State of New Hampshire

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November 19, 2013

Her Excellency, Governor Margaret Wood Hassan
State House
Concord, NH 03301

RE: Retiree Cost Containment Commission

Dear Governor Hassan:

As Chair of the Cost Containment Commission to Review Retiree Health Care Benefits for Employees Hired after July 1, 2013, I am pleased to submit the enclosed final report to you.

Chapter 144:33, Laws of 2013, established this Commission to study the question whether the State of New Hampshire should continue to offer retiree health benefits to new hires. This question is important to the state as an employer that competes to recruit and retain a quality workforce. It is also an extremely important question relevant to the state's financial health.

Governmental Accounting Standards Board (GASB) Statement No. 45 requires the state to determine on an actuarial basis and to disclose in its financial statements the cost of retiree health benefits and obligations for other post employment benefits (OPEB). In the last several months, the Department of Administrative Services working with the state's actuary, The Segal Company, conducted this actuarial analysis as of December 31, 2012 for inclusion in the state's FY 2013 Comprehensive Annual Financial Report and determined that the state's unfunded actuarial accrued liability totals $1.9 billion. Segal also conducted a thirty year projection of this unfunded actuarial accrued liability and estimated the state's OPEB liability to be $6.8 billion by 2042.

I am very pleased to report that the Commission continued to work with Segal to understand this long term liability and discovered that the $6.8 billion 30-year projection needed to be refined to reflect changes made to retiree health benefit eligibility laws, most recently as 2011. Under the current law, a Group I employee hired after July 1, 2011 is not eligible for retiree health benefits unless the individual has 20 years of state service and is age 65. Not only does the current retiree health benefit eligibility law require a significant period of state service, but a long-serving employee has to be age 65, the age when the individual is also eligible for Medicare, to receive retiree health benefits. This eligibility law has very positive financial benefits to the state since employees hired since its passage will only be eligible to receive a Medicare wrap retiree health benefit that we refer to as a Medicomp plan; significantly, the cost of the Medicomp plan is 1/3 the cost of the retiree health benefit that is available to today's retirees who are under the age 65 and not Medicare eligible. The Commission's work with Segal to incorporate the eligibility law changes refined the 30-year projection of the state's OPEB liability from $6.8 billion to $5.8 billion, a reduction of $1 billion. We encourage more analysis to see if changes already passed into law don't further reduce this liability.

Unfortunately, the establishing law provided very little time for the Commission to complete its study from the point commission members were named to serve to November 15th, the termination of the Commission. I am pleased the members met seven times in that condensed timeframe and identified a significant number of possible solutions to consider going forward. The Commission acknowledges in its report that it was only able to partially study the many issues it identified and therefore suggests issues for a successor commission to study. The Commission's report specifically recommends that any future commission should be provided the time and financial resources to adequately and fairly study the many important issues that should be considered when deciding whether to continue to offer newly hired employees the existing retiree health benefit or other alternative retiree health benefit support. In addition to attaching the report, I have attached the minutes of the Commission's meetings as well as the information and data that the Commission considered.

Please contact me if you have any questions.

Sincerely,

Linda M. Hodgdon

Linda M. Hodgdon

cc: Fiscal Committee members
Commission members

Commission to Review Retiree Health Care Benefits
For Employees Hired after July 1, 2013

FINAL REPORT

Background

Chapter 144:33, Laws of 2013, created RSA 21-I: 36-b and provided, "there is established a commission to review retiree health care benefits for employees hired after July 1, 2013 in light of the implementation of the Patient Protection and Affordable Care Act (ACA) and recommend a cohesive plan outlining cost effective health plan models effective for such new employees." The Commission is required to report its findings and recommendations to the Governor and the Fiscal Committee of the General Court by November 15, 2013.

The Commission had limited time and resources to fulfill its charge and met seven times over a period of seven weeks to review the current retiree health care plan model and to consider cost effective health plan models for new employees. The Commission reviewed data provided by the Department of Administrative Services (DAS) regarding retiree health benefits costs, the current retiree health care model and enrollment counts, conferenced with state contracted actuaries who conduct the actuarial valuation of the state's long term Other Post Employment Benefits (OPEB) liability, heard from a representative of the Department of Insurance about the ACA and the Marketplace exchange that is offering new health insurance products to New Hampshire citizens, and considered financial vehicles available that people may use to pre-fund future retiree health care costs. For purposes of its analysis, the Commission assumed that the law authorizing retiree health benefits for state employees would change no earlier than the end of the upcoming legislative session, or July 1, 2014. A summary of the Commission's work follows.

A. Health Care Public Policy

In 1985, the New Hampshire legislature passed a series of laws relative to employee and retiree health benefits and their administration. RSA 21-I: 26 articulates the purpose and policy that is the public rationale for providing retiree health insurance coverage for state employees and their spouses:

> "21-I: 26 Purpose and Policy. – This subdivision is to provide permanent group life insurance and group hospitalization, hospital medical care, surgical care and other medical and surgical benefits for New Hampshire state employees and their families, and retired state employees and their spouses. In view of the accepted value of group insurance to the well-being and efficiency of employees on the part of small and large private employers and the other 5 New England states in obtaining benefits of this type of insurance for their employees, the state of New Hampshire implements this subdivision in order that the state shall compare favorably to the standards now commonly accepted by private employers and the state employees in the other 5 New England states by making available to state employees and their families and retired state employees and

their spouses permanent group life insurance and group hospitalization, hospital medical care, surgical care and other medical and surgical insurance benefits."

Much has changed in the twenty-eight years since passage of RSA 21-I:26. From a public policy and legislative perspective, the 2010 passage of the ACA changed the health insurance landscape in many ways, most notably offering people a new way to access and purchase health insurance. The New Hampshire Health Insurance Marketplace (Marketplace) is an online exchange where retirees under the age of 65 may purchase health insurance. In fact, by going through the Marketplace, an individual, depending on his or her income, may be eligible for a subsidy or be directed to apply for Medicaid. While the Marketplace does not offer options to retirees over the age of 65 and others who are Medicare eligible, there are many options in the general market for purchasing health care coverage that is supplemental to Medicare, commonly referred to as a "Medicomp Wrap" benefit.

B. The State Employee Workforce

Against this backdrop of a health insurance Marketplace that provides individuals with access to health insurance options, the Commission looked at today's state employee workforce. Based on the 2012 State of New Hampshire, Division of Personnel Annual Report, the average full-time state employee has twelve years of service, is 47 years old and earns $46,559 in annual wages. From an employee recruitment perspective, over 80% of state employee positions require at least a high school degree and more than 50% require a postsecondary degree. More than 40% of state employee job applicants are between the ages of 41-50. From an employee retention perspective, 52% of the employees leaving state service had less than ten years of service. State employees today have more income earning potential and career mobility. Given the legislatively authorized retirement eligibility changes described later in this report, the number of newly hired workers that will remain in employ until retirement is likely to be significantly different than one would project for the current workforce.

C. The Cost of Retiree Health Benefits

The State of New Hampshire has long provided retiree health benefits to employees who meet age and years of state service eligibility requirements. Even though the State receives from its federal partners on a per employee basis approximately $10 million per year for post employment retiree health benefits, the state has never pre-funded the cost of retiree health benefits during the employee's active service. The use of this federal revenue is unrestricted and the state routinely reallocates these funds to other funding needs in the budget.

Rather than pre-funding retiree health care costs, the state pays for the retiree benefit when the employee retires and incurs medical costs, a funding method referred to as "pay-go". Further, in 2004, the state became self insured and annually adjusts the premiums, or working rates, to cover medical claims and modest administrative costs. The legislature's decision to move from fully insured to self insured was made primarily to lower the state's health care inflation trend for active and retiree health care costs. Notably, this decision has successfully achieved the desired outcomes. Today the active and retiree health plans consistently experience health care inflation trends that are significantly below the national average.

Effective July 1, 2007, governmental accounting rules applicable to the State of New Hampshire changed. Governmental Accounting Standards Board (GASB) Statement No. 45 requires the state to determine on an actuarial basis and disclose in its financial statements the cost of retiree health benefits and obligations for other post employment benefits (OPEB), just as it does for its pension plans. This had been established practice in the private sector that now is applied to governments as well. Most recently, the state conducted this OPEB actuarial valuation as of December 31, 2012, and although in FY 2013 the State paid nearly $50 million in retiree health benefits (with an additional $20 million in expenditures funded by certain plan participants and other revenue sources), this expenditure fell short of the actuarially calculated Annual Required Contribution (ARC) of approximately $132.3 million, that would be necessary to begin pre-funding the benefit. GASB requires New Hampshire to amortize the unfunded actuarial accrued liability over a period not to exceed thirty years and this unfunded actuarial accrued liability as of December 31, 2012 totals $1.9 billion. Thus the state's longstanding policy to provide retiree health care benefits on a "pay-go" basis results in a cost shift to the future.

Although the current OPEB liability represents the state's obligations to current employees and retirees, the state could implement a change that will impact new employees. The state could significantly reduce its ARC by setting aside funds in an OPEB trust to help pay for future retiree health care costs which may one day benefit new employees. In fact, in 2013, the New Hampshire legislature passed a law amending RSA 6:12-c and creating an OPEB trust, (Chapter 144:141, Laws of 2013), but did not provide funding for the trust. The $10 million per year in federal revenue referenced above could be placed into the OPEB trust to begin to reduce the state's long term unfunded liability, thereby applying the money to the purpose for which it was intended.

As the magnitude of the state's OPEB liability has come to light and been considered, the state has passed a series of laws to limit the state's liability and to study alternatives to offering retiree health benefits to its employees. The state's actuary originally estimated the OPEB liability to be $6.8 billion by 2042. As this Commission worked with the actuary to project the changes to the State's OPEB liability if retiree health benefits were not offered to new hires, it came to light that the actuary needed to refine its 30 year OPEB projection to take into account the changes to retiree health benefit eligibility described herein. This refined projection resulted in a reduction of the estimate of the state's OPEB liability as of 2042 from $6.8 billion to $5.8 billion.

D. Statutory Changes to Retiree Health Benefits Eligibility Laws

The State of New Hampshire has made significant statutory changes to eligibility laws that help to limit its liability for future retiree health benefit costs. For many years, Group I employees, the largest group of state employees, were required to have ten (10) years of service in order to be eligible for retiree health benefits provided that they received their pensions on a periodic basis rather than in a lump sum, and except for those having thirty (30) years of service, further required the retiree to be at least 60 years old in order to receive retiree health benefits.

These eligibility standards apply to 60% of the current state employee workforce who were hired when they were in place.

The state changed this eligibility standard in 2003, so that an employee hired on or after July 1, 2003 is required to have twenty (20) years of service in order to qualify for retiree health benefits, and except for those having thirty (30) years of service, continued to require the retiree to be at least 60 years old in order to receive retiree health benefits. Close to 40% of the current state employee workforce was hired under these new eligibility standards and will not be eligible to receive retiree health benefits until 2023.

In 2011, the state further restricted the eligibility for retiree health benefits for individuals hired after July 1, 2011 by eliminating the exception for those having thirty (30) years of service, and requiring the individual to have twenty (20) years of service and to be at least age 65 to receive retiree health benefits. This was an important change because retirees in this group will be Medicare eligible, presuming no changes to the age of Medicare eligibility occur, and the state share of the cost of retiree health benefits for someone who is Medicare eligible is one-third the cost of retiree health benefits for the non-Medicare eligible retiree. By 2031, the average state employee newly retiring will receive a retiree health benefit referred to as “Medicomp Wrap” that is supplemental to Medicare.

Group II employees have different eligibility rules for retiree health benefits due to the nature of their careers. For example, these employees do not earn or accrue a Social Security benefit during their Group II career, nor does the State make payments on behalf of these workers toward Social Security. Group II employees hired before July 1, 2010, do not have a minimum state service requirement and are eligible for retiree health benefits upon retirement from the state. In 2010, the state passed a law requiring Group II employees hired on or after July 1, 2010 to have twenty (20) years of state service in order to be eligible for retiree health benefits. In 2011, the law changed again so that Group II employees hired after July 1, 2011, must now have twenty (20) years of state service and be at least 52.5 years old to be eligible for retiree health benefits.

Prior to July 1, 2009, the state paid the full premium for all eligible retirees and their spouses. For the non-Medicare eligible retiree health benefit that the state provides, the retiree and the spouse must now each contribute 12.5% of the premium cost in order to obtain coverage. For the Medicare eligible retiree, the state pays the full cost of the Medicomp wrap coverage, which costs one-third of the amount of the non-Medicare plan, for the retiree and the spouse. In addition, a retiree’s dependents may access benefits if the retiree self-pays for dependent coverage.

From an OPEB liability perspective, the 2011 statutory changes to the eligibility requirements for retiree health benefits will reduce the state’s long term OPEB obligations. Those eligibility requirements have not been factored into the state’s recent OPEB liability calculations, in part because relatively few people have been hired since the new eligibility laws were put into place. It is very important to understand the effects of these statutory changes. A determination whether the changes resulted in the State’s intended effect should be made so that the state does not make further changes to benefits that may not be necessary. This Commission has worked with the State's actuary to review the question of the long-term impact of statutory eligibility changes to retiree eligibility, but further study is required.

The State of New Hampshire's 2012 Comprehensive Annual Financial Report reflects an OPEB liability of $1.9 billion for Fiscal Year ending 2013. Working with the state's actuary, the Commission studied what the effect to OPEB liability would be if the state did not offer a retiree health benefits to new hires beginning July 1, 2014. This analysis showed that for the first ten years following the policy change to discontinue offering retiree health benefits to new hires the actuarial accrued liability drops modestly, mostly because the retiree health costs during those years are for people who are already receiving the benefit. After a ten year period, however, the actuarial accrued liability begins to reduce more significantly such that after a period of thirty years, the state's OPEB liability drops from $5.7 billion to $2.3 billion.

E. <u>Retiree Health Benefits Alternatives and Considerations</u>

Given the changing demographics of the state employee workforce, the availability of new funding vehicles for retiree health care coverage, the availability of new group health insurance products and the OPEB liability that the current pay-go practice has accumulated, it is clear that further research is needed. The options and alternatives presented below are not prioritized and they are not recommendations. They are simply options that this Commission partially studied and believes that successor commissions should study further.

Whether the state maintains the status quo benefit for new hires or pursues changes to the benefit, some specific alternatives that should be further researched include:

1. Funding future retiree health benefits for new hires throughout their career to ensure OPEB liability does not grow with respect to this benefit for this portion of the state employee workforce.

2. Eliminating the statutory requirement for the state to provide retiree health benefits for new hires and instead provide funding, in an amount to be determined each biennium, to assist the future retiree in funding health care coverage, deductibles, co-pays, or portions thereof.

3. Maintaining the State of New Hampshire's ability to compete with other employers with respect to recruitment and retention of a quality state employee workforce.

    a. Study the factors that make the state an effective recruiter and allow it to retain its employees.
    b. Study the effect of changes to eligibility requirements for retiree health benefits on recruitment and retention given that a new hire with limited or no access to retiree health benefits could be working along side an employee who because of date of hire and years of service may have access to retiree health benefits.
    c. Study the unique recruitment and retention issues that apply to Group II employees.

4. Research options such as a VEBA, HRA or Section 115 trust. Employers, employee representatives, such as unions, and individual accounts are all options that may provide tax sheltered savings alternatives to funding retiree health benefits.

5. Research further changes to eligibility laws. Among the options that should be considered are:

   a. Increasing eligibility to require more years of state service for Group I and Group II employees

   b. Providing retiree health benefits only to the state retiree and make spousal coverage only at the expense of the retiree, as is dependent coverage now.

   c. Tying the age of retiree health benefit eligibility to the "age of Medicare eligibility", rather than to a specific age. This would result in an automatic change in the age of retiree health benefit eligibility in the event of future changes to age of Medicare eligibility and would maintain the contraction of the state's retiree health program to one that only offers the Medicomp wrap coverage.

   d. Matching spousal coverage eligibility requirements to the same age as is required for the employee/retiree, i.e. age 65 or 52.5 or age of Medicare eligibility.

6. Continue to study the impact of the changes to retiree eligibility on the state's OPEB liability and report on recommendations to contain those costs including some or all of the $10 million in federal funds being directed to the OPEB trust.

7. Provide any future Commissions with the time and the financial resources to adequately and fairly study the above topics so that it can make soundly formed recommendations for legislative changes.

8. Whether the state should discontinue offering the current retiree health benefit to new employees.

In conclusion, before any future Commission spends time and resources on the above suggestions, make sure there is a clear understanding of the changes to retiree health benefit eligibility already made, particularly in light of the state's interest in and ability to recruit and retain a quality state employee workforce.

Respectfully Submitted,

The undersigned hereby submit this Final Report of the Commission to Review Retiree Health Care Benefits for Employees Hired after July 1, 2013 on this 15th day of November 2013.

Linda M. Hodgdon, Chair
Commissioner, Department of Administrative Services

Stephen Arnold
NH State Director, New England Police Benevolent Association

John Beardmore, Public Member
Commissioner, Department of Revenue,

Diana Lacey
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