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How Memphis Reduced Its OPEB Liability by $319M — and — Gave Retirees Greater Affordability and Choice

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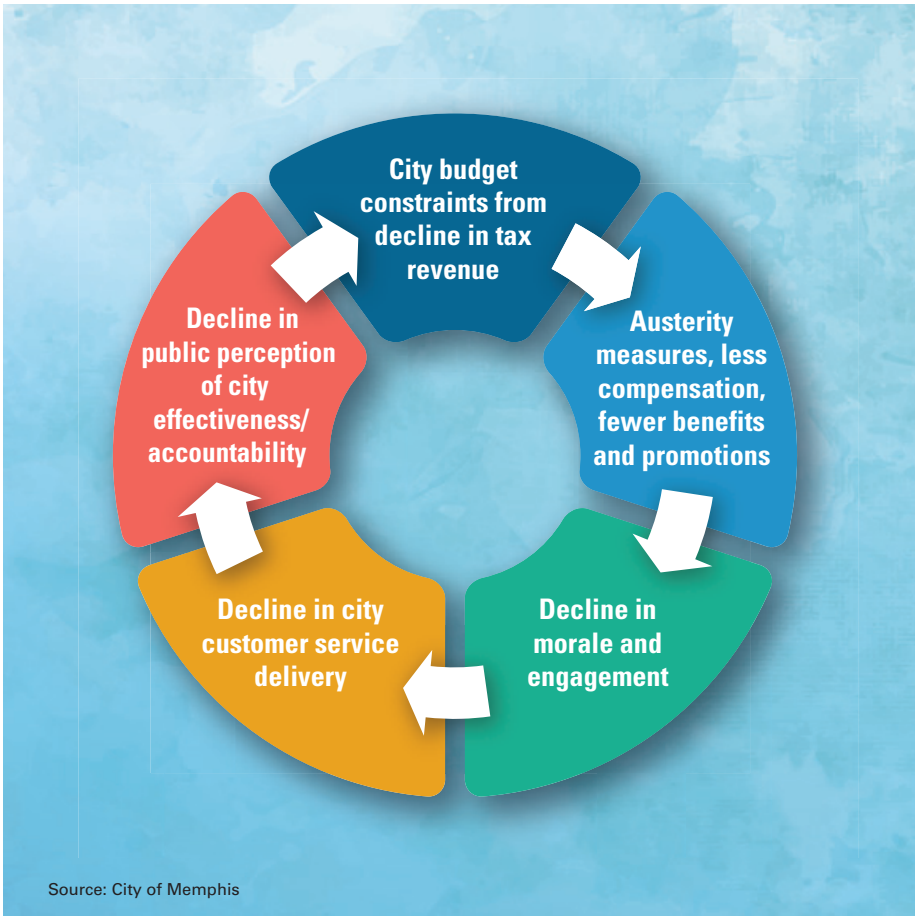
As a result of the Governmental Accounting Standards Board (GASB) Statement 75, issued in 2015, retiree health care liabilities are now more visible in financial reports — and the data is staggering. Among the country's 75 most populous cities, benefits beyond pensions, or other post-employment benefits (OPEBs), which mainly include retiree health care liabilities, add up to nearly $140 billion.[1]

Government entities, in response to growing economic burdens, have reduced retiree benefits. Today, only 68% of state and local governments provide retiree health care, down from 73% just five years ago. Some are addressing their problems by freezing health care eligibility for newer hires, eliminating spousal coverage, or increasing the years of service required to vest in benefits.

The fallout from these Band-Aid efforts to address the cost of retiree health care is palpable — retirees suing their former employers, teacher strikes across the country, and ongoing shortages of teachers, correctional officers, police and fire personnel. Difficult-to-fill jobs become even less attractive when they fail to provide meaningful retiree benefits. Moreover, bond rating agencies, which initially withheld judgment on the impact of the new GASB rules, now say the increased transparency could reduce cost-effective financing options because it "could inform our evaluation of a government's relative burden and management of these long-term liabilities."[2]

Figure 1. A Cycle that Band-Aids Can't Fix



Source: City of Memphis

The pressure continues to build. But there is a release valve.

Today, a growing number of public entities and retirement systems find substantial savings in shifting from traditional group health care insurance to a significantly more affordable solution: an *individual Medicare marketplace*. The move has saved public sector employers billions in OPEB liabilities. At the same time, it offers retirees more personalized health care coverage, often with lower premiums and out-of-pocket costs.

Not to be confused with the exchanges/marketplaces created under the Affordable Care Act, individual Medicare marketplaces, or private Medicare exchanges, are run by private vendors. Used successfully for more than a decade, they serve only Medicare-eligible retirees. More than 1,000 major employers already have moved millions of retirees from group plans to the individual Medicare marketplace — a win-win for retirees and plan sponsors.

Memphis' Story

In 2014, Memphis faced a $554 million pension deficit and $716 million in OPEB liabilities. The city's retiree risk pool was getting older and less healthy, and it faced premium increases of more than 30% for its Medicare supplement plans. A year later, the city eliminated its 70% health insurance premium subsidy to most of its retirees. The change affected more than 4,000 individuals and included both Medicare-eligible and non-Medicare-eligible retirees. A limited number of retirees retained a 25% subsidy, but most of the rest were left with no subsidy at all.

Many public employees in Memphis, and nationwide, chose to work in the public sector in part because of the promise of post-employment benefits. Breaking that promise to them further endangered recruitment and retention. For example, public safety recruitment in Memphis was already suffering as part of a broader trend — in cities nationwide, the number of law enforcement applicants dropped by 63% from 2013 through 2017.[3] Also, the city faced the high price of employee turnover, as the average cost to hire and train a new employee is just over $4,000.[4,5]

Memphis leadership identified a cycle they knew they needed to disrupt — low morale was affecting employee performance. When the city measured public perception, belief in the city's effectiveness also appeared to be faltering. Memphis concluded that if the public didn't believe in the city, then more significant problems would follow, such as citizens moving away or not supporting ballot measures (**Figure 1**).

In a comprehensive human resources overhaul, Memphis revisited retiree health care and ultimately decided to move its city retirees to the individual Medicare marketplace, affording the typical retiree a savings of about $2,000 a year in out-of-pocket costs. The more than 4,000 Memphis retirees embraced their expanded options in 223 unique health plans among 34 different carriers. Medicare-eligible retirees also saw a significant reduction in premiums. Under the group plan, premiums ranged from $185 to $383. In the marketplace, premiums fell to a range of $0 to $239, and coinsurance costs dropped as well.

The impact on Memphis' financial statement was also significant. The conversion resulted in average annual savings of $5 million and reduced the city's OPEB obligation by $319 million. The aggregate human resources and benefit changes, which included the move to the individual Medicare marketplace, contributed to a 3% reduction in overall employee attrition. Sworn police attrition dropped from 185 to 141 from one year to the next. Moreover, the

number of employees who said they were "somewhat to fully engaged" in their work rose from 50% the year before the benefits overhaul to 74% the following year.

Three Ways the Individual Medicare Marketplace Improves the Bottom Line

The individual Medicare marketplace is a way for public sector plan sponsors to fulfill the promise of retiree health care coverage and maintain a critical differentiation from private sector employment. The solution can improve the bottom line in several ways.

1. It reduces OPEB liabilities and health plan costs by millions — maybe billions.

Individual Medicare marketplace plans generally cost much less than group health care insurance. They allow retirees to pick from a variety of carriers and plans. The competition among insurers puts downward pressure on premiums. Also, even though a plan sponsor can take advantage of federal subsidies in a group plan, subsidies are higher for individual Medicare plans, further driving down costs.

Larger risk pools also reduce costs. A group plan is often limited to former employees, so a limited number of younger, healthier retirees age into it to offset the higher-cost claims of aging retirees. Sometimes these plans are closed to new entrants, resulting in rapidly accelerating costs. Of Medicare's 60 million beneficiaries, about half are in the individual market, which makes up the largest risk pool in the nation. Further, more than 10,000 people turn 65 every day, bringing a steady flow of younger, healthier retirees into that risk pool.

Finally, plan sponsors often provide stipends to retirees through health reimbursement accounts (HRAs) to help defray retirees' insurance premiums. It supports health care, which is unpredictable and inconsistent, through a predefined stipend. It also gives the sponsor cost control and an ability to forecast expenses. This financing structure enabled Memphis and many other employers to reduce their OPEB liability.

2. It substantially lowers administrative costs.

Ceasing to provide a retiree group plan significantly reduces administrative costs. Once a plan sponsor implements an individual Medicare marketplace, administrative and overhead expenses plummet. There is no need to go to procurement with a request for proposal every three to five years. Complex and costly medical claim audits go away with the need to keep up with ever-changing health care regulations and to complete carrier negotiations, annual plan redesign, fiduciary

Figure 2. Reducing Plan-Related Risk by Moving to an Individual Medicare Marketplace

COST AND RISK AREA	IMPACT TO THE EMPLOYER WHEN MOVING TO AN INDIVIDUAL MEDICARE MARKETPLACE
Overall health risk factors of the insured population	**Eliminated.** The benefit is a fixed stipend in an HRA, so the plan sponsor is no longer exposed to the risk of high claims.
Regulatory risk	**Mitigated.** Although the individual market is subject to regulatory risk, responsibility for compliance shifts from the plan sponsors to individual health plans chosen by retirees.
Rising health care cost trends	**Greatly reduced or eliminated.** The plan sponsor sets the HRA level. Because the employer controls the stipend level and rules, this risk can be managed or eliminated.
The richness of the inherent plan design, carrier network discounts, etc. (i.e., over- or under-insuring the population)	**Reduced.** A wide variety of plans are available to meet retirees' specific needs.
Discount rate for determining liability	**Reduced volatility.** The duration of the liability is shortened, reducing exposure to long bond price fluctuation.

oversight, and market benchmarking. The HRA element becomes as simple as the individual Medicare marketplace vendor sending a bill for reimbursement claims paid (for premiums or out-of-pocket costs) and the plan sponsor wiring the funds. In one large state retirement system, for example, the move to an individual Medicare marketplace reduced the hours required to administer the health care program by two-thirds.

3. It reduces or eliminates risk.

Risk is inherent in any health care plan, from rising costs to the health level of the insured population, to regulatory and legal risks. The individual Medicare marketplace can help mitigate or even eliminate some of those risks (**Figure 2**).

Conclusion

An individual Medicare marketplace can sound too good to be true, with its promise of cost savings for both employers and retirees, along with better health plan options for retirees. But actuarial analyses prove the argument. Hundreds of public sector entities have already made the move, like the city of Memphis, and reinforced that the sponsors, retirees, stakeholders, elected officials, and taxpayers all benefit. ■

Endnotes

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THE HISTORY OF INDIVIDUAL MEDICARE MARKETPLACES

Historically, public sector plan sponsors provided retiree health care through traditional group insurance plans, offered by private insurance companies and administered by the plan sponsor. Oftentimes in this model, retirees receive one-size-fits-all coverage, and the plan sponsor provides subsidies to reduce the standard premium. Large OPEB liabilities are the result.

The individual Medicare marketplace model came into play with the 2006 Medicare Modernization Act, which introduced Medicare Part D prescription drug plans and expanded Medicare Advantage options. Early adopters, including Chrysler, Ford and General Motors, used the strategy for many Medicare-eligible former employees.[6] Private sector adoption picked up after the 2008 financial crisis, when corporations looked to the individual Medicare marketplace as a way to reduce their costs and liabilities. Now, as GASB pressure combines with rising health care costs, public sector plan sponsors are taking a closer look at this option.

Individual Medicare marketplace vendors:

- Offer core products of Medigap, Medicare Advantage, and Part D (prescription drug) plans. Other products available can include dental, vision, life, senior critical illness, short-term medical, and hospital indemnity insurance.
- Offer "personal shopper" guidance from a licensed benefit advisor. Retirees can purchase health insurance plans from hundreds of private insurers with thousands of choices, enabling retirees to customize their coverage to meet their needs and budgets.
- Provide retiree communications, evaluation of options, and enrollment support while also managing employer subsidies (if provided) in the form of an HRA.
- Serve as the primary point of contact (and lifetime advocate) for retirees regarding benefit issues they may encounter.