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Moody's: U.S. State and Local Governments Increasingly Rely on Medicare to Lower OPEB Costs.

New York, March 06, 2014 — The availability of federal Medicare coverage for a growing number of state and municipal retirees is helping these governments achieve significant savings on their retiree health care costs by reducing "other post-retirement benefits," or OPEB, liabilities, says Moody's Investors Service in a new report.

"Even small reductions in the cost of health benefits for Medicare-eligible retirees can have considerable positive impact on future costs, because savings compound over retirees' growing lifetimes," says Marcia Van Wagner, a Moody's Vice President and Senior Analyst in the report, "US Municipal Governments Can Leverage Federal Medicare to Lower Costs."

"Governments have already begun to trim OPEB costs and are likely to continue this trend given the growing population of retirees age 65 and over eligible for baseline health coverage offered by the federal program," says Van Wagner.

In addition to demographic shifts, two factors will drive the portion of government retirees who are over 65. First, governments have been raising retirement ages. Second, the portion of those ineligible for Medicare will shrink because participation in Medicare has been mandatory for state and local government employees since 1986.

Initiatives to trim the costs of benefits to Medicare-eligible retirees include cost-shifting, such as requiring increased co-payments or premium contributions for supplemental benefits, as well as initiatives to reduce the growth of health costs more directly.

Moody's says the portion of retirees eligible for Medicare tends to be smaller for local governments than states because more municipal retirees are firemen and policemen, who tend to retire before they become eligible for Medicare at age 65.

"This difference demonstrates that Medicare-based reforms will provide greater long-run cost savings in some jurisdictions than in others," says Van Wagner.

Some governments have significantly reduced OPEB liabilities by requiring employees to pay a greater share of supplemental health insurance costs and reducing prescription drug costs. For example Aaa-rated Maryland reduced its OPEB liability to $9.4 billion from $16.1 billion in 2010 through a 2011 change that requires retirees to enroll in Medicare Part D (prescription drug coverage) starting in 2020, in addition to increased prescription drug copayments, retiree premium payments, and out-of-pocket maximums.

The Affordable Care Act offers governments a way to reduce pharmaceutical costs through its Medicare Part D employer group waiver plan, which provides subsidies and also allows employers to take advantage of manufacturers' discounts. For example, New York State reduced its OPEB liability 9%, in part due to implementing such a plan.

Unfunded OPEB liabilities reported by state governments total more than $530 billion, an amount comparable to their total net tax-supported debt, says Moody’s.

For more information, Moody’s research subscribers can access this report here.

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