

**REPORT OF THE
VIRGINIA SUPPLEMENTAL RETIREMENT SYSTEM**

**Study Of The Costs Of
Insurance Premiums For Certain
Retired Career State Employees**

**TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA**



Senate Document No. 13

**COMMONWEALTH OF VIRGINIA
RICHMOND
1988**

Executive Summary
Study of Health Care Costs For Certain
Retired Career State Employees
(Senate Joint Legislation No. 74-1986 Session)

SJR No. 74 requested that the Virginia Supplemental Retirement System (VSRS) study the cost of insurance premiums for retired State employees who have 20 or more years of service and whose retirement benefits are less than \$10,000 annually, less than \$5,000, and less than each \$1,000 increment between \$10,000 and \$5,000. Subject to certain assumptions and limitations enumerated in the study, the annual costs ranged from \$1.6 million to \$3.9 million. The annual premium for providing health care for all State retirees regardless of benefit level would be approximately \$13.1 million.

Upon review of the results on the study requested by the legislature and observations of trends related to health care coverage for retirees, the VSRS is suggesting two alternatives to the General Assembly to assist retirees with the cost of health insurance premiums.

The first alternative is a "leveling option" which will allow a retiree to elect a higher benefit than he would normally receive prior to age 65. After age 65, when the cost of health care decreases for most retirees, the benefit would be reduced actuarially. This option can now be provided under the provisions of Section 51-111.60(a)(4) of the Code without legislative action and has no cost.

The second alternative is a monthly supplement to the retiree based on longevity. A retiree could receive a monthly benefit supplement based on years of service. For instance, assuming that a \$1 per year of service supplement is provided, an employee with 25 years of service credit would receive \$25 per month, in addition to regular VSRS benefits, to offset the cost of health care premiums. This provision requires legislation and can be provided to all employers as an option. The projected annual cost for State employees and teachers for current retirees would be approximately \$10.8 million.

1986 SESSION

LD4195506

SENATE JOINT RESOLUTION NO. 74
AMENDMENT IN THE NATURE OF A SUBSTITUTE
(Proposed by the House Committee on Rules on
February 26, 1986)
(Patron Prior to Substitute—Senator Goode)

Requesting the Virginia Supplemental Retirement System to study the costs of insurance premiums for certain retired career state employees.

WHEREAS, active service state employees who retire at an early age may continue to participate in the Commonwealth of Virginia health care coverage plan; and

WHEREAS, this continued participation allows these employees to maintain a comprehensive level of health insurance protection during these early retirement years; and

WHEREAS, health care coverage costs represent a large percentage of expenditures for retired state employees, especially for those in the lower and middle income ranges; and

WHEREAS, career state employees who have worked for the Commonwealth for twenty years or more should be entitled to at least some assistance with their health care costs and coverage; and, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That the Virginia Supplemental Retirement System is requested to conduct a study to determine the estimated cost to the Commonwealth to provide all retired state employees who have completed more than twenty years of active service and whose total state supplemental retirement benefits are less than \$10,000 with cost-free health insurance. The study should also determine the costs for such retirees whose total state supplemental retirement benefits are less than \$5,000 and less than each \$1,000 increments between those amounts.

The VSRS shall complete this study in sufficient time to report to the Governor and General Assembly prior to the time that the major planning for the 1988-90 Biennium appropriation begins.

Official Use By Clerks

Agreed to By The Senate
without amendment
with amendment
substitute
substitute w/amdt

Agreed to By
The House of Delegates
without amendment
with amendment
substitute
substitute w/amdt

Date: _____

Date: _____

Clerk of the Senate

Clerk of the House of Delegates

Study of Health Care Costs for
Certain Retired Career State Employees
(Senate Joint Resolution No. 74 - 1986 Session)

This report has been prepared pursuant to Senate Joint Resolution No. 74 (1986 Session). The Resolution requested the Virginia Supplemental Retirement System to study the costs of insurance premiums for retired state employees who have twenty or more years of active service and whose total state supplemental retirement benefits are less than \$10,000 annually. This report contains two sections. The first section responds to the specific requirements of SJR No. 74. The second section contains some observations concerning the general trends in health insurance for retirees and some alternatives for assisting retirees in defraying the cost of health insurance.

I. Senate Joint Resolution No. 74

This section is divided into three parts as follows:

- A. Background on the State Health Care Program
- B. Scope and Limitations of the Study
- C. Costs of Providing Coverage to Retirees.

A. Background on the State Health Care Program

As of the date of this report, nine different health benefits plans divided over four geographic regions cover state retirees. The following is a breakdown of each region with its plans:

- 1. Richmond area
 - Standard Plan - Blue Cross/Blue Shield
 - Keycare Plan - Blue Cross/Blue Shield
 - Prucare Plan - Health maintenance organization (HMO)
 - United Medical - HMO
- 2. Tidewater area
 - Standard Plan - Blue Cross/Blue Shield
 - Keycare Plan - Blue Cross/Blue Shield
 - Cost Awareness Plan - Blue Cross/Blue Shield
 - HMO Plus - HMO
 - Maxicare/HealthAmerica - HMO
 - United Medical/Equicor - HMO
- 3. Northern Virginia
 - Standard Plan - Blue Cross/Blue Shield
 - Cost Awareness - Blue Cross/Blue Shield
 - Group Health Association - HMO
 - Network Health - HMO
- 4. All other areas
 - Standard Plan - Blue Cross/Blue Shield
 - Keycare Plan - Blue Cross/Blue Shield
 - Cost Awareness Plan - Blue Cross/Blue Shield

Each plan offers five types of contract based on family needs and/or eligibility for Medicare coverage. These are:

1. Retiree Only - not eligible for Medicare
2. Retiree Only - eligible for Medicare
3. Retiree and One Dependent - one eligible for Medicare
4. Retiree and One Dependent - both eligible for Medicare
5. Retiree and Family

When Medicare coverage is available to a retiree and/or a dependent, the health plan coordinates its benefits and payments with those of the Medicare program.

Eligibility for membership in the State retiree group requires two conditions:

1. The individual must be retired with a monthly benefit from the Virginia Supplemental Retirement System (VSRS) or with a periodic benefit from the Teachers Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF), and
2. The last employer while contributing to VSRS or TIAA-CREF must have been the State.

Dependents of the retiree may also be eligible for coverage. If a retiree has dependent coverage and dies leaving the dependent a monthly survivor benefit from VSRS or a periodic benefit from TIAA-CREF, the dependent may remain in the retiree group. However, if the survivor does not receive such a benefit, he or she cannot remain in the group beyond the month in which the retiree died.

Retirees who elect coverage under the State Health Care Program authorize VSRS to deduct the applicable premium from their monthly retirement benefit. The premiums thus collected are transmitted to the various carriers by VSRS. In cases where the monthly retirement benefit is insufficient to pay the premium, the retiree is billed directly by the carrier.

B. Scope and Limitations of the Study

The scope and limitations of this study are enumerated below to explain the basis on which costs were calculated and to point out some of the factors which could affect those costs in the future:

1. Pursuant to the criteria established by Senate Joint Resolution No. 74, the costs of providing free health insurance coverage for the retiree only were calculated for State retirees who:
 - a. have 20 or more years of service and
 - b. are receiving less than \$10,000 annually from VSRS, or
 - c. are receiving less than \$9,000 annually from VSRS, or
 - d. are receiving less than \$8,000 annually from VSRS, or
 - e. are receiving less than \$7,000 annually from VSRS, or

- f. are receiving less than \$6,000 annually from VSRS, or
- g. are receiving less than \$5,000 annually from VSRS.

In determining the number of retirees at each level of annual retirement income described above, no adjustment has been made to reflect the type of option selected by the retiree. Thus, a retiree may be included in the group of less than \$10,000 because an option with survivor benefits was selected. Had the basic benefit been chosen, the annual retirement income might have exceeded the \$10,000 level. Benefits determined for purposes of this study are net of cost-of-living allowances.

- 2. The study is based on the number of eligible State retirees as of August 1, 1987. This date was chosen to allow all carriers sufficient time to process all contract changes reported during the May 1987 enrollment period.
- 3. The calculations used the health care rates in effect for fiscal year 1987-88.
- 4. No projection for future rate increases and/or increases in the number of State retirees has been made; nor has any projection been made concerning the effects of salary increases for future retirees. Such salary increases could, realistically, preclude any retiree from being included in coverage if a fixed dollar ceiling is maintained as a criterion for eligibility.
- 5. The effect of cost-of-living adjustments on retirement benefits has not been taken into account. Benefit increases due to cost-of-living adjustments may eventually exclude some eligible retirees because their annual retirement income from VSRS will have exceeded the ceiling set by S.J.R. No. 74, i.e. less than \$10,000, \$9,000, etc.
- 6. In the case of eligible State retirees who are not presently covered under the State Health Care Program, the study has assumed that all such employees will enroll in the Standard Blue Cross/Blue Shield plan.

C. Costs of Providing Coverage to Retirees

Costs are based upon retiree only coverage in the plan selected by the retiree using medicare and non-medicare rates where applicable. Where the retiree was not currently participating in a plan, the assumption was made that the retiree would select the standard Blue Cross/Blue Shield plan. These were also costed at the retiree only rate with or without Medicare as appropriate.

The costs requested by Senate Joint Resolution No. 74 are as follows:

	<u>Annual Cost</u>
1. Retirees with 20 or more years of service and receiving less than \$10,000 annually from VSRS: Number of retirees: 5,649	\$ 3,913,086.00
2. Retirees with 20 or more years of service and receiving less than \$9,000 annually from VSRS: Number of retirees: 5,199	\$ 3,585,433.00
3. Retirees with 20 or more years of service and receiving less than \$8,000 annually from VSRS: Number of retirees: 4,654	\$ 3,196,740.00
4. Retirees with 20 or more years of service and receiving less than \$7,000 annually from VSRS: Number of retirees: 4,041	\$ 2,754,297.00
5. Retirees with 20 or more years of service and receiving less than \$6,000 annually from VSRS: Number of retirees: 3,289	\$ 2,224,059.00
6. Retirees with 20 or more years of service and receiving less than \$5,000 annually from VSRS: Number of retirees: 2,402	\$ 1,609,566.00

In addition to the costs of providing free health care coverage for certain groups of state retirees, the contribution for all state retirees has also been calculated. Given the assumptions noted above, the annual premium for providing health care for all state retirees would be approximately \$13.1 million.

II. Observations and Alternatives

This Section contains information that the VSRS Board of Trustees makes available to the General Assembly to assist in the development of a sound policy for participating in the cost of health insurance for State retirees.

A. Observations

Because of provisions for earlier retirement and increasing longevity, the number of retirees is increasing and is expected to continue to increase in the future. The Federal government is shifting the burden of health care financing back to employers by pursuing a policy of deficit reduction through Medicare "pullbacks."

These two observations alone cause a concern for any employer contemplating providing health care coverage for its retirees. The VSRS has requested that its consulting actuaries, Buck Consultants, comment on these trends. Those comments are provided in Appendix 1 of this report.

B. Alternatives

In developing the cost data that appears in Section I of this report, and noting the trends mentioned above and in Appendix 1 of this Section, the VSRS has recognized the potential costs that the State might incur by providing health care for retirees. The VSRS also recognizes that increasing health care costs have become a concern of all retirees and those contemplating retirement, especially those not immediately eligible for Medicare, i.e. under 65 years of age.

To address these problems, the VSRS is suggesting two alternatives. The first alternative is to provide retirees with a special leveling option to help defray the cost of health insurance for those under age 65. The second alternative is to provide, through employer funding, a benefit supplement based on longevity.

Leveling Options

Section 51-111.60(a)(4) of the Code of Virginia allows the VSRS to provide retirees with benefit options to meet special needs as long as those benefits are calculated on an actuarially equivalent basis.

This provision authorizes VSRS to allow any retiree to elect an option which would help offset the cost of health insurance between the time of retirement and age 65 by structuring their retirement benefit on an actuarially equivalent basis. The retiree can select a slightly higher benefit prior to age 65 which would be reduced after age 65.

Examples of benefits before and after age 65 for a retiree selecting different options under this provision are shown in Exhibit A.

Advantages of the leveling option are that (1) it may be used by any retiree under VSRS, not just State employees; (2) since it is actuarially equivalent, no additional employer cost is incurred; and (3) no legislation is required.

Benefit Supplement

Another means of assisting retirees in defraying health insurance costs is through a benefit supplement. The alternative being suggested by VSRS consists of a supplement to the retirement benefit based on longevity. The supplement is of a fixed dollar amount for each year of service at retirement. For example, the retiree who retires after 30 years of service with a VSRS monthly benefit of \$800 would receive a payment of \$830 from the VSRS, assuming a \$1 per year supplement.

The cost of this supplement would be charged to the employer on a "pay-as-you-go" basis and reflected in the VSRS employer contribution rate.

This alternative could also be provided to local governments, unless a specific local government elects not to participate.

Based on a \$1 per year of service supplement, the annual costs for State, teacher, and local retirees would be:

State	\$4.3 million
Teacher	<u>6.5</u> million
	10.8
Local	<u>1.8</u> million
	<u>\$12.6</u> million

Election to provide this alternative would require action by the General Assembly.

The leveling option and benefit supplement alternatives are both viable and realistic means for employers to assist retirees with health insurance costs. They may be used separately or together, or in combination with other alternatives.

EXHIBIT A

Assume unreduced basic benefit of \$815 per month before leveling option

	Retiring at Age 55		Retiring at Age 60		Retiring at Age 62	
	<u>Pre Age 65</u>	<u>Post Age 65</u>	<u>Pre Age 65</u>	<u>Post Age 65</u>	<u>Pre Age 65</u>	<u>Post Age 65</u>
VSRS + \$50 before age 65	\$865	\$756	\$865	\$793	\$865	\$804
BC/BC retiree only	(82)	(50)	(82)	(50)	(82)	(50)
Net	<u>\$783</u>	<u>\$706</u>	<u>\$783</u>	<u>\$743</u>	<u>\$783</u>	<u>\$754</u>
VSRS + \$50 before age 65	\$865	\$756	\$865	\$793	\$865	\$804
BC/BC family	(206)	(100)	(206)	(100)	(206)	(100)
Net	<u>\$659</u>	<u>\$656</u>	<u>\$659</u>	<u>\$693</u>	<u>\$659</u>	<u>\$704</u>
VSRS + \$100 before age 65	\$915	\$698	\$915	\$772	\$915	\$793
BC/BS retiree only	(82)	(50)	(82)	(50)	(82)	(50)
Net	<u>\$833</u>	<u>\$648</u>	<u>\$833</u>	<u>\$722</u>	<u>\$833</u>	<u>\$743</u>
VSRS + \$100 before age 65	\$915	\$698	\$915	\$772	\$915	\$793
BC/BS family	(206)	(100)	(206)	(100)	(206)	(100)
Net	<u>\$709</u>	<u>\$598</u>	<u>\$709</u>	<u>\$672</u>	<u>\$709</u>	<u>\$693</u>

November 25, 1987

Mr. Glen D. Pond, Director
Virginia Supplemental Retirement System
Post Office Box 3-X
Richmond, Virginia 23207

Dear Mr. Pond:

We have reviewed your draft report in response to SJR74. As requested, we are providing our comments concerning contribution trends in retiree health care.

Among those public and private sector employers that provide retiree health care coverage, most do not assist with contributions toward health care for early retirees under age 65. In the past, benefit policy reflected the viewpoint that an early retiree should consider the cost of health care as a liability to be accommodated by his own resources. However, as health care costs have escalated in the last ten years and as some employers have encouraged early retirement, the trend is changing towards a comprehensive policy that meets the individual's needs, both while an active employee and a retiree. We expect more public and private employers to accommodate the needs of their early retirees. A few plans that have paid 100% of early retiree health costs have changed or are attempting to change to a cost sharing of premium with the early retiree so that premium increases can also be shared. Finally, there is much discussion about mandated health benefits in Washington, D.C. If the Kennedy Bill is enacted, the responsibility for funding health care below age 65 will rest heavily on the employer. It is not completely clear how early retirees will be treated but the intent of the legislation will be to provide comprehensive coverage up to Medicare eligibility. It is very likely that employers will shoulder this responsibility through their existing health care plans.

Employers' premium contributions toward retirees with Medicare are quite different than early retiree contributions. When a retiree reaches age 65, Medicare becomes primary and health care premium rates for Medicare supplement policies are approximately 50% of active employee rates. Forty percent of large private employers have covered the entire cost of the retiree's Medicare supplement premium. Because of increasing Medicare supplement premiums, many of these employers are concerned about their liability and have changed retiree benefit policy; now they ask for some cost sharing and/or a reduction of plan benefits. Among private sector employers, 35% to 40% offer no assistance toward premiums and about 20% share the cost with the retiree. Among public sector plans another survey reported approximately 45-50% of employers covering some or all of the cost with the majority of those providing 100% of Medicare supplement premiums. In total, then, the majority

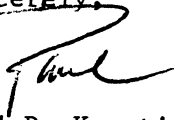
Mr. Glen D. Pond
November 25, 1987
Page 2

(60%) of employers who make retiree coverage available require the retiree to participate in the premium cost. The remaining employers pay the full cost of the retiree's Medicare supplement although many are reconsidering this policy.

In summary, it appears that the trend in contributions is toward premium cost sharing by both employer and the retiree. Those public and private sector employers who have not provided any assistance in paying premiums are under pressure from retirees and a sense of obligation to provide benefits to long term employees. On the other hand, those employers who have paid 100% of retiree health care premium are now attempting to change this practice due to the future liability and are cost sharing the premium and/or reducing benefits.

We would recommend cost sharing of retiree premiums, both for the early retiree who is not eligible for Medicare and the retiree who is eligible for Medicare. By doing so, VSRS retirees are aware of their responsibility to share in costs, and future rate increases can be shared more readily.

Sincerely,



Paul D. Kersting
Regional Director
Group Benefit Services

PDK:lt