended consequences

Left unchecked, OPEB liabilities will continue to grow and create a greater burden. Public institutions understand the impact of OPEB liabilities, and many have taken action by:

- reducing benefits
- increasing cost-sharing with employees
- changing plan eligibility criteria
- eliminating benefits for new hires
- moving retirees from employer-based insurance plans to private exchanges

While these efforts may help stem the financial impact of DB retiree health programs, they also have important drawbacks. They may affect your ability to recruit and retain talent, and they could negatively affect your employees' retirement security.

Competing for talent: Higher education institutions are not only competing for talent across the higher education sector, but they are also competing with for-profit organizations. Retiree healthcare benefits are a standard offering at public institutions and serve as a key differentiator with private sector firms. Without this offering, institutions may find themselves at a competitive disadvantage.

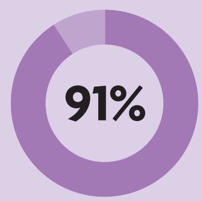
Reducing retirement readiness: Retiree healthcare costs are a leading expense for retirees. Reducing retiree health benefits or significantly increasing employee cost-sharing could negatively impact their retirement readiness.

For many institutions, a DB retiree health offering is proving to be a financial strain, but it's also a valued employee benefit that enhances the retirement security of its employees. A balanced approach is needed.

Employees need help with retiree health costs

$301,000

Amount needed for a 65-year-old couple today to cover out-of-pocket retirement healthcare expenses.[3]



of plan sponsors

say that rising healthcare costs are a significant concern for retirement security.[4]

An increasingly common challenge

The following hypothetical case study mirrors the situation many public higher education institutions are now experiencing.

The problem

Elaine is the chief benefits officer at a mid-sized public university located in the Northeast. She recently met with the institution's chief financial officer, Jeremy, to discuss the impact that the retiree healthcare benefits program was having on their balance sheet. The finance team just finalized their financial reports, and because of GASB 75, they had to recognize the full actuarial liability from their retiree healthcare program. Jeremy was already concerned with past annual OPEB liabilities, and this exacerbated his concerns. He wanted to explore ways to get this liability under control either by eliminating the program or reducing costs through greater cost-sharing with employees or benefit reductions.

More than just a financial consideration

Elaine was well aware of the financial considerations but cited the importance of retiree health benefits. It's a competitive necessity to offer these benefits to avoid losing talent to nearby universities, and employees rated these benefits as a key differentiator in a recent survey. Elaine also shared her concerns about how changes to retiree health benefits could negatively affect employee retirement readiness and result in faculty and staff working past traditional retirement ages.

Action is needed

Jeremy was sympathetic to Elaine's arguments, but he remained concerned about the magnitude of current liabilities and how they could ultimately impact their credit rating and ability to borrow funds in the future. Rising medical inflation and aging employee demographics were also likely to result in liability growth. Jeremy also informed Elaine that the university's Board of Trustees was scheduled to discuss OPEB liabilities at their next meeting, and he wanted to present them with some viable options.

A path forward

Elaine considered her options. She knew that retiree healthcare was a valued employee benefit that served as a competitive differentiator. She was also aware that it was a costly benefit, especially when considering the financial strains the university was experiencing due to rising costs and declining public funding. After careful consideration, she decided to evaluate how a DC-like benefit could help address their problem.

Benefits structure determines options

Elaine's story probably resonates with many of you, although the details of your situation could be different. For example, the sponsorship and funding of your retiree healthcare benefits may vary.

- **Elaine's situation:** Her university participated in a voluntary state-sponsored benefit, and her university paid its proportionate share of expenses.
- **Mandatory state-sponsored benefit:** An institution may not have the option to opt out of the benefit, and the state may or may not cover the full expense.
- **Institution-sponsored benefit:** Some institutions may sponsor their own programs separate from the state and have greater autonomy.

In each of these cases, a DC-type retiree health benefit could address many of your institution's challenges. However, the structure of your plan determines how you can approach this challenge, and your benefits consultant can help you evaluate your options.

Balancing financial concerns and effective employee benefits

Finding a cost-effective way to offer retiree healthcare benefits should appeal to both the financial and benefits side of the institution. A preferable solution limits financial exposure liability, strengthens employee retirement security and creates a differentiator for the institution.

A DC retirement health savings program (RHSP) meets all of these criteria. In the following situations, it can especially be an effective solution for institutions looking to reduce future cost risk and existing liabilities as a:

Replacement plan for new hires: New hires are offered an RHSP option, while existing employees remain covered by the DB retiree health benefit option.

Full benefit conversion: The DB retiree health benefit option is converted to a DC benefit either through an optional or mandatory employee conversion.

Benefits of a risk-managed DC approach

Limits financial liability

- Fully funded (no GASB OPEB liability)
- Not subject to healthcare inflation
- Flexible funding for employers
- Sustainable benefit

Supports employee retirement security

- Dedicated assets that can't be taken away
- Asset growth opportunity throughout working years
- Allows for tax-free investment earnings and reimbursement for qualified medical expenses in retirement
- Useable for health premiums

Strengthens employer benefits offering

- Demonstrates commitment to employee retirement security
- Serves as a key benefits differentiator
- Allows for health plan flexibility that isn't tied to an employer plan.

Taking action

Benefits leaders often face difficult trade-offs between the benefits they would like to offer their employees and budgetary constraints. Many of you may be facing such a situation with your institution's DB retiree health offering.

The good news is that a DC RHSP could help you to avoid this trade-off and continue offering retiree health benefits while reducing costs and possibly freeing up funds for other programs.

To discuss how an RHSP might benefit your institution, contact Rod Crane, Vice President, Business Development, TIAA Health, at 303-607-2896.

TIAA

[1] S&P Global Ratings, Rising U.S. States' OPEB Liabilities Signal Higher Costs Ahead, November 28, 2018.

[2] S&P Global Ratings, Rising U.S. States' OPEB Liabilities Signal Higher Costs Ahead, November 28, 2018. Note: Some states provide a state general fund contribution to local teacher OPEB plans, and for these we have also included teacher OPEB. In most cases, OPEBs of public university systems are not included, unless a state considers these a direct state responsibility or if they are not reported separately from the states' cost-sharing, multiple-employer plan.

[3] EBRI Issue Brief, May 16, 2019, No. 481. National average. Savings needed for Medigap Plan F premiums, Medicare Part B premiums and out-of-pocket (median) drug expenses. Does not include long-term care. A couple with a goal of having a 90% chance of having enough savings to cover healthcare expenses in retirement needs $301,000.

[4] 2018 TIAA Plan Sponsor Retirement Survey.