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Moody's: Most US State Retiree Health Care Costs Becoming More Affordable.

New York, November 10, 2014 — Many states have largely stabilized their retiree health care expenses through a combination of benefit changes and moderating health insurance costs, but these liabilities remain high for some states — particularly those that fully pay for teacher benefits. Retiree health care, also known as other post-employment benefits (OPEB), for states is fully explored in the new Moody's Investors Service report, "States Controlling Retiree Health Costs, but Teacher Benefits Are Costly for Some."

Thirty-one states have been able to lower or maintain OPEB costs relative to revenue since 2011 by adjusting healthcare benefits and aided by low price inflation. Overall, the majority of states are seeing stable to improving OPEB affordability, with median OPEB costs under 1% of revenues from fiscal years 2011 to 2013. Most states pay for retiree health costs on a pay-as-you-go basis, rather than putting money aside now for the benefits that current employees will receive when they retire.

"Unlike pension benefits, OPEB liabilities are not contractually protected in most states," says Marcia Van Wagner, a Moody's Vice President and Senior Analyst. "This allows government employers to control costs by adjusting health benefits and employee or retiree contribution requirements."

Changes to benefits and other factors also have reduced total state OPEB liabilities, which measures in present value terms all the retiree health benefits that current employees and retirees would receive given plan benefits. OPEB liabilities fell 7.5% from 2011 to 2013. Some states were able to reduce OPEB liabilities by a much greater amount. Ohio, whose costs declined the most, changed eligibility provisions for covering spouses, children, and benefits for Medicare-eligible retirees. Kentucky raised the level of contributions required of active employees toward their retiree health benefits. Some states also changed the vesting periods for eligibility for retiree health insurance.

Provisions in the Affordable Care Act (ACA) have also allowed states to change the way they account for future OPEB liabilities. The ACA has allowed states to shift pharmacy costs to Medicare and raise drug subsidy discount rates, thereby pre-funding a portion of future liabilities.

Furthermore, average insurance premiums and total national health expenditures have moderated along with medical care inflation, allowing states to lower cost trend assumptions in their OPEB valuations.

However, states that fully or partially pay for teacher retiree health benefits continue to have greater OPEB debt burdens. Five states with the highest OPEB liabilities — Connecticut, New Jersey, Illinois, Hawaii, and Delaware — fall into this category. Many of these states also have high debt and pension costs for the same reason.

Containing costs will be more difficult for states with less flexibility to adjust OPEB benefits as the aging state workforce retires. The small number of states whose laws protect OPEB benefits will be most challenged, but states that pre-fund liabilities will face budgetary pressure during periods of low-to-moderate revenue growth.

Moody’s subscribers can access this report here.