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Issues and Trends in Retiree Health Insurance Benefits

In 1986, 75 percent of full-time workers in medium-sized and large private-sector establishments participated in health insurance plans that continued coverage in retirement. Most of these plans also partly or fully paid for the cost of coverage.

Employer-sponsored retiree health plans are an important source of health insurance among the elderly. Nearly one-half of the elderly with private insurance to supplement Medicare have coverage from a retiree health plan.

Most recently, attention has focused on the amount of employer liability for retiree health benefits. A forthcoming ruling by the Financial Accounting Standards Board is expected to require employers to report unfunded liability for retiree health insurance in corporate financial statements, which would reduce reported corporate profits. This change in accounting practice would also place pressure on employers to fund retiree health obligations or to modify benefits and obligations to reduce their liability. Employers, in turn, may ask Congress to provide greater tax incentives to advance-fund retiree health plans. However, Congress may be reluctant to provide greater tax incentives without also establishing funding and vesting rules for tax-qualified plans.

Introduction

Retiree health insurance as an employee benefit has grown rapidly, emerging as a common benefit among both private and public employees. Nevertheless, the future of retiree health benefits is uncertain. Employers and public policymakers face major unresolved issues related to accounting, funding, and the contractual nature of the retiree benefit promise.

Employers have historically regarded retiree health benefits as a year-to-year promise financed as part of the same health insurance plan provided to active workers. Consequently, many employers have not focused on the cost of promised future benefits as a corporate liability. New Financial Accounting Standards Board (FASB) rules—expected by year-end—will require disclosure of accrued unfunded liability for retiree health benefits. Anticipating these rules, employers have begun to focus on the amount of unfunded liability that they will be required to disclose and its impact on corporate profit.

Current tax law severely limits tax-exempt funding of future retiree health benefit costs to offset accrued liability. Congress may be reluctant to increase tax preferences for funding retiree health benefits not only because of the potential federal budget impact but also because current law requires no vesting of the benefits that would clarify employee rights if the plan were modified or terminated.

A series of court decisions based on contract law have upheld retiree rights to continued health benefits when employers have sought to terminate retiree plans or modify benefits. These decisions have begun to clarify retiree rights to health benefits under certain contractual circumstances.[1]

This *Issue Brief* describes the prevalence of retiree health insurance as an employee benefit and its prevalence and distribution among early retirees (aged 55 to 64) and retirees aged 65 or older. The data presented distinguish between retirees who receive private plan benefits and those who receive benefits from a public-employer plan—through federal, state, or local governments. Revised estimates of the current value of both private and public employer liability for retiree health insurance benefits are presented. These estimates distinguish between liability for benefits provided to current retirees and that for future benefits of active workers.

The *Issue Brief* closes with a review of recent legislation affecting retiree health benefits. Included is a description of a new law—and events leading up to it—that prevents the unilateral termination of retiree health insurance benefits upon an employer's filing for Chapter 11 bankruptcy. Also reviewed are various legislative proposals intended to encourage private employers to fund health insurance liability associated with current and future retirees.[2]

Retiree Health Insurance as an Employee Benefit

Continuation of health insurance benefits after retirement is a common feature of both private- and public-employer plans. In 1986, three-quarters (75 percent) of full-time permanent workers in medium-sized and large private-sector establishments participated in health insurance plans that continued coverage after early retirement (before age 65); more than two-thirds (68 percent) participated in plans that continued coverage after retirement at age 65 (U.S. Department of Labor, 1987).

Most plans that continue coverage after retirement also provide for an employer (or sponsor) contribution to the cost of coverage. In 1986, 64 percent of full-time permanent workers in medium-sized or large private-sector establishments had plans that continued coverage after early retirement, with the employer paying all or part of the plan cost; 58 percent had plans with fully or partly employer-financed coverage after retirement at age 65 (table 1). An estimated 41 percent of workers in larger private-sector establishments had health

[1] A summary of current tax law and a brief history of court decisions related to retiree health insurance benefits are provided in Chollet and Friedland (1987).

[2] Retiree health benefit issues were discussed at the Employee Benefit Research Institute's recent policy forum, "Employer-Provided Retiree Health Benefits: Provision, Funding, Legal, and Public Policy Issues." The proceedings of this forum will be published in a forthcoming EBRI book.

insurance plans for which the employer paid the full cost of coverage after either early or normal retirement.

Fully or partly employer-paid retiree coverage is less common among public-sector workers than among private-sector workers in larger establishments. In 1987, nearly one-half (47 percent) of full-time state or local government workers with employer-based health insurance had plans that would continue with an employer contribution after early retirement; 44 percent had coverage that would continue with an employer contribution after retirement at age 65. About one-half of state and local employees who participated in plans to which the employer contributed had the full cost of coverage after retirement paid by the employer.

Employer plans that continue coverage typically continue benefits at the same level as that provided to workers before retirement; that is, the scope of services covered and retirees' cost-sharing under the plan are maintained at preretirement levels. However, retiree plans typically integrate Medicare coverage into plan benefits, making Medicare the first payer for services covered by both Medicare and the retiree plan.[3] Because Medicare integration substantially reduces plan costs, it has probably encouraged the growth of health insurance as a retiree benefit.

Since 1981 (the first year for which data are available), the number of workers with health insurance plans that continue coverage with an employer contribution after retirement has grown substantially. Between 1981 and 1985, the number of private-sector workers with plans that provided employer-subsidized benefits after early retirement grew by more than 14 percent (table 2); the number of private-sector workers with plans that continue coverage after age 65 grew 18 percent. The most rapid growth of retiree benefits apparently occurred among workers in manufacturing establishments and those in very large establishments (with 2,500 or more workers). The number of workers in medium-sized and large manufacturing establishments with plans that continue employer-subsidized benefits after retirement at age 65 grew nearly 20 percent

[3] Alternative methods of Medicare integration are described in Chollet and Friedland (1987).

Table 1

Percentage of Private- and Public-Employer Health Insurance Plan Participants with an Employer Contribution to Coverage after Retirement, by Selected Benefit Provisions and Age of Retiree, 1986 and 1987

	Medium-Sized and Large Private Employer Plans[a]		State and Local Employer Plans[b]	
Benefit Provision	Retirees under 65	Retirees 65 or older	Retirees under 65	Retirees 65 or older
With Retiree Coverage	64%	5~~8~~9%	47%	44%
Effect of Retirement on Benefit Level:				
No change	50	46	45	41
Reduced coverage	12	10	3	3
Increased coverage	1	1	c	c
Retiree Share of Cost:				
Partial cost	23	17	24	23
No cost	41	41	24	24
No Retiree Coverage[d]	32	38	48	52
Provision Not Determinable	2	2	2	2
Retiree Policy Not Established	1	1	e	e
Other[f]	1	1	e	e

Source: Estimated from U.S. Department of Labor, Bureau of Labor Statistics, *Employee Benefits in Medium and Large Firms, 1986* (Washington, DC: U.S. Government Printing Office, 1987), tables 29 and 30; and U.S. Department of Labor, Bureau of Labor Statistics, *Employee Benefits in State and Local Governments, 1987* (Washington, DC: U.S. Government Printing Office, 1988), tables 48 and 49.

Note: Data reflect benefits provided to full-time permanent employees. Individual items may not add to totals because of rounding or because the specific provision was indeterminable.

[a]Data are for 1986. Estimates assume that specific benefit provisions are proportionately distributed among plans to which the employer contributes.

[b]Data are for 1987. Data on the number of participants with retiree plans to which the employer does not contribute are unavailable.

[c]Less than 0.05 percent.

[d]Includes participants in plans that continue access to coverage after retirement other than that required by federal law (the Consolidated Omnibus Budget Reconciliation Act of 1985), but to which the employer does not contribute. These workers represent 11 percent of all plan participants.

[e]No plan participants in this category.

[f]Includes employees who participate only in the employer's dental insurance plan and for whom health insurance coverage and provisions are unknown.

Table 2

Number and Percentage of Workers in Employer-Sponsored Health Insurance Plans with an Employer Contribution to Coverage after Early or Normal Retirement: Medium-Sized and Large Private Establishments, by Establishment Size and Industry Group, 1981–1985

Establishment Size/ Industry Group	1981 Number (in millions)	1981 Percent	1985 Number (in millions)	1985 Percent	Percent Increase in Workers with Provision, 1981–85
			Early retirement[a]		
All Participants with an Employer Contribution to Retiree Coverage	11.2	61.1%	12.8	63.9%	14.3%
Establishment Size:					
100–249	0.8	39.3	1.1	46.2	37.5
250–499	1.6	45.7	1.6	40.6	b
500–999	2.4	61.3	2.2	63.4	–8.3
1,000–2,499	2.4	64.8	2.8	72.5	16.7
2,500+	3.7	80.3	5.0	80.7	35.1
Industry Group:					
Manufacturing	6.3	59.7	7.3	64.4	15.9
Nonmanufacturing	4.8	63.2	5.4	63.3	12.5
			Retirement at age 65[c]		
All Participants with an Employer Contribution to Retiree Coverage	10.0	55.0	11.8	58.9	18.0
Establishment Size:					
100–249	0.8	39.3	1.0	42.6	12.5
250–499	1.3	37.1	1.5	36.4	15.4
500–999	2.2	55.5	1.9	54.2	−13.6
1,000–2,499	2.2	58.7	2.6	67.3	18.2
2,500+	3.4	72.9	4.8	76.8	41.2
Industry Group:					
Manufacturing	5.6	52.4	6.7	59.1	19.6
Nonmanufacturing	4.5	58.6	5.0	58.6	11.1

Source: Michael A. Morrisey and Gail A. Jensen, "Employer-Sponsored Post-Retirement Health Benefits: The State of Knowledge and Some Unresolved Issues," unpublished working paper, University of Alabama at Birmingham (September 1988); and Gail A. Jensen, unpublished tabulations of the U.S. Department of Labor Employee Benefit Survey, 1981 and 1985.
Note: Individual items may not add to totals because of rounding. Data are not strictly reliable in firm size and industry disaggregation.
[a]Data include workers with coverage that continues at least until age 65; workers with some other limited period of continuation are not included.
[b]No measurable change.
[c]Data include only workers with coverage that continues indefinitely; workers with a limited period of continuation are not included.

between 1981 and 1985. The number of workers in very large establishments with this type of benefit grew 41 percent.[4]

[4]These data from the Bureau of Labor Statistics are not strictly reliable in firm size and industry disaggregation. Nevertheless, the tabulations presented here probably provide reasonable estimates of general magnitudes.

Retirees with Employer-Sponsored Coverage

Employer-sponsored plans are an important source of health insurance among retirees. In 1984 (the most recent year for which data are available), at least 11.3 million retirees aged 55 or older had health insurance

Table 3
Number and Percentage of People Aged 55 or Older with Retiree Health Insurance, by Age, 1984

Retiree Age	Number[a] (in millions)	Percent within Age Group	Percent of All People Reporting Retiree Health Insurance
Total	11.3	23.6%	100.0%
Aged 55–59	1.2	10.2	10.2
Aged 60–64	2.6	24.4	23.1
Aged 65–69	2.9	32.9	25.2
Aged 70–74	2.1	30.0	18.8
Aged 75+	2.6	26.3	22.6
Summary:			
Under age 65	3.8	17.1	33.4
Aged 65 or older	7.6	29.6	66.6

Source: Preliminary EBRI tabulations of the Survey of Income and Program Participation, matched waves 2 through 5 (U.S. Department of Commerce, Bureau of the Census).
Note: Data omit individuals living in households that were not interviewed at any time during the calendar year. Items may not add to totals because of rounding.
[a]Includes primary-insured retirees and people with dependents' coverage.

from an employer-sponsored plan (table 3). Of these, 7.6 million were aged 65 or older. In 1984, at least 29 percent of all elderly persons reported having health insurance coverage from a past employer.

The evolution of retiree coverage as a feature of employer health plans is reflected in higher rates of retiree coverage among recent retirees. In 1984, nearly one-third of the elderly aged 65–69 (33 percent) reported having health insurance coverage from a past employer, compared with just over one-quarter (26 percent) of elderly persons aged 75 or older.

Employer-sponsored retiree health insurance plans represent a substantial share of the elderly's Medigap insurance (table 4). Among all people aged 65 or older with private insurance to supplement Medicare (62 percent of the elderly in 1984), about one-half—47 percent—had all or part of that coverage provided by an employer-sponsored retiree health insurance plan. Including elderly workers with employer coverage, nearly 60 percent of the elderly with private coverage to supplement Medicare derived all or part of that coverage from an employer plan.

Most retirees who report having health insurance from a past employer live in low- and middle-income families. Consequently, health insurance benefits represent an important real income supplement for most of the retirees who have them. In 1984, more than one-half of the elderly with retiree health insurance (56 percent) had family income of less than $20,000; 79 percent had family income of less than $30,000 (table 5). Retirees under age 65 with health insurance from a past employer report slightly higher, but generally comparable, levels of family income. In 1984, 47 percent of early retirees with employer-sponsored health insurance reported family income of less than $20,000; 76 percent reported family income of less than $30,000.

Available data do not directly indicate whether the health insurance benefits that retirees are now receiving

Table 4
Percentage of People Aged 65 or Older with Private Health Insurance from Selected Sources, by Age, 1984

Source of Coverage	Total, Age 65+	Aged 65–69	Aged 70–74	Aged 75+
Active Worker Coverage from a Current Employer	8.5%	16.4%	7.2%	2.5%
Direct[b]	5.6	10.4	5.1	a
Dependents' coverage[c]	2.9	6.0	2.1	a
Retiree Coverage from a Past Employer	29.6	32.9	30.0	26.3
Direct[b]	23.7	24.7	23.6	22.9
Dependents' coverage[c]	5.9	8.2	6.4	3.4
Other Private Insurance	54.8	48.6	58.2	57.9
No Private Insurance	38.1	31.7	36.3	45.1

Source: Preliminary EBRI tabulations of the Survey of Income and Program Participation, matched waves 2 through 5 (U.S. Department of Commerce, Bureau of the Census).
Note: Data omit individuals living in households that were not interviewed at any time during the calendar year. Items may not add to totals because of rounding.
[a]Statistically insignificant.
[b]Includes people with survivors' coverage and those who report both direct and dependents' coverage of the same type.
[c]Excludes people with both direct and dependents' coverage of the same type.

Table 5
Number and Distribution of People with Retiree Health Insurance, by Family Income and Age, 1984

Annual Family Income	Recipients under Age 65: Total[a] (in millions)	Recipients under Age 65: Cumulative percent of beneficiaries	Recipients Aged 65 or Older: Total (in millions)	Recipients Aged 65 or Older: Cumulative percent of beneficiaries
Less than $10,000	0.5	11.7%	1.2	14.8%
$10,000–$14,999	0.7	29.2	1.5	35.2
$15,000–$19,999	0.7	46.7	1.6	55.8
$20,000–24,999	0.4	63.8	1.2	70.2
$25,000–$29,999	0.5	76.2	0.7	79.4
$30,0000–$39,999	0.5	88.3	0.8	89.7
$40,000 or more	0.5	100.0	0.8	100.0

Source: Preliminary EBRI tabulations of the Survey of Income and Program Participation, matched waves 2 through 5 (U.S. Department of Commerce, Bureau of the Census).
Note: Data omit individuals living in households that were not interviewed at any time during the calendar year. Items may not add to totals because of rounding.
[a]Includes only retirees aged 55–64.

are sponsored by a private or public employer. Nevertheless, most retirees' health plan sponsors can be inferred from data about their pension plan sponsors. From these data, we estimate that at least one-half of all retirees with health insurance from a past employer receive coverage from a private employer plan; that is, the retiree also receives income from a private pension plan (table 6). While 20 percent of retirees with health insurance from a past employer report no current pension income, most of these individuals probably receive their health insurance benefits from a private plan sponsor. At least 30 percent of retirees now receiving health insurance from a past employer have coverage as retirees from public employment—federal, state, or local government.

Evidence that private employer plans have been providing retiree benefits with increasing frequency, and that retiree coverage as a public plan benefit matured relatively early, is again apparent in the relatively high rate of private employer-sponsored coverage reported among recent retirees (and, conversely, their relatively low rate of public plan coverage). Among covered retirees aged 75 or older in 1984, 44 percent had coverage sponsored by a private employer and 31 percent had coverage from a public employer plan. By comparison, among younger retirees (aged 65–69), at least 55 percent of all retirees with coverage from a past employer apparently were covered by a private employer plan; 28 percent had public employer-sponsored coverage.

While most retirees receive some contribution to the cost of their plan (a characteristic of private and public plans that is clear from the Department of Labor data on active workers' plans described earlier), a significant minority report that they pay the full cost of coverage themselves, with no sponsor contribution. In 1984, nearly 22 percent of all retirees paid the full cost of coverage without a sponsor contribution; among retirees aged 65 or older, 23 percent paid the full cost of coverage (table 7). Conversely, for nearly 39 percent of retirees with health insurance from a past employer, the employer paid the full cost of coverage.

Table 6
Number and Percentage of People Aged 55 or Older with Retiree Health Insurance, by Type of Pension Plan Sponsor[a] and Recipient Age, 1984

Recipient Age	Total with Retiree Health Coverage (in millions)	Percent with Pension Income: Total[b]	Percent with Pension Income: Private pension	Percent with Pension Income: Public pension[c]	Percent with No Pension Income
Total	11.3	79.8%	50.2%	29.7%	20.2%
Aged 55–59	1.2	78.7	44.7	34.1	21.3
Aged 60–64	2.6	82.3	54.5	27.8	17.7
Aged 65–69	2.9	82.1	54.0	28.1	17.9
Aged 70–74	2.1	79.2	49.6	29.6	20.8
Aged 75+	2.6	75.8	44.4	31.4	24.2
Summary:					
Aged 55–64	3.8	81.2	51.4	29.7	18.8
Aged 65+	7.6	79.1	49.5	29.6	20.9

Source: Preliminary EBRI tabulations of the Survey of Income and Program Participation, matched waves 2 through 5 (U.S. Department of Commerce, Bureau of the Census).
Note: Data omit individuals living in households that were not interviewed at any time during the calendar year. Items may not add to totals because of rounding.
[a]For people with only dependent coverage from a spouse's plan, the spouse's pension plan sponsor is reported.
[b]Also includes military pensions and other pensions from unspecified sources.
[c]Federal, state, or local government employee plan. Category excludes military pensions.

The likelihood that the plan sponsor contributes all or part of the cost of coverage is substantially higher among retirees with coverage from a private plan than among those with public plan coverage, an observation also consistent with the reported features of active worker plans. Among both early retirees (aged 55 to 64) and retirees aged 65 or older with private plan coverage, approximately one-half (49 percent and 51 percent, respectively) had their coverage fully paid by the plan sponsor.[5] By comparison, about one-quarter of retirees with coverage from a public employer (23 percent) had the full cost of coverage paid by the plan sponsor.

Table 7

People Aged 55 or Older with Retiree Health Insurance by Level of Retiree Contribution to Coverage, Type of Pension Plan Sponsor, and Retiree Age, 1984

Retiree Age and Pension Sponsor	Number of Retirees with Benefit (in millions)	Share of Plan Cost Paid by Retiree: All	Part	None
		(percentage of participants)		
All Retirees	11.3	21.9%	39.3%	38.8%
Aged 55-64				
Total	3.8	19.3	42.2	38.5
Pension sponsor:				
private	2.0	14.3	36.4	49.3
public	1.1	19.1	60.2	20.7
not reported	0.8	33.4	29.6	37.1
Aged 65+				
Total	7.6	23.2	37.9	38.9
Pension sponsor:				
private	3.9	14.8	34.0	51.2
public	2.2	22.4	54.4	23.3
not reported	1.7	44.3	23.8	31.9

Source: Preliminary EBRI tabulations of the Survey of Income and Program Participation, matched waves 2 through 5 (U.S. Department of Commerce, Bureau of the Census).
Note: Data omit individuals living in households that were not interviewed at any time during the calendar year. Items may not add to totals because of rounding.

Employer Liability for Retiree Benefits

Since 1979, the Financial Accounting Standards Board has issued a series of documents that address appropriate accounting practice for corporate-sponsored retiree health and life insurance benefits.[6] In 1984 these documents culminated in FASB *Statement Number 81*, which required employers to disclose either the current cost of retiree welfare benefits or accrued unfunded liability for them as a footnote to the corporation's balance sheet, if the amounts were distinguishable from benefits costs for active workers. Although most corporations apparently now disclose the current cost or unfunded liability for retiree welfare benefits, many do not.[7] *Statement Number 81* offers no guidance on how employers should measure or amortize accrued unfunded liability, and it specifically does not apply to multiemployer plans.

Subsequent to issuing *Statement Number 81*, FASB has been considering appropriate standards for measurement and balance sheet disclosure of accrued unfunded liability for retiree welfare benefits. FASB is expected to release an exposure draft dealing with these issues by the end of the year. Anticipating new accounting rules for retiree health benefits, employers have begun to focus on the amount of unfunded liability that they will be required to disclose as an offset to corporate income, directly reducing reported profit.

Table 8 provides new estimates of both private and public employer liability for retiree health insurance benefits. Although private employer and public employer estimates are reported together, they are of public policy interest for different reasons. Specifically,

[5] Because retirees in plans whose sponsor was indeterminable are excluded, the percentage of retirees in private plans with coverage fully paid by the plan sponsor may be slightly biased upward.

[6] The following FASB publications are concerned with retiree welfare benefits: *Disclosure of Pension and Other Post-Retirement Benefit Information* (July 12, 1979); *Employers' Accounting for Pensions and Other Postemployment Benefits*, discussion memorandum (February 19, 1981); *Preliminary Views on Major Issues Related to Employers' Accounting for Pensions and Other Postemployment Benefits* (November 1982); *Employers' Accounting for Pensions and Other Postemployment Benefits*, discussion memorandum (April 19, 1983); *Disclosure of Postretirement Health Care and Life Insurance Benefits*, exposure draft (July 3, 1984); and *Statement Number 81, Disclosure of Postretirement Health Care and Life Insurance Benefits* (November 1984).

[7] A survey of 100 corporate annual reports for 1987 indicates that nearly 90 percent of corporations with retiree benefits disclose costs. Of these, 8 percent reported costs to be immaterial, 18 percent did not distinguish between costs for retirees and active employees, and 74 percent provided separate cost figures for retirees (Charles D. Spencer and Associates, 1988).

Table 8
Private- and Public-Employer Liability for Retiree Health Insurance Benefits: Intermediate Estimate, Discounted Present Value, 1988

Worker/Retiree Status	Private Employers	Public Employers	Total
		(in billions)	
Current Retirees	$ 68.2	$ 23.0	$ 91.2
Current Workers	100.5	87.7	188.2
Total, retirees and current workers	168.7	110.7	279.4

Source: Employee Benefit Research Institute, preliminary estimates.
Note: Estimates include reductions in plan cost as a result of recent legislation expanding Medicare benefits. On average, corporate and public employer liabilities are estimated to decline by approximately 30 percent as a result of new Medicare benefits.

the new FASB rules would apply only to private employers. Amounts of unfunded liability for retiree health benefits are probably distributed very unevenly among employers, even among those that sponsor retiree benefits. Equity markets have not anticipated individual corporations' unfunded liability for retiree health benefits. Consequently, disclosure of the liability will, all else being equal, produce an adjustment in the relative value of corporate stocks.

The issues associated with public employer liability for retiree health insurance are different. Public employer liabilities represent a claim against future tax dollars. The current cost of state and local government obligations for retiree health benefits directly affects their operating budgets and poses an increasing strain on fiscal management. Most states and municipalities are required to balance their budgets annually.

The Employee Benefit Research Institute's (EBRI) preliminary estimate of the present value of private employers' liability for retiree health insurance obligations is approximately $169 billion. Most of this liability, nearly $101 billion, is associated with current workers. The present value of corporate liability for current retirees is slightly more than $68 billion. Retiree medical benefits typically are not vested prior to retirement, providing employers with the ability to make changes that could significantly reduce the $101 billion figure.

These estimates are low compared with those recently reported by the U.S. General Accounting Office (U.S. Congress, 1988), and they are much lower than those suggested by various benefits consultants, or the trillion-dollar estimates reported by the press. One major reason that EBRI's estimates appear relatively low is that they include a downward adjustment for recent legislation expanding Medicare benefits.[8]

The value of the new Medicare benefits to plan sponsors can vary radically from plan to plan, depending on the plan provisions, the Medicare assignment rate among physicians in the areas where retirees live, and a host of other factors. Nevertheless, the new Medicare benefits, phased in over a five-year period, are likely to greatly reduce employer liability for the benefits provided to retirees over age 65. Much of this saving will probably occur as a consequence of Medicare's coverage of prescription drugs during the last two years of the phase-in period. EBRI's estimates assume that the new Medicare coverage will reduce employer plan costs by 10 percent in 1990, 40 percent in 1991, 45 percent in 1992, and 50 percent in subsequent years. This assumption, applied to both private and public plans, reduces estimated liability by approximately 30 percent. Without this adjustment, the current value of private, corporate liability for retiree health benefits would be $247 billion—$98 billion for current retirees and $149 billion for current workers.

EBRI estimates the present value of private employers' liability for retiree health insurance obligations at approximately $169 billion.

A second major assumption implicit in these estimates is the projected rate of inflation in health care services. The estimates assume that health care cost inflation will continue to exceed general inflation but that the difference between the rates will gradually decline over the

[8] The Medicare Catastrophic Coverage Act of 1988 (P.L. 100-360) becomes effective in 1989.

next 25 years. The rates of inflation are assumed to converge (at 3.5 percent) in the year 2013, when aggregate spending for health care services reaches 22 percent of Gross National Product (GNP); real per capita GNP is assumed to grow at a rate of 1.5 percent per year, resulting in assumed annual per capita health care spending increases of 5 percent after the year 2013.[9]

Employers' annual cost to amortize their unfunded benefit obligations would be substantial. Information released by FASB indicates that their forthcoming rules will allow employers to amortize initial accrued unfunded liability (i.e., past service liability accumulated before 1992) over employees' remaining service lives, or 15 years, whichever is greater. However, FASB will also require employers, beginning in 1997, to recognize a minimum liability equal to the present value of all future benefits for current retirees and for active workers eligible to retire.

Amortizing unfunded liability for current and future retirees would greatly increase employers' current spending for health insurance benefits, and their costs for retiree benefits in particular. Based on a survey of 76 retiree medical plans conducted by Towers, Perrin, Forster & Crosby, the annual cost of retiree health insurance benefits would total about 12 percent of payroll (about 10 times more than the current pay-as-you-go system) if it were calculated on a basis similar to that used for pension plans (*Investor's Daily*, 1988).

Legislative Activity

The loss of health insurance by retirees when a plan sponsor declares bankruptcy captured congressional attention several years ago and generated enactment of a new law to protect retirees. In particular, LTV Corporation's Chapter 11 bankruptcy reorganization in 1986 became a catalyst for congressional action. The Omnibus Budget Reconciliation Act of 1986 made a firm's initiation of Chapter 11 bankruptcy reorganization a qualifying event under the provisions of the 1985 Consolidated Omnibus Budget Reconciliation Act (COBRA) that required employers to offer continued health insurance benefits. Under COBRA's amended continuation provisions, retirees may purchase continued post-retirement medical benefits from the plan until they die or obtain coverage from another source. The retiree's surviving spouse can purchase continued coverage for an additional 36 months. As with other continuation provisions in COBRA, the plan may require retirees to pay premiums of as much as 102 percent of the plan's average (per participant) cost.

The Retiree Benefits Bankruptcy Protection Act of 1988 prevents an employer from unilaterally canceling or reducing retiree coverages when filing for Chapter 11 protection in bankruptcy.

In 1986, Congress also issued House Joint Resolution 738, requiring any company paying post-retirement medical benefits as of October 2, 1986, which had not had reorganization plans confirmed by a bankruptcy court, as well as companies filing for Chapter 11 reorganization after that date, to continue paying benefits until May 15, 1987. This legislation was later extended through October 14, 1987.

Subsequently, Congress passed, and President Reagan signed into law, the Retiree Benefits Bankruptcy Protection Act of 1988 (P.L. 100-334). This law prevents an employer from unilaterally canceling or reducing retiree coverages when filing for Chapter 11 protection in bankruptcy; it also prevents the plan sponsor or administrator from attempting to collect from individual retirees repayment of plan expenses incurred before the filing. P.L. 100-334 allows retirees to claim creditor status in Chapter 11 bankruptcy proceedings for the value of cancelled or reduced health insurance benefits and to be represented by a court-designated representative or committee. The law requires the plan sponsor to continue retiree benefits pending agreement to modification by the retirees' representative or a decision by the bankruptcy court to modify or terminate benefits.

[9] These are the same economic assumptions that are described in Doran, MacBain, and Reimert (1987).

Benefit modification or termination will be permitted only on a showing by the plan sponsor that such a change is necessary for the sponsor to reorganize. As a formal creditor in bankruptcy proceedings, and in most cases having a large, high-priority claim for continuation of benefits, retirees may increasingly compete with the Pension Benefit Guaranty Corporation (PBGC)[10] as a principal claimant to employer assets.[11]

Various proposals have been drafted to encourage employers to fund retiree health insurance obligations by allowing the use of excess pension assets to fund the benefits or allowing tax-free status for employer contributions to a trust designated for funding retiree health benefits. One such proposal (H.R. 5309), sponsored by Rep. Rod Chandler (R-WA), is likely to be reintroduced, in its current or a similar form, in the 101st Congress.

H.R. 5309 would allow employers with defined benefit or defined contribution pension plans to make tax-deductible contributions toward future retiree health care and long-term care expenses. Unlike current federal law governing employer contributions to a retiree health insurance plan, H.R. 5309 would also make plan investment earnings tax-exempt. In addition, employers would be allowed to transfer excess pension assets (above 125 percent of plan liability) to a separate trust for the purpose of funding retiree health benefits or long-term care benefits. The bill does not separately specify provisions for employers that sponsor both defined benefit and defined contribution pension plans.

H.R. 5309 would allow employers to deduct funding for plans that provide annual retiree health benefits worth $2,500 per retiree and, additionally, long-term care plans that provide average annual benefits worth $2,500. Annual contribution limits would be set at $825 for retiree health benefits and an equal amount for long-term care benefits; both contributions would count against the pension contribution limits now imposed under section 415 of the tax code.

Corporations may ask Congress to provide new tax incentives for retiree health plan funding, removing some of the strict limitations that apply under current law.

H.R. 5309 would also rescind a provision of the Omnibus Budget Reconciliation Act of 1987 that limits employers' tax-deductible contributions to defined benefit pension plans to 150 percent of the plans' current liabilities; however, plan sponsors would be prohibited from recovering excess pension assets when they terminate an overfunded defined benefit pension plan, and employees would be prohibited from taking cash distributions from the plan prior to retirement, unless those distributions are rolled into another qualified pension plan or an individual retirement account. In 1987, Chandler proposed less comprehensive legislation affecting funding for retiree health insurance benefits (H.R. 2860); this bill was referred to the House Ways and Means Committee, which has not acted on it.

Other proposals share various features of Chandler's proposal and/or impose additional restrictions on tax-qualified retiree health insurance plans. In 1987, the Reagan administration proposed that employers be allowed to use excess pension assets to fund retiree health insurance benefits; the proposal was never introduced in Congress. Another proposal, circulated in 1988 by the Senate Special Committee on Aging as a draft bill, would authorize tax-deductible employer contributions to retiree health insurance but limit the value of a qualified plan to $1,200 per retiree per year. Tax-deductible employer contributions would not be

[10]PBGC is a quasi-government agency established under the Employee Retirement Income Security Act (ERISA) of 1974 to ensure payment of basic benefits following termination of underfunded pension plans. It is financed by mandatory premiums paid by all private defined benefit plan sponsors.

[11]In May, 1988, PBGC filed an objection in the U.S. Bankruptcy Court of the District of Colorado relating to the Kaiser Steel Corporation bankruptcy reorganization proceedings (*In re* Kaiser Steel Corporation, et al., May 27, 1988). PBGC protested the way in which the retiree health insurance liabilities (estimated at $400 million) were calculated in the firm's dislcosure statement. Since the employer plan was cancelled before the Chapter 11 filing, whether P.L. 100-334 applied was unclear. PBGC has since settled its claims in this case.

counted against the section 415 limits, but the proposal would apply pension vesting, funding, and participation standards to the retiree health insurance plan. In addition, the proposal would require employers to provide health benefits to spouses of deceased employees, if the employees had been eligible for benefits.

The House Ways and Means Subcommittee on Oversight held a hearing on retiree health benefits on September 15, 1988, but no further action was taken before the adjournment. However, Congress will focus on retiree health insurance next year, after FASB releases its exposure draft defining new accounting rules related to employers' unfunded liability for retiree health insurance benefits.

Conclusion

Retiree health insurance benefits are a common provision of private- and public-employer plans. Most large-firm employees with health insurance benefits have plans that provide for continued coverage after early retirement, two-thirds have plans that continue coverage after retirement at age 65, and more than one-half will receive an employer contribution to coverage. Among state and local government employees with health insurance benefits, about one-half have plans that continue coverage after early or normal retirement with an employer contribution.

Employer plans are a major source of Medicare supplemental insurance among elderly persons, providing coverage for nearly 8 million retirees aged 65 and over. Among all elderly people with private insurance to supplement Medicare benefits, one-half report coverage from a private or public retiree health plan.

To date, congressional activity related to corporate-sponsored retiree health insurance benefits has focused on ensuring that retirees receiving benefits can continue coverage in the event that a plan sponsor initiates bankruptcy reorganization under Chapter 11. The Retiree Benefits Bankruptcy Protection Act of 1988 prohibited unilateral termination of a retiree health plan and allowed retirees creditor status in Chapter 11 bankruptcy. By assisting retirees to compete more effectively with PBGC as major claimants to employer assets in bankruptcy reorganizations, this legislation may increasingly put PBGC in a position of, in effect, insuring retiree health benefit obligations as well as pension benefits.

The forthcoming FASB ruling, which is expected to require employers to report unfunded liability for retiree health insurance in corporate financial statements, would mean that unfunded liability would count directly against corporate earnings, reducing reported profit. At this writing, FASB is expected to require employers to begin entering the unfunded liability associated with retiree benefits on their balance sheets by 1992; by 1997, employers also would have to report a minimum liability equal to the present value of benefits to be paid to both current retirees and workers eligible to retire.

This expected change in accounting practice will bring employers under great pressure to fund retiree health obligations and/or to modify benefits and obligations to reduce their liability. Concurrently, corporations may ask Congress to provide new tax incentives for retiree health plan funding, removing some of the strict limitations that apply under current law. However, in an era of budget neutrality it seems unlikely that such tax incentives will come without a "price": some provision in the same legislation that would make new tax incentives budget-neutral. Retiree health insurance benefits will be a priority issue for the 101st Congress.

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