United States General Accounting Office

GAO Testimony

For Release
on Delivery
Expected at
9:30 a.m. EDT
Friday
July 27, 1990

EMPLOYEE BENEFITS: Trends in Retiree Health Coverage

Statement of
Joseph F. Delfico, Director
Income Security Issues
Human Resources Division

Before the
Subcommittee on Retirement
Income and Employment
Select Committee on Aging
House of Representatives

SUMMARY

Company-sponsored health plans play a major role in providing retirees with access to needed medical services. This health coverage is especially important to retirees under age 65, because most are not eligible for Medicare.

Retiree health coverage has become a major concern for companies because retiree health costs have been--and are expected to continue--rising dramatically. An accounting standard proposal would require companies to report on their financial statements the amount of their future liabilities. GAO supports the proposed requirement as an appropriate method for recognizing and disclosing the costs and liabilities associated with retiree health benefits.

This proposal has forced an increased focus on retiree health benefits. Concerns about increasing costs and the effects of this proposal have raised questions about companies' ability to continue providing these benefits. GAO developed estimates of retiree health coverage, and analyzed changes companies are making to help limit retiree health costs.

Based on our surveys, GAO estimates that only about 4 percent of all companies provide retiree health coverage. Companies with retiree health benefits were generally larger--employing 40 percent of private sector workers.

GAO estimates that about 9 million retirees are currently in company-sponsored plans. About 39 percent of these retirees are under age 65. Two-thirds, or 64 million, of an estimated 96 million private sector workers do not have retiree health coverage. The remaining 32 million workers are in company health plans with provisions for retiree coverage. If company health plan provisions do not change, these are the workers who may expect to receive retiree health benefits in the future.

GAO estimates that since 1984, fewer than 1 percent of companies have terminated retiree health benefits. However, companies are taking measures short of termination to limit retiree health costs. Companies have changed health plan provisions to shift costs to retirees or reduce benefits, and appear to be doing so at an increasing rate. Retirees currently receiving health benefits and active workers who may expect to receive them when they retire have limited protection from such actions under current law.

The security of company-sponsored retiree health benefits is in question. Millions of workers are not covered, and those that are face an uncertain future. GAO believes that if the Congress wants to preserve company-sponsored retiree health benefits, it may have to take explicit action. In considering the various options available, the Congress should assess the trade-offs between enhancing benefit security, reducing the budget deficit, and increasing the regulatory burden on private businesses.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the results of our analyses of company-sponsored retiree health coverage.

Company group health plans play a major role in providing active and retired workers and their dependents with access to needed medical services. Through group health plans, workers and their dependents may obtain hospitalization, physician, and other health services at less cost than they could purchase them individually. Retiree health plans usually cover similar services. This health coverage is especially important to retirees under the age of 65, because most are not eligible for Medicare.

Concerns about significant and increasing retiree health costs, and the effects on business operations of disclosing unfunded liabilities on accounting statements, have raised questions about wnether, and to what extent, companies will continue to provide these benefits. The Congress is faced with deciding whether the federal government should take steps to increase the security of retiree health benefits.

Mr. Chairman, to help in addressing this issue, you asked us to (1) summarize our findings regarding the extent of company-sponsored retiree health benefits, (2) determine the extent to which companies are taking steps to reduce or terminate retiree health coverage, (3) describe the protection under current law for retirees covered by company health plans, (4) comment on the Financial

Accounting Standards Board's (FASB)[1] proposed requirement and how it might change companies' willingness to offer retiree health benefits, and (5) explore possible options for ensuring that company-sponsored retiree health benefits play a greater role for current and future retirees.

EXTENT OF COMPANY-SPONSORED COVERAGE

Companies provide retiree health benefits to workers either directly, through company plans, or indirectly, through multiemployer plans. To determine the extent to which companies are providing retiree health benefits, we surveyed a random sample of 5,550 companies and all the multiemployer health plans we could identify.[2]

Our company survey shows that over one-half of companies provide health coverage to active workers, and 60 million workers are in company health plans. Only about 105,000, or 4 percent of all companies, extend health coverage to retirees. Larger companies are much more likely to provide retiree health benefits--the relatively few companies with retiree health coverage employ 40 percent of private sector workers.

---

[1] An independent authority responsible for setting accounting standards for the private sector.

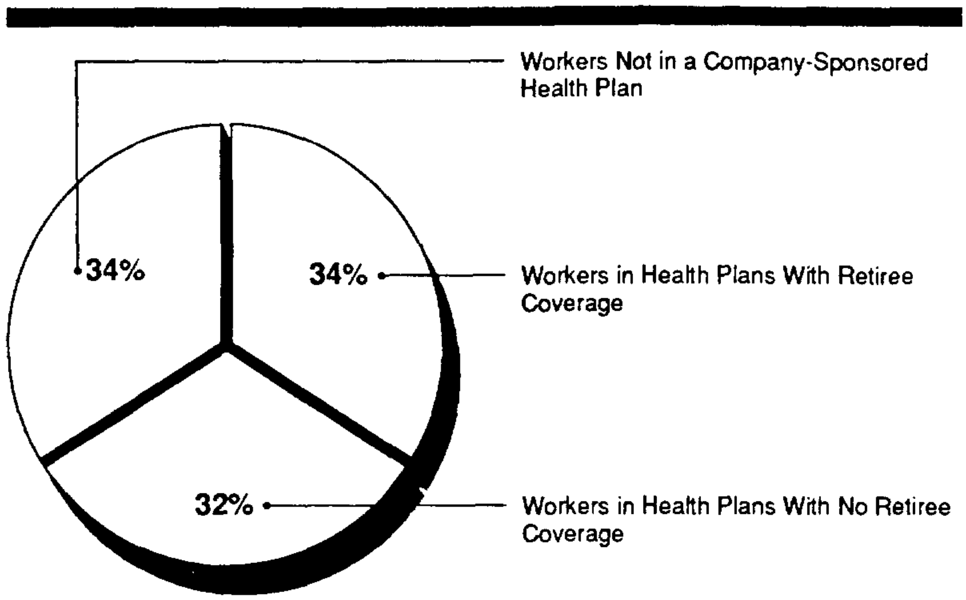
[2] The results of our company survey are reported in Employee Benefits: Extent of Companies' Retiree Health Coverage (GAO/HRD-90-92, March 28, 1990). For more information on multiemployer plans, see our report, Employee Benefits: Extent of Multiemployer Plan Retiree Health Coverage (GAO/HRD-90-132, July 17, 1990).

About Nine Million Retirees Have Benefits; Millions More May Become Eligible

Combining the results of the two surveys, and assuming nonrespondents had provided comparable coverage, we estimate that about 9 million retirees are currently in company-sponsored health plans. This estimate is based on a 62 percent response rate for our company survey. As we noted earlier, retiree health coverage is especially important for retirees under 65 because most are not yet eligible for Medicare. About 39 percent of retirees with company-sponsored health coverage are under age 65.

We estimate that of the approximately 96 million private sector workers, two-thirds, or 64 million, do not have retiree health coverage. They are either in company-sponsored health plans with no retiree coverage, or are not enrolled in a company-sponsored health plan. The remaining 32 million workers are in company health plans with provisions for retiree coverage. If company health plan provisions do not change, these are the workers who may expect to receive retiree health benefits in the future. (See figure 1.)

Figure 1: Workers' Participation in Company-Sponsored Health Plans, by Retiree Coverage



COMPANIES ARE MAKING CHANGES TO LIMIT RETIREE HEALTH COSTS

Since 1984, fewer than 1 percent of companies have terminated a health plan which resulted in retirees losing their coverage, or active workers not being eligible for coverage upon retirement. However, a recent benefit survey[3] and a recent GAO study[4] both found that companies are taking measures short of termination to limit retiree health costs. Companies have changed health plan provisions

---

[3]Foster Higgins, Health Care Benefits Survey 1988, Report of Survey Findings, 1988.

[4]Employee Benefits: Company Actions to Limit Retiree Health Costs (GAO/HRD-89-31BR, February 1, 1989).

to shift costs to retirees or reduce benefits, and appear to be doing so at an increasing rate.

One way companies can limit their health costs is by requiring participants to share in the cost of coverage. Our survey shows that, as of 1987, over one-third of companies with health plans for active workers or retirees required contributions to help pay for the cost of coverage. Many multiemployer health plans also require cost sharing. According to our survey, about 56 percent of multiemployer plans require workers or retirees to share coverage costs. Companies may also limit their costs by requiring participants to pay more of the costs for services received.

Companies appear increasingly to be shifting more of the coverage costs to participants. A 1988 survey of over 1,600 companies by the consulting firm Foster Higgins reported that 21 percent of respondents offering retiree health coverage had increased the level of contributions in the last 2 years or planned to increase it by 1990.

In our February 1989 report we reviewed the changes that a sample of 29 medium and large companies in the Chicago area had made to limit retiree health costs. All 29 companies had changed their health plan provisions during the period 1984-88 to require retirees to pay more of the costs for coverage and services received. When we recontacted these companies in June 1989, we found that 21 of the 29 had made additional changes in the last year. While many of these changes were similar to those made in previous years, a few made even more significant changes to help limit retiree health costs. One company has decided to phase out retiree health coverage altogether; current employees and retirees will not be affected, but new employees will not receive health benefits upon retirement.

CURRENT LAW PROVIDES LIMITED BENEFIT PROTECTION

Retirees currently receiving health benefits and active workers who may expect to receive them when they retire have limited protection from such actions under current law. In particular, the comprehensive protection now provided to pension plans under the Employee Retirement Income Security Act of 1974 (ERISA) are not provided to health plans. These include (1) giving workers and retirees nonforfeitable rights to accrued benefits (vesting) and (2) requiring benefits to be funded in advance to help ensure that money is available to pay them.

Although it has not legislated comprehensive benefit protection standards, the Congress has acted to protect retiree health benefits in specific situations. When LTV, one of the largest companies in the United States, filed for bankruptcy in July 1986, it attempted to terminate health benefits to over 78,000 retirees. The Congress enacted temporary legislation that required LTV to continue to provide health benefits to these retirees. In June 1988, the Congress enacted the Retiree Benefits Bankruptcy Protection Act to replace the temporary legislation. This act prohibits companies that file for chapter 11 bankruptcy from modifying retiree health benefits unless they can prove in court that modification is necessary to avoid liquidation.

Further, the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) requires companies to offer retiring and other terminated employees the opportunity to continue to participate in a company's group health plan for a limited period of time, generally 18 months, at the former employees' expense.

Company actions to modify retiree health plans have been challenged in court. Recent court decisions have generally upheld a company's right to modify its plan if the plan documents contained explicit language reserving the right to make changes. Some courts have ruled that companies have the right to increase retirees' health insurance rates even when their plans do not contain such language.

COMPANIES' RETIREE HEALTH LIABILITIES ARE LARGE

Retiree health coverage has become a major concern for companies because retiree health costs have risen and are expected to continue to increase dramatically in the future. We estimate that the present value of unfunded accrued benefits is large--about $272 billion this year, assuming benefit and cost-sharing provisions do not change.[5] Under these conditions, companies' annual costs will rise in 20 years from over $9 billion in 1990 to about $25 billion by the year 2010.[6] Factors causing retiree health cost increases include increased numbers of people retiring in the future and living longer, increased utilization of medical services, more costly medical technology, and medical cost inflation.

Most companies fund these costs as they come due (pay-as-you-go), rather than set aside funds to help pay for health coverage once workers retire (advance funding). Companies currently recognize only the pay-as-you-go retiree health costs as expenses on their income statements. However, the FASB has announced its intention to require companies to recognize on their financial statements accrued retiree health liabilities for current and future retirees. The FASB has tentatively postponed for a year the effective date of its proposed requirement, with the final standard to be effective for fiscal years beginning after December 15, 1992. The planned FASB accounting standards would require companies to include the present value of accrued retiree health liabilities as a liability on annual financial statements.

---

[5] Employee Benefits: Companies' Retiree Health Liabilities Large, Advance Funding Costly (GAO/HRD-89-51, June 14, 1989).

[6] These cost estimates are reported in 1988 dollars.

We support the proposed FASB disclosure requirements. From a financial reporting perspective, we agree with the desirability of recognizing these costs and liabilities. Although most companies have the flexibility to change their retiree health plans to help limit costs, the existence of such plans implies an agreement between the employer and its employees to provide a future benefit in return for current services. This agreement, therefore, gives rise to a liability for financial reporting purposes for the cost of those future benefits as the service is performed.

Impact of FASB Proposal

The FASB proposal has forced an increased focus on retiree health benefits. Many companies, particularly those with an older work force and many retirees, are concerned that such disclosure will adversely affect their short-run financial position as portrayed in their financial statements. For example, officials at 26 of the 29 Chicago companies whose plans we reviewed expressed uncertainty about their companies' ability to continue providing retiree health benefits in the face of rising costs and the FASB proposal to require companies to disclose future retiree health costs on their financial statements. Officials at 21 companies said they were considering further changes to their retiree health plan structures; at 10 companies officials said they were studying the impact of FASB's proposed regulations before making changes.

The FASB proposal does not require companies to actually set aside funds to pay for future benefits. Funding in advance, as is now done for pensions, would stabilize companies' annual expenditures and make benefits more secure, but would be very costly. If companies had begun advance funding accrued retiree health liabilities in 1988, their first-year funding costs would have been $32 billion--three and a half times their pay-as-you-go costs. Company officials we spoke with in Chicago told us that expanded tax preferences would provide a major incentive for advance funding their benefit payments.

OPTIONS FOR INCREASING RETIREE HEALTH BENEFIT SECURITY

Millions of workers and retirees have or may become eligible for company-sponsored retiree health benefits. However, the security of these benefits is uncertain. Companies are taking actions to limit rising retiree health costs. While few companies have terminated benefits, many are requiring retirees to pay more for their medical care. Current and future retirees have limited protection under current law against company actions to reduce or terminate benefits. FASB's proposal that companies recognize retiree health liabilities on their financial statements has caused some companies to reconsider whether they will continue providing retiree health benefits.

If the Congress wants to preserve retiree health coverage through company plans, it may have to take explicit legislative action. At one end of the range of possible actions, the Congress could require companies with health plans to extend COBRA provisions to cover all retirees under age 65. Retirees would be charged the employers' average cost for retiree health benefits, but would have access to coverage at group rates. The main disadvantage is that some retirees will have to pay more for their health benefits, because companies would no longer be paying as much of the coverage costs.

At the other end of the spectrum, the Congress could impose a complete set of requirements similar to those now applicable to pension plans under ERISA. This would probably require additional tax preferences for advance funding in exchange for requiring companies to meet minimum vesting and funding standards. This option would make health benefits of current and future retirees more secure, but will create tax losses for the federal treasury at a time when reducing the budget deficit is extremely important. This option could also be costly to companies and could cause taxes from corporate profits to fall.

In considering the various options available, the Congress should assess the trade-offs between enhancing benefit security, reducing the budget deficit, and increasing the regulatory burden on private businesses.

- - -

Mr. Chairman, this concludes my statement. I would be happy to answer any questions at this time.