


1-1-2016

Accounting and the ACA: New Choices and Challenges for Public Sector Retiree Health Plans

Natalya Shnitser

Boston College Law School, natalya.shnitser@bc.edu

Follow this and additional works at: <http://lawdigitalcommons.bc.edu/lspf>

 Part of the [Health Law and Policy Commons](#), [Insurance Law Commons](#), [Labor and Employment Law Commons](#), and the [State and Local Government Law Commons](#)

Recommended Citation

Natalya Shnitser. "Accounting and the ACA: New Choices and Challenges for Public Sector Retiree Health Plans." *The Employee Rights and Employment Policy Journal* 20, no.1 (2016): 147-171.

This Article is brought to you for free and open access by Digital Commons @ Boston College Law School. It has been accepted for inclusion in Boston College Law School Faculty Papers by an authorized administrator of Digital Commons @ Boston College Law School. For more information, please contact nick.szydowski@bc.edu.

ACCOUNTING AND THE ACA: NEW CHOICES AND
CHALLENGES FOR PUBLIC SECTOR RETIREE HEALTH
PLANS

BY
NATALYA SHNITSER*

I. INTRODUCTION	147
II. PUBLIC SECTOR RETIREE HEALTH BENEFITS BEFORE THE ACA.....	150
III. ACA PROVISIONS FOR RETIREE HEALTH BENEFITS.....	153
IV. THE NEW ACCOUNTING STANDARDS UNDER GASB 75.....	157
V. THE MODIFICATION OF RETIREE HEALTH PLANS POST <i>M & G POLYMERS USA, LLC v. TACKETT</i>	159
VI. ASSESSING PUBLIC EMPLOYER STRATEGIES FOR RETIREE HEALTH PLANS	164
A. <i>Maintaining the Status Quo</i>	164
B. <i>Modifying Plan Terms</i>	165
C. <i>Shifting Early Retirees onto Public Exchanges</i>	166
D. <i>Prefunding</i>	168
VII. CONCLUSION.....	170

I. INTRODUCTION

In October of 2015, the city of Glendale voted to end the provision of subsidized health insurance to its seven hundred retirees.¹ The move saves the California city from having to report a \$240 million liability on its balance sheet, as would have been required for the 2017-18 fiscal year under the new accounting rules recently adopted by the Governmental Accounting Standards Board (GASB).² The city had considered – and rejected – a similar measure in 2009. The “game changer” this time around: the Affordable Care

* David and Pamela Donohue Assistant Professor, Boston College Law School.

1. Arin Mikailian, *Glendale to Change Health Benefit for Retired City Workers*, L.A. TIMES (Oct. 7, 2015, 6:55 PM), <<http://www.latimes.com/socal/glendale-news-press/tn-gnp-glendale-to-end-health-benefit-for-retired-city-workers-20151007-story.html>>.

2. *Id.*; see *infra* Part IV.

Act (ACA or the Act).³

Just as the city of Glendale was negotiating to eliminate retiree health benefits, the state of California reached a collective bargaining agreement with the Professional Engineers in California Government (PECG) in which PECG members and the state would make contributions to prefund retiree health care benefits for the first time.⁴ The agreement on a prefunding strategy signaled an important shift away from the pay-as-you-go financing method that had been the norm for retiree health care benefits for many decades.⁵

Since the 1960s, public sector employers have routinely provided health benefits to retired employees, even as such benefits have gradually disappeared in the private sector.⁶ In 2014, 86 percent of state government employees and 66 percent of local government employees had access to employer-sponsored retiree healthcare prior to turning sixty-five.⁷ Eighty-four percent of state employees and 59 percent of local employees had access to retiree health benefits after turning sixty-five.⁸ Longer life expectancies and growing healthcare costs, however, have made the provision of retiree health and other non-pension benefits such as life and disability insurance (together, “other post-employment benefits” or OPEBs) a costly undertaking for public employers.⁹ As of 2014, estimates of the total unfunded accrued liability of state and local governments for OPEBs exceeded \$1 trillion.¹⁰

Today, the future of such employer-sponsored benefits is more uncertain than ever as state and local governments respond to the implementation of the Affordable Care Act and the adoption of new GASB accounting standards for OPEB liabilities, all in the shadow of

3. Mikailian, *supra* note 1.

4. Kyle Glazier, *California Cites OPEB Progress in Labor Deal*, THE BOND BUYER (Sept. 10, 2015, 12:48 PM ET), <<http://www.bondbuyer.com/news/regionalnews/california-cites-opeb-progress-in-labor-deal-1084272-1.html>>.

5. *See infra* Part II.

6. ROBERT L. CLARK & MELINDA SANDLER MORRILL, RETIREE HEALTH PLANS IN THE PUBLIC SECTOR: IS THERE A FUNDING CRISIS? 5-6 (2010).

7. U.S. BUREAU OF LABOR STATISTICS, DEP'T OF LABOR, NAT'L COMPENSATION SURVEY, TABLE 42, HEALTH-RELATED BENEFITS: ACCESS STATE AND LOCAL GOVERNMENT WORKERS (2014), available at <<http://www.bls.gov/ncs/cbs/benefits/2014/ownership/govt/table42a.pdf>>.

8. *Id.*

9. Although health insurance is the most common OPEB, other benefits in the OPEB category include dental, vision, and prescription benefits, as well as life insurance, disability insurance, long-term care insurance, and other benefits.

10. Byron Lutza & Louise Sheiner, *The Fiscal Stress Arising from State and Local Retiree Health Obligations*, 38 J. HEALTH ECON. 130, 130 (2014).

the evolving case law on retiree health plan amendments. Although the Affordable Care Act does little to address employer-sponsored retiree health benefits directly, it creates a critical alternative to employer-sponsored health benefits. For retirees not yet eligible for Medicare, the ACA, as interpreted by *King v. Burwell*, ensures access to health insurance outside employer-sponsored plans.¹¹ For public employers, in turn, the ACA presents an opportunity to limit or eliminate retiree health benefits without depriving former employees of access to health insurance, a move that some have estimated could save state and local governments up to \$21 billion over ten years.¹²

Expanded access to individual insurance coverage comes at a time when the newly adopted GASB rules aim to bring to light – and to the attention of taxpayers and credit rating agencies – the employer liabilities associated with the promised benefits. Although the accounting rules in no way change the actual cost of the benefits nor impose any funding requirements, they are likely to motivate some public employers to modify or terminate the benefits provided to retirees. Legal constraints on such modifications vary tremendously across states, but recent Supreme Court guidance in *M & G Polymers USA, LLC v. Tackett* may facilitate the amendment of retiree health benefits determined by collective bargaining agreements.¹³

The new GASB rules are also likely to encourage state and local governments – either as an alternative to or in conjunction with benefit changes – to alter the funding of OPEBs. While traditionally OPEBs have been funded on a pay-as-you-go-basis, the GASB rules adopted in 2004 and 2015 provide strong incentives for state and local governments to establish trusts and set aside assets for accrued benefits. Plans with dedicated assets for OPEBs can invest those assets and use the returns to help offset OPEB costs. Under the GASB rules, such plans are permitted to use higher discount rates to calculate the present value of the accrued liabilities and, in turn, of the contributions required to achieve full funding. The response by public plan sponsors has been quite striking. Over the last decade, some thirty-two states have set up OPEB trusts.¹⁴ Although the assets

11. 135 S. Ct. 2480 (2015).

12. Jeremy D. Goldhaber-Fiebert et al., *Will Divestment from Employment-Based Health Insurance Save Employers Money? The Case of State and Local Governments*, 12 J. EMPIRICAL LEGAL STUD. 343 (2015).

13. See 135 S. Ct. 926 (2015); *infra* Part V.

14. SUSSAN S. CORSON, STANDARD & POOR'S RATING SERVICES, DIVERGING TRENDS

in such trusts currently represent a small fraction of the total accrued liabilities, the trend toward prefunding may nevertheless reshape how employers and employees view retiree health commitments and how such commitments are treated under the law.

This article reviews the changes in public sector retiree health benefits since the enactment of the ACA and examines the important choices and competing incentives presently facing public employers. Part II describes retiree health benefits in the public sector prior to the passage of the ACA, with a particular focus on the variation across state-administered plans and the challenges facing such plans. Part III surveys the ACA provisions that directly impact retiree health plans, as well as those that may indirectly reshape the provision of health benefits for public sector retirees. Part IV presents the new accounting rules adopted by GASB in 2015 and analyzes their impact on public sector retiree health plans. Part V describes the evolving legal landscape for plan modification and the ways in which new funding strategies may impact the legal status of retiree health benefits. Part VI assesses the options available to public employers in light of the incentives presented by the ACA, the new GASB rules, and the recent case law developments. It also reviews the trends in public sector benefits to date. Finally, Part VII concludes.

II. PUBLIC SECTOR RETIREE HEALTH BENEFITS BEFORE THE ACA

To attract and retain employees, public sector employers have traditionally offered relatively generous pension and retiree health benefits. The health benefits have included access to employer-sponsored health insurance both for retirees not yet eligible for Medicare (the so-called “early retirees”) and retirees ages sixty-five and older (the so-called “Medicare-eligible” retirees). Although a valuable benefit for both groups, prior to the passage of the ACA, access to employer-sponsored plans was a benefit that saved many early retirees from the “financial disaster” of having to obtain individual insurance coverage.¹⁵ Pre-existing medical conditions and other underwriting criteria had made obtaining quality individual health insurance “forbiddingly expensive, if not completely impossible” for early retirees.¹⁶

UNDERLIE STABLE OVERALL U.S. OPEB LIABILITY 5 (2014).

15. Richard L. Kaplan et al., *Retirees at Risk: The Precarious Promise of Post-Employment Health Benefits*, 9 YALE J. HEALTH POL'Y, L. & ETHICS 287, 291 (2009).

16. *Id.*

The quality and cost of health insurance sponsored by public employers, however, have varied widely across plans. In the absence of overarching federal regulation, heterogeneity in state law and in collective bargaining dynamics has produced hundreds of public sector retiree health plans that differ in the eligibility criteria to qualify for the benefits, the generosity of the plan terms, and the proportion of the premiums covered by the employer.¹⁷ The variation has also extended to the organization and governance of retiree health plans. Among plans administered at the state level, for example, some cover only state employees, while others cover both state and local government employees.¹⁸ Some plans are administered by state retirement systems, while others are administered by departments of administration or similar state agencies.¹⁹ In some cases, entirely new “systems” have been created to manage retiree health benefits.²⁰ Plans that cover the employees of more than one employer vary in the allocation of assets and liabilities: the so-called “agent” plans maintain individual accounts to track each employer’s assets and liabilities (even if assets are pooled for investment

17. CLARK & MORRILL, *supra* note 6, at 26-83; Michael Nadol et al., *Managing Public-Sector Retiree Health-Care Benefits Under the Affordable Care Act*, GOV’T FIN. REV., Apr. 2014, at 11, 11-13.

18. In Alabama, for example, the State Employees’ Health Insurance Plan (SEHIP) covers only state government employees and retirees, while the Public Education Employees’ Health Insurance Fund is a health insurance plan for active and retired employees of state and local educational institutions. In 2007, Constitutional Amendment 798 created irrevocable trusts for both plans. STATE OF ALA., COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2014, at 118-27 (2014) [hereinafter AL 2014 CAFR], available at <<http://comptroller.alabama.gov/pdfs/CAFR/cafr.2014.Alabama.pdf>>.

19. For example, the California Public Employees Retirement System administers the California Employers’ Retiree Benefit Trust Fund for state employees and employees of participating local employers. CAL. PUB. EMPS. RET. SYS., COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR FISCAL YEAR ENDED JUNE 30, 2014, at 45 (2014) [hereinafter CalPERS 2014 CAFR], available at <<https://www.calpers.ca.gov/docs/forms-publications/cafr-2014.pdf>>. In Indiana, the State Personnel Department administers the State Personnel Plan for retired state employees. STATE OF IND., COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR FISCAL YEAR ENDED JUNE 30, 2014, at 112 (2014), available at <http://www.in.gov/audit/or/files/Entire_2014_CAFR.pdf>.

20. For example, the State Employees’ Insurance Board (SEIB) is a state agency established by the Alabama Legislature to administer the State Employees’ Health Insurance Plan (SEHIP). The SEIB members include the five members of the State Personnel Board, the Director of Finance, the Secretary-Treasurer of the Employees’ Retirement System of Alabama, two elected active employees of the state, and two elected retirees covered under the SEHIP. See ALA. STATE EMPS. INS. BD., THE STATE EMPLOYEES’ HEALTH INSURANCE PLAN, FAQs, <<http://www.alscib.org/PDF/SEHIP/FAQ/SEHIPFAQ-AboutSEHIPPlan.pdf>> (last visited Apr. 8, 2016). The state of Rhode Island set up a separate OPEB system in 2010. 36 R.I. GEN. LAWS § 36-12.1-5 (2015) (“An OPEB System is hereby established and placed under the management of the OPEB Board for the purpose of providing and administering OPEB Benefits for Retired Employees of the State of Rhode Island and their dependents.”).

purposes) while “cost-sharing” plans pool the assets and liabilities of all the participating employers.²¹

Despite the differences in design and administration, public sector retiree health plans share certain practices and challenges with respect to plan funding. In stark contrast to pension benefits, retiree health benefits have been – and many still are – funded on a pay-as-you-go basis. Under the pay-as-you-go approach, public employers contribute each year only the amount equal to the benefits distributed or claimed in that year. No money is set aside to prefund the accrued liabilities, even if state statutory and constitutional provisions include nonimpairment provisions for retiree health benefits. The practice reflects the norm in the private sector, where the Employee Retirement Income Security Act of 1974 (ERISA) explicitly provides for the vesting and funding of “pension” but not “welfare” benefits.²² Barring contrary provisions in collective bargaining agreements, private sector employers may eliminate retiree health benefits at any time.²³

In the public sector, the pay-as-you-go model has come under scrutiny since GASB adopted the first set of significant accounting changes in 2004.²⁴ The accounting standards in GASB Statement 45 (GASB 45) extended GASB’s previously adopted standards for pension plans to state and local government OPEB plans. GASB 45 required public employers to disclose, for the first time, the value of the benefits already earned and those expected to be earned by employees in the future, the value of any assets set aside to cover such benefits, and the difference between the two categories.²⁵ It also required public employers to calculate the “annual required

21. For example, the California Employers’ Retiree Benefit Trust Fund is an agent multiple-employer plan with 427 employers. *See* CalPERS 2014 CAFR, *supra* note 19, at 31. Meanwhile the Alabama Retired Education Employees’ Health Care Trust is a multiple employer cost-sharing defined benefit health care plan with 197 participating employers. *See* AL 2014 CAFR, *supra* note 18, at 127.

22. *See* Employee Retirement Income Security Act (ERISA) § 201, 29 U.S.C. § 1051 (2012); ERISA § 301, 29 U.S.C. § 1081; *see also* M & G Polymers USA, LLC v. Tackett, 135 S. Ct. 926, 933 (2015) (“Although ERISA imposes elaborate minimum funding and vesting standards for pension plans . . . it explicitly exempts welfare benefits plans from those rules.”) (internal citations omitted).

23. *Tackett*, 135 S. Ct. at 933 (“Employers or other plan sponsors are generally free under ERISA, for any reason at any time, to adopt, modify, or terminate welfare plans.”).

24. GOVERNMENTAL ACCOUNTING STANDARDS Bd., STATEMENTS OF GOVERNMENTAL ACCOUNTING STANDARDS NO. 45: ACCOUNTING AND FINANCIAL REPORTING BY EMPLOYERS FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS (2004) [hereinafter GASB 45].

25. *Id.* at Summary.

contribution” (ARC) – defined as the amount a public employer would have to contribute annually to cover the cost of benefits accrued in that year and to pay off any accrued unfunded liabilities in no more than thirty years – and to disclose the percentage of the ARC contributed in the reporting year.²⁶ Although as Part V describes, GASB 45 left public employers with tremendous discretion to select actuarial methods and allowed employers in cost-sharing plans to obfuscate individual employer liabilities, the rules nevertheless brought to light the value of unfunded OPEB promises and the growing percentage of state and local government budgets that would have to be spent to cover retiree health benefits.

The disclosure requirements went into effect just as the 2008 financial crisis began to strain the budgets of state and local governments.²⁷ The initial disclosures revealed great disparities in the absolute and relative amounts of unfunded OPEB liabilities across states, with most public employers paying for the benefits of retired workers from current revenue.²⁸ For example, as of 2007-08, unfunded state liabilities ranged from \$71 million for Arizona to \$11 billion for Massachusetts and \$62 billion for California.²⁹ On the whole, the new GASB requirements – along with rising healthcare costs, mounting unfunded pension liabilities, and declining state revenues – began to increase the pressure on public employers to find ways to control OPEB costs. It was at this time that Congress enacted the ACA.

III. ACA PROVISIONS FOR RETIREE HEALTH BENEFITS

The ACA does little to regulate employer-sponsored retiree health benefits directly and even shields retiree-only plans from the Act’s most significant reforms. Nevertheless, by expanding individual access to health insurance, enhancing certain Medicare benefits, and subjecting public sector plans to the Cadillac tax, the ACA dramatically alters the costs and benefits of employer-sponsored retiree healthcare. This Part describes the provisions of the ACA that

26. *Id.*

27. U.S. GOV’T ACCOUNTABILITY OFFICE, STATE AND LOCAL GOVERNMENT RETIREE HEALTH BENEFITS 21 (2009), *available at* <<http://www.gao.gov/new.items/d1061.pdf>> [hereinafter GAO REPORT] (“Unfunded OPEB liabilities on their own are large enough to represent a fiscal pressure for state and local governments but are also likely to be considered part of the broader fiscal challenge of managing increasing health care costs. State and local governments faced increasing fiscal pressures in 2008, in part because of recession-induced revenue shortfalls.”).

28. *Id.* at 9-10.

29. *Id.* at 36-37.

affect retiree health benefits and builds on the insights and evidence from the six years since the law's passage to assess their impact.

The Act's sole provision to address employer-sponsored retiree benefits directly is the Early Retiree Reinsurance Program (ERRP).³⁰ Designed to encourage employers to maintain retiree health benefits for retirees over the age of fifty-five but not yet eligible for Medicare, the ERRP provided a temporary subsidy for private and public employers that offered health benefits to early retirees through 2014, when such retirees could access health insurance through the public exchanges.

For eligible employers, and while the funds lasted, the Department of Health and Human Services offered to reimburse 80 percent of claims costs for health benefits between \$15,000 and \$90,000.³¹ The program proved popular with both public and private employers. Demand for the subsidies quickly outpaced the available \$5 billion in funding and the program ceased accepting applications in May of 2011.³²

Beyond providing a temporary subsidy, the ACA imposes few new requirements on employer-sponsored health plans for retirees. In fact, the ACA leaves in place a critical exemption for retiree-only plans. Pursuant to section 732(a)(1) of ERISA, group health plans with "less than two participants who are current employees" on the first day of a given plan year are exempt from all of the group health plan requirements of ERISA.³³ To the extent that the ACA's substantive requirements have been incorporated by reference into ERISA, retiree-only plans are exempt from the ACA's mandated insurance market reforms.³⁴ Therefore, requirements such as the extension of medical plan eligibility for adult children and the ban on

30. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of 26, 42 U.S.C.).

31. *Id.* § 1102, 124 Stat. at 143 (codified at 42 U.S.C. 18002 (2012)).

32. See U.S. GOV'T ACCOUNTABILITY OFFICE, PATIENT PROTECTION AND AFFORDABLE CARE ACT, ENROLLMENT AND SPENDING IN THE EARLY RETIREE REINSURANCE AND PRE-EXISTING CONDITION INSURANCE PLAN PROGRAMS 9 (2013), available at <<http://www.gao.gov/assets/660/654260.pdf>>.

33. The exception is the standards relating to benefits for mothers and newborns under ERISA section 711, 29 U.S.C. § 1191a(a) (2012).

34. This interpretation was challenged in *King v. Blue Cross Blue Shield of Illinois*, currently on appeal to the Ninth Circuit. In this case, the spouse of a participant in a retiree-only plan challenged a plan amendment that set a \$500,000 lifetime benefit maximum. The district court held that, pursuant to ERISA section 732(a), the ACA's lifetime coverage limit ban did not apply to retiree-only plans. *King v. Blue Cross Blue Shield of Ill.*, 104 F. Supp. 3d 1062 (S.D. Cal. 2015), docketed, Case No. 15-55880 (9th Cir. June 9, 2015).

annual dollar limits for essential health benefits do not apply to private sector retiree-only plans. Agency guidance extends the same treatment to retiree-only plans sponsored by public sector employers.³⁵

Although the ACA allows retiree-only plans to escape much of its substantive bite, the ACA's establishment and regulation of health-insurance exchanges, together with its reforms to Medicare, make employer-sponsored retiree health insurance a less essential benefit.³⁶ Whereas retirees not yet eligible for Medicare once faced extremely limited and prohibitively expensive alternatives to employer-sponsored health insurance, the ACA's creation of public health insurance exchanges in every state, and the corresponding guaranteed availability and renewal rules, prohibitions on exclusions and discrimination on the basis of health status, and controlled rate setting aim to ensure access to health insurance outside the employer context.³⁷ The ACA's provision of premium tax credits to eligible individuals who purchase insurance on an exchange – as upheld by *King v. Burwell* – means that for a subset of early retirees, health insurance obtained through the exchanges may be less costly than the insurance available through employer-sponsored plans.³⁸

For Medicare-eligible retirees, the ACA makes a number of changes to Medicare that impact the value of any supplemental benefits or subsidies offered through employer-sponsored retiree health plans. Most notably, the ACA aims to close Medicare Part D's so-called “donut hole,” which has required Medicare beneficiaries to cover 100 percent of drug costs after reaching a specified threshold

35. Although ERISA section 732(a)(1) does not apply to state and local government plans, in the preamble to the Interim Final Rules, the Departments of Labor, Treasury, and Health and Human Services indicated that they will treat such plans like private sector plans for purposes of the retiree-only exemption. See Interim Final Rules for Group Health Plans and Health Insurance Coverage Relating to Status as a Grandfathered Health Plan Under the Patient Protection and Affordable Care Act, 75 Fed. Reg. 34,538, 34,538-40 (June 17, 2010) (indicating that the Department of Health and Human Services does not intend to use its resources to enforce the requirements of HIPAA or the Affordable Care Act with respect to nonfederal governmental retiree-only plans).

36. Susan E. Cancelosi, *The Bell Is Tolling: Retiree Health Benefits Post-Health Reform*, 19 ELDER L.J. 49, 109-10 (2011).

37. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, §§ 1311(b)-(d), 124 Stat. 119, 173-78 (2010) (codified at 42 U.S.C. §§ 18031(b)-(d) (2012)).

38. 135 S. Ct. 2480 (2015); see also Goldhaber-Fiebert et al., *supra* note 12, at 353 (observing that 33 percent of state and local government retirees had incomes in the 138-400 percent of the Federal Poverty Line range, which would make them eligible for subsidies and/or cost sharing on the health insurance exchanges); Nadol et al., *supra* note 17, at 14 (discussing the report of the Retiree Health Benefits Commission in Chicago, which found that 58 percent of annuitants in the Chicago city plan in 2014 would pay less through the state's exchange).

and before becoming eligible for catastrophic coverage.³⁹ Historically, the gap in prescription drug coverage made employer-sponsored drug coverage relatively more appealing. The ACA also provides that Medicare-eligible retirees will have enhanced coverage of preventive care services under Medicare, although this and other benefit enhancements must be considered alongside the ACA provisions – including changes to Part D premiums and Medicare Advantage plan payments – that may increase the individual costs of Medicare coverage.⁴⁰

For both early and Medicare-eligible retirees, the ACA’s “Cadillac plan” excise tax – which does apply to retiree-only plans – is expected to increase the cost of public sector OPEB plans.⁴¹ The 40 percent excise tax, originally set to go into effect in 2018 but delayed for two years in 2015, is to be imposed on the cost of employer-sponsored coverage that exceeds certain statutory thresholds.⁴² Although the thresholds are slightly higher for employer-sponsored plans that cover retirees, state and local government estimates suggest that the tax is expected to impose significant costs on public sector employers.⁴³ The anticipation of such significant costs united public sector unions with the employer community and health insurance companies in 2015 to lobby for the delay of the Cadillac tax.⁴⁴

In sum, the ACA alters the traditional cost-benefit analysis for public sector OPEB plans. The availability of individual coverage through the exchanges (and the yet-to-be implemented Cadillac tax) creates incentives for public employers to shift early retirees onto the exchanges. While the ACA restricts the ability of employers to

39. Health Care and Education Reconciliation Act, Pub. L. No. 111-152, 124 Stat. 1029, 1036-40 (2010) (amending 42 U.S.C. §§ 1395w-102, 1395w-152 (2012)).

40. Cancelosi, *supra* note 36, at 116.

41. See generally I.R.C. § 4980I(c) (2012) (setting applicable dollar limits).

42. *Id.*

43. The Commonwealth of Massachusetts, for example, estimated that the excise tax results in a 1.37 percent and 3.73 percent increase to the Commonwealth of Massachusetts’s Actuarial Accrued Liability and Normal Cost, respectively. See AON HEWITT, COMMONWEALTH OF MASSACHUSETTS POSTEMPLOYMENT BENEFIT OTHER THAN PENSIONS ACTUARIAL VALUATION FISCAL YEAR ENDING JUNE 30, 2015, at 6 (2015), available at <<http://www.mass.gov/osc/docs/reports-audits/opcb/2015-mass-gasb-45-report.pdf>>. See generally Kate Taylor, *Health Care Law Raises Pressure on Public Unions*, N.Y. TIMES (Aug. 4, 2013), <<http://www.nytimes.com/2013/08/05/nyregion/health-care-law-raises-pressure-on-public-employees-unions.html>> (noting that the Cadillac tax could cost New York City \$22 million in 2018, increasing to \$549 million in 2022).

44. See, e.g., Kristen Ricaurt Knebel, *Two-Year Delay of Cadillac Tax Included in Spending Bill*, BLOOMBERG BNA (Dec. 17, 2015), <<http://www.bna.com/twoyear-delay-cadillac-n57982065306/>> (describing the “Alliance to Fight the 40” that fought to delay the Cadillac tax).

“offload” active employees in this manner, the unique exemption available to retiree-only plans affords state and local governments greater flexibility to respond to the changes wrought by the ACA. In particular, through retiree-only health reimbursement arrangements (HRAs), public employers may cover, in full or in part, the cost of marketplace coverage for pre-Medicare retirees.⁴⁵ Although access to funds through such HRAs would preclude retirees from receiving premium tax credits, employers can permit retirees to choose on a prospective basis whether they would be better off using the HRA funds or maintaining eligibility for the federal tax credits.⁴⁶

IV. THE NEW ACCOUNTING STANDARDS UNDER GASB 75

For public sector employers, the changes brought about by the historic ACA legislation have coincided with important, albeit less well known changes to the accounting rules governing state and local government OPEB plans. A year after the ACA’s public exchanges became operational in 2014, GASB once again sought to bring accounting standards for OPEBs in line with its revised standards for pension benefits.⁴⁷ The changes adopted in 2015 – despite opposition from some public employers⁴⁸ – impose a series of significant new

45. LESLEY LADERMAN & RICHARD STOVER, XEROX CORPORATION AND BUCK CONSULTANTS, *RETIREE HRAS AND THE ACA – DOING IT RIGHT* (2015), <https://hrlaws.services.xerox.com/wp-content/uploads/sites/2/2015/08/hrc_fyi_In-depth-2015-08-24.pdf>.

46. *Id.* In many cases, the value of the premium tax credits may exceed the value of the amounts available through the HRA. Employers, therefore, should provide a retiree with the opportunity to waive HRA coverage for any year in which he or she will be eligible for a premium tax credit.

47. GOVERNMENTAL ACCOUNTING STANDARDS BD., *STATEMENTS OF GOVERNMENTAL ACCOUNTING STANDARDS NO. 75: ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS* (2015) [hereinafter GASB 75]. The changes to pension benefits were adopted in 2012. *See* GOVERNMENTAL ACCOUNTING STANDARDS BD., *STATEMENTS OF GOVERNMENTAL ACCOUNTING STANDARDS NO. 67: FINANCIAL REPORTING FOR PENSION PLANS* (2012); GOVERNMENTAL ACCOUNTING STANDARDS BD., *STATEMENTS OF GOVERNMENTAL ACCOUNTING STANDARDS NO. 68: ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS* (2012).

48. *See generally Online Comment Letters, Project 34-1E, Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*, GOVERNMENTAL ACCOUNTING STANDARDS BD., <http://www.gasb.org/jsp/GASB/CommentLetter_C/GASBCommentLetterPage&cid=1176157116776&project_id=34-1E> (last visited Apr. 11, 2016). The Ohio Public Employees Retirement System, for example, opposed the balance sheet disclosure of OPEB liabilities, claiming that “OPERS’ health care plan is not contractually required or socially obligated and the Board actions to modify the plan demonstrate that lack of obligation.” Letter from Karen Carraher, CPA Exec. Dir., OPERS, to Dir. of Research & Tech. Activities, Governmental Accounting Standards Bd. (Aug. 22, 2014). The International Association of Firefighters disputed the application of pension accounting rules to OPEBs, since the latter “do not receive the same legal protections as pensions, and are frequently subject to modification or even termination.” Letter from Harold A. Schaitberger, Gen. President, Int’l Ass’n of Fire

standardization and disclosure requirements on state and local governments that sponsor OPEB plans. Like the ACA, GASB 75 changes the cost-benefit analysis for OPEB plan sponsors. Although a complete review of GASB 75 is beyond the scope of this article, the following three changes represent the most significant and consequential departures from the status quo.

First and foremost, under GASB 75, state and local governments will be required – for the first time – to include unfunded OPEB liabilities on their balance sheets. Previously, the total unfunded liabilities were disclosed in supplementary materials, while only the annual OPEB cost was included in the balance sheet.⁴⁹ GASB 75 also imposes a uniform actuarial methodology on the calculation of OPEB liabilities. The standardization of methodology is a significant departure from prior GASB guidance and an important step in facilitating the comparison of OPEB liabilities across plans. In the absence of such standardization, plan sponsors have differed dramatically in the actuarial methods and discount rate assumptions used to calculate OPEB liabilities.⁵⁰ Once GASB 75 is in effect, all plan sponsors will be required to use the entry-age cost method to calculate the actuarial present value of projected benefit payments. In addition, plan sponsors will be able to use the long-term expected rate of return on investments as the discount rate only to the extent that the plan’s available assets and expected future contributions are projected to be sufficient to make benefit payments. Beyond that point, the discount rate will have to reflect the yield on a tax-exempt, high-quality municipal bond. Under this approach, the more assets a plan sponsor sets aside for the plan, the higher its permissible discount rate will be. Plans relying solely on pay-as-you-go funding will have to discount liabilities using the relatively low municipal bond rate.

Finally, GASB 75 addresses the obfuscation of liabilities

Fighters, to Dir. of Research & Tech. Activities, Governmental Accounting Standards Bd. (Aug. 26, 2014). St. Mary’s Community Public Library, a small public employer, challenged GASB’s new requirements for cost-sharing plans, suggesting that the liability allocation method under GASB 75 would be misleading, and would also undermine fiscal planning and the employer’s bond rating. The latter effect would “significantly impact [the employer’s] operating expenses.” Letter from Susan Heckler Pittman, Dir., St. Mary’s Cmty. Pub. Library, to Dir. of Research & Tech. Activities, Governmental Accounting Standards Bd. (Aug. 28, 2014).

49. GASB 45, *supra* note 24, at Summary.

50. GAO REPORT, *supra* note 27, at 6-7 (noting that “differences in the actuarial cost methods and assumptions used can result in significant differences in OPEB liability estimates, which can make it challenging to compare estimates across governments”).

previously permitted under the “cost-sharing” arrangements described in Part II. Under GASB 45, employers participating in either single-employer or agent plans have been required to disclose the ratio of assets to liabilities attributable to each employer, but employers in cost-sharing plans have been required only to disclose the aggregate funding levels of the plans. As a result, a significant proportion of public employers – particularly municipalities – have not had to calculate or disclose their unfunded OPEB liabilities. As has been the case with pension obligations for employers in such cost-sharing plans, the new GASB requirements for cost-sharing plans are expected to dramatically increase the reported unfunded liabilities of participating municipalities.⁵¹

Although the GASB 75 standards in no way impose any funding requirements on plan sponsors, nor do they change the underlying reality in any way, the new reporting requirements will make retiree health costs much more prominent, which in turn should subject such costs to closer scrutiny from legislators, credit-ratings agencies, taxpayers, and plan participants. For public employers with relatively high unfunded liabilities, the GASB rules – and specifically the potential downgrades in credit ratings and the corresponding increases in borrowing costs – provide a powerful incentive to reduce the present value of accrued unfunded liabilities.⁵² Public employers can achieve this result by decreasing the benefits provided, prefunding OPEB liabilities, or through a combination of both strategies. Part V below turns to the legal framework for making any such changes to public sector OPEBs.

V. THE MODIFICATION OF RETIREE HEALTH PLANS POST *M & G POLYMERS USA, LLC V. TACKETT*

Public sector retiree health plans vary not just in the eligibility and coverage terms, but also in the legal protection afforded to the benefits. A public employer’s ability to modify benefits for employees

51. ALICIA H. MUNNELL & JEAN-PIERRE AUBRY, CTR. FOR RETIREMENT RESEARCH AT BOSTON COLL., STATE & LOCAL PENSION PLANS NO. 47, GASB 68: HOW WILL STATE UNFUNDED PENSION LIABILITIES AFFECT BIG CITIES (2016), available at <http://crr.bc.edu/wp-content/uploads/2016/01/SLP_47.pdf>.

52. See, e.g., Press Release, Office of the N.Y. State Comptroller, DiNapoli Proposes Option to Help State & Local Governments Pay for Retiree Health Care (Apr. 13, 2015), available at <<http://www.osc.state.ny.us/press/releases/apr15/041315.htm>> (arguing that “New York is behind the eight ball on this issue” and proposing legislation to “establish the legal structure for creating trusts that the state and local governments could use to start saving the funds needed to pay for these [OPEB] benefits”).

or retirees depends on the highly idiosyncratic combination of applicable statutory provisions, collective bargaining terms, and case law in a particular jurisdiction.⁵³ For example, in 2015, an appellate court in California held that after the memorandum of understanding between the city of South Pasadena and its police union expired, the city was entitled to unilaterally reduce its medical insurance contribution for retirees.⁵⁴ Two years prior, however, a California superior court held that a Los Angeles city ordinance freezing the retiree health premium subsidy or requiring current employees to contribute additional amounts constituted an impairment of a vested right.⁵⁵ Such variation reflects the lack of a coherent legal theory of what retiree health benefits are, and how public employer “promises” to provide such benefits should be treated. This Part first reviews the legal framework – patchwork as it may be – for retiree health plan modification. It then assesses the impact of the recent Supreme Court guidance in *M & G Polymers v. Tackett*, a case that some suggest should liberalize the modification of retiree health benefits.⁵⁶ Lastly, this Part also considers how the prefunding of retiree health benefits encouraged by GASB and embraced by some public employers could impact the benefits’ status under the law.

At the heart of the challenge with adjudicating changes to retiree health benefits is the question of whether retiree health benefits have vested for particular groups of participants. In the private sector, the traditional analysis under ERISA classifies retiree health plans as “welfare benefit plans.”⁵⁷ Pursuant to this categorization, such plans are explicitly excluded from the vesting and funding requirements that ERISA imposes on plans that provide “retirement income” to

53. See, e.g., John R. Dorocak & James Estes, *State and Local Government Funding of Health and Retirement Benefits for Employees: Current Problems and Possible Solutions with California Health Benefits as an Example*, 62 SYRACUSE L. REV. 303, 304 (2012); John Sanchez, *The Vesting, Modification, and Financing of Public Retiree Health Benefits in Light of New Accounting Rules*, 41 J. MARSHALL L. REV. 1147, 1149 (2008); Jenna Amato Moran, Comment, *The OPEB Tsunami: Riding the Wave of Public Sector Postemployment Health Benefits*, 58 BUFF. L. REV. 677, 677 (2010).

54. *S. Pasadena Police Officers’ Ass’n v. City of S. Pasadena*, No. B254176, 2015 WL 1094691 (Cal. App. Mar. 9, 2015).

55. *L.A. City Attorney’s Ass’n v. City of L.A.*, No. BS135294 (Super. Ct. Cnty. L.A. Sept. 13, 2013), available at <<http://www.lacaa.org/docs/13-09-13-order-granting-writ.pdf>>.

56. Robert C. Pozen & Ronald J. Gilson, *Debt-Saddled Municipal Budgets Get a Lifeline*, WALL ST. J., Mar. 1, 2015, at A13; Robert Pozen, *Renegotiating Retiree Health Care Plans After New Supreme Court Guidance*, HEALTH AFFAIRS BLOG (May 7, 2015), <<http://healthaffairs.org/blog/2015/05/07/renegotiating-retiree-health-care-plans-after-new-supreme-court-guidance/>>.

57. ERISA § 3(1), 29 U.S.C. § 1002(1) (2012).

retirees.⁵⁸ Absent statutorily mandated vesting requirements, any vesting must be provided by contract, typically through a collective bargaining agreement (CBA). In many cases, however, such CBAs are ambiguous – at times intentionally so – as to the duration of the retiree health benefits set forth in the agreement.⁵⁹

Such ambiguity has generated extensive litigation.⁶⁰ In 2015, the Supreme Court stepped in to resolve a circuit split as to the presumptions used to resolve ambiguous CBA terms. In *M&G Polymers USA, LLC v. Tackett*, the employer had entered into a collective bargaining agreement that promised that union employees who reached a certain age and years of service would receive a full company contribution for healthcare benefits at retirement.⁶¹ Such benefits were to be provided for the duration of the agreement, which was itself subject to renegotiation after three years. After the agreement expired, the employer announced that retirees had to begin contributing toward the cost of their health insurance. The retirees sued, alleging that they had a vested right to lifetime contribution-free healthcare benefits.⁶²

In a unanimous decision, the justices held that “when a contract is silent as to the duration of retiree benefits, a court may not infer that the parties intended those benefits to vest for life.”⁶³ Instead, the Court suggested the ordinary contract law principles would apply, including the principle that contractual obligations generally cease upon the termination of the bargaining agreement.⁶⁴ In a concurrence, Justice Ginsburg noted that clear and express language is not required to show that parties intended health benefits to vest; instead, both explicit and implied terms of an agreement could evidence such intent.⁶⁵ In cases where a contract was found to be ambiguous, the court could consider extrinsic evidence to determine the intentions of

58. ERISA § 3(2), 29 U.S.C. § 1002(2); David A. Pratt, *The Past, Present and Future of Retiree Health Benefits*, 3 J. HEALTH & BIOMED. L. 103, 113 (2007) (suggesting that “a plan that provides health benefits across a worker’s retirement period functions as a type of pension plan, a pension plan that pays in specie rather than in dollars”).

59. Maria O’Brien Hylton, *After Tackett: Incomplete Contracts for Post-Employment Healthcare* (Boston Univ. Sch. of Law Pub. Law & Legal Theory Research Paper Series No. 15-30 Aug. 4, 2015), available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2639607>.

60. *Id.* at 4.

61. 135 S. Ct. 926, 931 (2015).

62. *Id.* at 931-32.

63. *Id.* at 937.

64. *Id.* at 933, 935-36.

65. *Id.* at 937-38 (Ginsburg, J, concurring).

the parties.⁶⁶ The Court's elimination of the presumption in favor of vesting – long-espoused by the Sixth Circuit – favored employers seeking to amend benefits.⁶⁷ Legislative efforts to mandate a presumption in favor of vesting absent clear and convincing language to the contrary were not successful.⁶⁸

The Court's decision in *Tackett* has been called a “lifeline” for public employers struggling with unfunded OPEB obligations.⁶⁹ Under the “lifeline” theory, public employees would now have to show with affirmative evidentiary support that the terms of a collective-bargaining agreement extend the retiree health obligations of state and local governments beyond the duration of a CBA. State courts commonly look to private sector precedent in employee-benefit matters and indeed, in the months since the decision was handed down, *Tackett* already has been cited in several cases concerning public sector benefits.⁷⁰ Nevertheless, the jump from *Tackett* to public sector plans may not be so simple. After all, *Tackett* considers private sector plans subject to ERISA, the National Labor Relations Act, and the Labor Management Relations Act, none of which apply to public sector plans.⁷¹ Furthermore, in the public sector, the terms of collective bargaining agreements must be considered alongside any relevant state and local government law, including constitutional and statutory provisions that protect OPEBs against curtailment⁷² as well as ones that preserve employer flexibility to

66. *Id.* at 938.

67. See, e.g., Gilbert Brosky, *Ding-Dong, Yard-Man Is Dead! Supreme Court Decision in Tackett a Huge Win for Employers in the Retiree Healthcare Arena*, EMP'T CLASS ACTION BLOG (Jan. 28, 2015), <<http://www.employmentclassactionreport.com/benefits/ding-dong-yard-man-is-dead-supreme-court-decision-in-tackett-a-huge-win-for-employers-in-the-retiree-healthcare-arena/>>.

68. Bankruptcy Fairness and Employee Benefits Protection Act, S. 2418, 113th Cong. (2014).

69. Pozen & Gilson, *supra* note 56.

70. *S. Pasadena Police Officers' Ass'n v. City of S. Pasadena*, No. B254176, 2015 WL 1094691 (Cal. App. Mar. 9, 2015) (citing *Tackett* for the proposition that “when a contract is silent as to the duration of retiree benefits, a court may not infer that the parties intended those benefits to vest for life”); *Harper Woods Retirees Ass'n v. City of Harper Woods*, No. 318450, 2015 WL 5737812 (Mich. App. Oct. 1, 2015) (concluding that “that the Supreme Court's reasoning in *Tackett* is consistent with Michigan's contract jurisprudence regarding CBAs, which applies with equal force in both the public and private sectors in this regard”); *Pontiac Police & Fire Retiree Prefunded Group Health & Ins. Tr. Bd. of Trs. v. City of Pontiac*, 873 N.W.2d 783, 791 (Mich. App. 2015) (citing to *Tackett* for the proposition that since the “retirees' rights to healthcare benefits flow from the pertinent CBAs, they are governed by ordinary contract principles”).

71. See 29 U.S.C. § 151(2) (2012) (excluding public employers); 29 U.S.C. § 142 (2012) (adopting the NLRA's definition of employer for the LMRA).

72. Article XII Section 7 of the Alaska Constitution provides that “[m]embership in

modify benefits unilaterally.⁷³

The “lifeline” presented by *Tackett* may also be strained by the prefunding strategies adopted over the last decade by many public sector plan sponsors in response to the GASB standards described in Section III. To prefund OPEB liabilities, state and local governments have set up OPEB trusts to hold assets that may be used only to provide retiree health benefits and cover the relevant administrative costs. The looming question is whether the strategy of prefunding OPEB trusts will alter the legal status of OPEBs.⁷⁴ In particular, will funding terms be read as evidence of the parties’ intent to vest benefits or, alternatively, if a CBA is found to be ambiguous, what role will a prefunding strategy play in the assessment of extrinsic evidence? The state of Michigan, for example, recently sought to alleviate any such uncertainty. In legislation authorizing the issuance of municipal securities “to pay the costs of the unfunded accrued health care liabilit[ies],” Public Act 46 states that “the funding of postemployment health care benefits by a county, city, village, or township as provided in this act shall not constitute a contract to pay the postemployment health care benefits.”⁷⁵ The new law in Michigan is the latest example of state-by-state variation in the legal provisions that apply to the creation, vesting, and modification of OPEBs.

employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired.” ALASKA CONST. art. XII, § 7. In *Duncan v. Retired Public Employees of Alaska*, the Supreme Court of Alaska held that “accrued benefits” included retiree health benefits. 71 P.3d 882, 886-87 (Alaska 2003). Litigation is ongoing in Illinois over recently enacted changes to the state’s obligation to contribute toward the cost of group health coverage for retirees. In 2014, the Supreme Court of Illinois held that health insurance subsidies for state retirees that flowed directly from membership in one of the state’s public pension systems were constitutionally protected by the state’s pension protection clause. Accordingly, the General Assembly was precluded from diminishing or impairing the benefits of retirees whose rights were governed by the version of the Group Insurance Act in effect prior to the 2012 changes. *Kancerva v. Weems*, 13 N.E.3d 1228, 1240 (Ill. 2014).

73. For example, in Massachusetts, state law provides that while changes to healthcare plan design and contribution rates for current employees must be accomplished through the collective bargaining process, municipalities have the authority to change retiree healthcare insurance benefits unilaterally as long as the benefits meet the minimum standards set by the Commonwealth. See MASS. GEN. LAWS ch. 32B, § 9A (2015); *City of Somerville v. Cmmw. Emp’t Relations Bd.*, 24 N.E.3d 552 (Mass. 2015); see also RUTHANNE FULLER ET AL., *CITY OF NEWTON RETIREE BENEFITS: A PRIMER* 6 (2014), available at <<http://www.newtonma.gov/civicax/filebank/documents/58583>>.

74. See, e.g., *Sanchez*, *supra* note 53, at 1180 (noting that “the law is unclear whether the vesting of [post-retirement health benefits] may occur once a state decides on pre-funding as a means of financing [post-retirement health benefits]”).

75. MICH. COMP. LAWS § 141.2518 (2015).

VI. ASSESSING PUBLIC EMPLOYER STRATEGIES FOR RETIREE HEALTH PLANS

The expanded access to health insurance through the public exchanges established by the ACA, together with the looming Cadillac tax and the new disclosure requirements required under GASB 75, alter significantly the conditions that have historically underpinned the provision of retiree health benefits by public sector employers. Most notably, public employers must now evaluate their retiree health benefits in light of the individual coverage that early retirees may obtain through the public exchanges. At the same time, while GASB 75 rewards public employers for prefunding OPEBs, such prefunding strategies may limit the flexibility to modify benefits. This Part reviews the new retiree health landscape, outlines the options currently available to public employers, and assesses the trends in public sector OPEBs to date. The analysis suggests that although public sector OPEB plans are likely to change in the coming years, the ACA and GASB 75 reforms should ultimately leave participants and taxpayers with greater clarity about the security and the cost of post-employment benefits.

A. Maintaining the Status Quo

The aggregate level of unfunded OPEB liability for public employers in the United States masks tremendous variation in liabilities across different plans. Among state-sponsored OPEB plans, the bulk of the unfunded liability belongs to a relatively small number of plan sponsors.⁷⁶ The per capita unfunded OPEB liabilities also range widely: from \$10,726 in Alaska, to \$6075 in Hawaii, \$2037 in South Carolina, \$797 in Florida, and just \$1 in Oklahoma.⁷⁷ Using the various actuarial methods permitted by GASB 45, eight states report a per capita OPEB liability of \$100 or less. While such statistics do not reveal how the OPEB liabilities compare to the annual budgets or revenues of the plan sponsors and do not take into account the particular challenges that OPEBs may pose for municipal and county governments, they nevertheless suggest that a subset of plan sponsors

76. By some estimates, over 75 percent of the total is carried by just ten states. JOSHUA FRANZEL & ALEX BROWN, CTR. FOR STATE & LOCAL GOV'T EXCELLENCE & NAT'L ASS'N OF STATE RETIREMENT ADM'RS, SPOTLIGHT ON RETIREE HEALTH CARE BENEFITS FOR STATE & LOCAL EMPLOYEES IN 2014, at 2 (2014), available at <<http://slge.org/wp-content/uploads/2014/12/OPEB-Spotlight-12.14.pdf>>.

77. CORSON, *supra* note 14, at 10-12.

may not face any immediate pressure to deviate from the status quo.

Yet even public sponsors without immediate pressure to amend OPEB plans should consider the future of such plans in the new regulatory environment. In particular, plans maintained solely for retirees and hence exempted from the ACA's insurance market reforms may increasingly grow out-of-sync with ACA-compliant plans, and with participant expectations about plan terms. Plans that merely offer early retirees the opportunity to participate in group coverage for active employees – the so-called “implicit subsidy” plans – will have to consider whether the rates offered to early retirees by public employers are competitive with the rates available on the public exchanges. If not, the value of such OPEB plans as a recruitment and retention tool will decrease dramatically.

B. Modifying Plan Terms

To the extent that OPEBs typically have not been subject to the vesting requirements commonly applied to pension benefits, they have – and continue to be – subject to frequent amendment at the plan sponsors' discretion. Over the last decade, public sector OPEB plan sponsors have sought various ways to decrease the cost of OPEBs. Accordingly, state governments have increased premiums, deductibles and copayment amounts, expanded eligibility requirements, lowered cost-of-living adjustments (COLAs) and, in some cases, capped the total amount of state expenses for individual retirees.⁷⁸ In 2014 alone, 61 percent of state and local government human resource executives reported having made changes to health benefits over the past year, up from 45 percent in 2011.⁷⁹ At present, commentators continue to call on public sector employers to further reduce and restructure OPEB plans by implementing reforms similar to those described above.⁸⁰ In addition, consulting companies, brokers, and insurers have been promoting so-called “private exchanges” that allow individual employers to offer employees multiple plans with different sets of benefit options.⁸¹ In a 2016 report, for example, the New Jersey Pension and Health Benefit Study

78. *See id.* at 7.

79. FRANZEL & BROWN, *supra* note 76, at 2.

80. *See, e.g.*, Robert Pozen, *Renegotiating Retiree Health Care Plans After New Supreme Court Guidance*, HEALTH AFFAIRS BLOG (May 7, 2015), <<http://healthaffairs.org/blog/2015/05/07/renegotiating-retiree-health-care-plans-after-new-supreme-court-guidance/>>.

81. THE KAISER FAMILY FOUNDATION, EMPLOYER HEALTH BENEFITS 2015 ANNUAL SURVEY 8 (2015) [hereinafter KAISER SURVEY].

Commission recommended providing state retirees with an annual funding allotment to purchase coverage through such a private exchange.⁸² The move would allow the state of New Jersey to reduce and cap its “exceedingly costly” contributions to retiree healthcare by offering a menu of plans that would, on average, result in higher out-of-pocket costs for participants.⁸³

The reduction of retiree health benefits offers immediate costs-savings but also frustrates participant and beneficiary expectations. Over time, the reforms enacted under the ACA may limit public tolerance for repeated changes to health insurance. The ACA’s employer mandate, insurance exchanges, premium tax credits, and insurance standards all aim to ensure continued access to health insurance either through employer-sponsored plans or through plans purchased on the public exchanges. The uncertainty inherent in many OPEB plans today may become increasingly incongruent with the healthcare model espoused by the 2010 health reform. For now, some legislators have attempted to stop the tide of repeated retiree benefit reforms. For example, in January of 2016, New York state senators introduced legislation to impose a uniform standard of protection that would bar the state and local governments in New York from diminishing health insurance benefits provided to retirees below those in place as of the date of the act.⁸⁴ Such legislative efforts reflect the recent pattern of gradual but repeated reductions in OPEB plan benefits. With the ACA and GASB 75, more significant structural changes may be on the horizon.⁸⁵

C. Shifting Early Retirees onto Public Exchanges

As public employers consider the future of their OPEB plans, they must consider what role, if any, the new health insurance exchanges will play in the lives of public sector early retirees. One

82. N.J. PENSION & HEALTH BENEFIT STUDY COMM’N, SUPPLEMENTAL REPORT ON HEALTH BENEFITS (2016), *available at* <<http://www.state.nj.us/treasury/pdl/NJPensionCommission-Supplemental-Report-on-Health-Benefits.pdf>>.

83. *Id.* at 6. The proposal would replace the “platinum-plus” level plans currently provided to retirees with plans that meet the “gold” level standard under the ACA.

84. S. 3320, 2015 Leg., 238th Sess. (N.Y. 2015); *see also* Brian Molongoski, *State Senate Bill Could Burden Municipalities with More Health Care Costs*, WATERTOWN DAILY TIMES (Jan. 31, 2016), <<http://www.watertowndailytimes.com/news03/state-senate-bill-could-burden-municipalities-with-more-health-care-costs-20160131>>.

85. KAISER SURVEY, *supra* note 81, at 186 (reporting that twenty-six percent of employers with 200 or more workers indicated that they are considering changes in the way they offer retiree health benefits because of the new marketplaces).

option is for public employers to maintain the status quo by sponsoring retiree-only plans or permitting early retirees to participate in the group coverage available to active employees. A new option for public sector employers that sponsor retiree-only plans is to take advantage of the ACA exchanges and of the federal tax subsidies upheld by *King v. Burwell*.⁸⁶ Public employers may terminate their benefit programs for early retirees, thereby forcing such retirees onto the public exchanges. This strategy – recently adopted by Detroit and Chicago – could, by some estimates, save state and local governments nearly \$21 billion over ten years.⁸⁷

Under the unique exemption available to retiree-only plans, public employers may also provide subsidies to retirees who obtain individual coverage on the exchanges. While the ACA generally does not permit employers to merely offer their employees stipends to purchase insurance on the public exchanges, employers sponsoring retiree-only plans can establish stand-alone health reimbursement arrangements.⁸⁸ Under this approach, retirees could compare the subsidies provided by former employers to the premium tax subsidies that would be available absent the employer plans and opt out of employer sponsor coverage if such coverage does not offer the best terms. Depending on the subsidies provided, such a move could result in significant cost-savings, while also allowing public employers to limit their liability to a specified annual contribution and to exit the business of plan administration. To the extent that such a move would implicitly embrace the exchanges created by the ACA, however, willingness to consider this option may hinge on the political preferences of the relevant policymakers.

86. 135 S. Ct. 2480, 2491-92, 2494-95 (2015) (ensuring that early retirees will have access to the federal tax credits regardless of whether they purchase coverage on an exchange established by a state or by the federal government).

87. See Goldhaber-Fiebert et al., *supra* note 12 (estimating that “that shifting retirees and their households to health insurance purchased on the exchanges could save SLGs nearly \$21 billion over 10 years Every state would save.”); Fran Spielman, *Emanuel Completes Three-Year Phaseout of Retiree Health Care Subsidy*, CHICAGO SUN TIMES (Sept. 11, 2015, 10:01 PM), <<http://chicago.suntimes.com/politics/emanuel-completes-three-year-phaseout-of-retiree-health-care-subsidy/>>; Alana Smuells, *Cities Are Eliminating the Healthcare Benefits Once Promised to Retirees*, THE ATLANTIC (Oct. 14, 2014), <<http://www.theatlantic.com/business/archive/2014/10/cities-are-eliminating-the-healthcare-benefits-once-promised-to-retirees/381375/>>.

88. See, e.g., I.R.S. Notice 2015-17, 2015-14 I.R.B. 845 (reiterating prior guidance that “employer payment plans are group health plans that will fail to comply with the market reforms that apply to group health plans under the Affordable Care Act”).

D. Prefunding

For any given level of benefits that public employers choose to provide, GASB 75 amplifies the incentives created by GASB 45 to prefund OPEB liabilities. Prefunding has both long-term and short-term consequences for public employers. In the long term, the investment returns decrease the required employer contributions. In the short term, putting in place a prefunding strategy immediately permits OPEB sponsors to use a higher discount rate to calculate the present value of accrued liabilities. A higher discount rate generates a lower liability, which is critical since GASB 75 requires plan sponsors to include the net OPEB liability on the plan sponsors' balance sheets. Recent actuarial calculations prepared for California's state controller illustrate the impact of prefunding on the discount rate and on the liability calculation: With pay-as-you-go funding, the assumed discount rate is 4.25 percent and the 2015 actuarial accrued liability totals \$74.19 billion. Conversely, fully funding the OPEB obligation over a thirty-year period justifies a discount rate of 7.28 percent, and in turn, an actuarial accrued liability of just \$48.50 billion. As the controller has emphasized, prefunding just 10 percent of the total obligation increases up-front costs but ultimately takes \$3.29 billion off of the state's unfunded liability because of investment returns and compound interest.⁸⁹

The impact of prefunding on the liability calculations helps to explain the significant changes in OPEB funding patterns over the last decade. Whereas prior to the passage of GASB 45, pay-as-you-go funding was the norm, today, over half the states have dedicated trusts to prefund OPEB liabilities.⁹⁰ Funding ratios, as well as the percentage of the ARC contributed have increased over time, with state sponsors contributing on average 55 percent of the ARC in 2013.⁹¹ Between 2005 and 2015, numerous plan sponsors took the controversial step of issuing bonds – totaling almost \$1.98 billion in the aggregate – to prefund OPEB liabilities.⁹² OPEB funding – as opposed to just benefits – has also become the subject of collective

89. Press Release, Cal. State Controller's Office, State Controller Yee Updates Unfunded Retiree Health Care Liability (Jan. 26, 2016), available at <http://www.sco.ca.gov/eo_press_rel_16936.html>.

90. CORSON, *supra* note 14, at 5.

91. FRANZEL & BROWN, *supra* note 76, at 4.

92. Lynn Hume, *GFOA: States, Localities Shouldn't Issue OPEB Bonds*, THE BOND BUYER (Jan. 28, 2016), <<http://www.bondbuyer.com/news/washington-budget-finance/gfoa-states-localities-shouldnt-issuc-opcb-bonds-1095144-1.html>>.

bargaining agreements and state legislation.⁹³

While the overall trend toward prefunding is clear, the ability of plan sponsors to achieve their funding goals, and the impact of any funding progress on the legal status of OPEBs is far less certain. To start with the latter issue, prefunding requires plan sponsors to set aside funds in a manner that restricts their use to the payment of OPEBs and immediately deprives the plan sponsor of flexibility with respect to the assets in the trust. The amounts set aside in OPEB trusts secure the claims of OPEB plan participants. But what effect does the gradual or partial funding of OPEB liabilities have on the nature of the legal obligation to provide OPEBs? To what extent does prefunding OPEBs bring the analysis of applicable legal protections closer to the analysis used for public pension benefits? While definitive guidance is lacking – and indeed the answer is unlikely to be uniform across states – provisions and progress for funding OPEBs are consistent with the vesting of such benefits. Accordingly, where either legislation or collective bargaining agreements leave some ambiguity about the status of OPEBs, prefunding of future liabilities may serve as evidence in favor of vesting.

The impact of prefunding is also likely to vary with the success of the funding efforts undertaken by different plan sponsors. While a majority of states have now created OPEB trusts, average funding levels remain low, and certain trusts have received minimal contributions.⁹⁴ Indeed, some have already expressed concern that GASB 75 will merely encourage state and local governments to join the “prefunding club,” using rosy assumptions to generate immediate discount rate benefits, but that it will not be sufficient to ensure that plan sponsors follow through with the annual contributions required

93. Glazier, *supra* note 4. In recent years, some states have enacted statutory provisions for funding the full ARC. *See, e.g.*, 36 R.I. GEN. LAWS ANN. § 36-12.1-19 (West 2015) (requiring the actuary to compute, and the state of Rhode Island to contribute “a yearly employer contribution that will: (1) Pay the actuarial estimate of the normal cost for the next succeeding fiscal year; (2) Amortize the unfunded liability of the system as of June 30, 2006 utilizing a time period not to exceed thirty (30) years”). Others have limited ability of public employers to incur additional unfunded liabilities. *See, e.g.*, ME. STAT. tit. 5, § 286-B (2015) (“Unfunded liabilities may not be created except those resulting from experience losses.”).

94. The average funding level across all states as of fiscal year 2013 was 9.4 percent. CORSON, *supra* note 14, at 10-12. The Louisiana state legislature, for example, approved the creation of an OPEB trust in 2008 but it was not funded as of year-end 2015. STATE OF LA., COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE FISCAL YEAR ENDED JUNE 30, 2015, at 84 (2015).

to reach full funding.⁹⁵ Analysis of funding patterns among U.S. public pension plans suggests that the variation in institutional design – particularly with respect to the allocation of control over funding decisions and the availability of mechanisms to monitor and enforce funding commitments – is likely to be associated with variation in funding discipline among OPEB plans.⁹⁶ Across all OPEB plans, GASB 75’s elimination of the requirement that plan sponsors report annual contributions relative to the ARC benchmark will undermine the ability of participants, taxpayers, and analysts to easily assess and compare funding progress for OPEB liabilities.⁹⁷

VII. CONCLUSION

The ACA and the new GASB accounting standards expand both the challenges and the choices facing state and local governments that sponsor OPEB plans. As public employers look to reduce their unfunded healthcare obligations, the majority of states have begun to prefund OPEBs to take advantage of the immediate accounting benefits and the long-term savings that prefunding offers. At the same time, a small but growing number of plan sponsors have chosen

95. Robert C. Pozen & Joshua D. Rauh, *Relief for Cities’ Budget-Busting Health-Care Costs*, WALL ST. J., July 27, 2015, at A13. Pozen and Rauh express concern about the use of overly optimistic assumptions both with respect to the investment returns and the rate of future employer contributions. They offer the following example to illustrate the incentives under GASB 75: Consider a city that currently reports a \$1 billion liability for its retiree health-care obligations, based on an average life of twenty years for benefit payments and a discount rate of 5 percent. Under the new GASB rules, the city must use the interest rate on high-quality, tax-exempt bonds with a maturity of twenty years, or 3.3 percent today, which brings the reported liability to approximately \$1.35 billion. If, instead, the city contributes \$100 million to a qualifying trust and assumes that the trust’s investments will earn an average annual return of 6 percent, and that each year it will contribute enough to pay the premiums for current retirees so the trust doesn’t run out of money in the future, the city’s unfunded liabilities decrease from \$1.35 billion to as low as \$750 million. *Id.*

96. Indeed, while much of the prior research has focused on state-by-state comparisons of OPEB obligations, funding patterns are likely to depend on the particular features of the more than one hundred individual state-administered OPEB plans, and the hundreds of OPEB plans administered by municipalities and local agencies. *See, e.g.*, STATE BUDGET CRISIS TASK FORCE, FINAL REPORT (2014), available at <http://www.pgpf.org/sites/default/files/state_bud_get_crisis_task_force_finalreport_01142014.pdf>; Amy B. Monahan, *State Fiscal Constitutions and the Law and Politics of Public Pensions*, 2015 U. ILL. L. REV. 117; Natalya Shnitser, *Funding Discipline for U.S. Public Pension Plans: An Empirical Analysis of Institutional Design*, 100 IOWA L. REV. 663 (2015).

97. *See, e.g.*, ALICIA H. MUNNELL ET AL., CTR. FOR RETIREMENT RESEARCH AT BOSTON COLL., STATE AND LOCAL PENSION PLANS NO. 23, HOW WOULD GASB PROPOSALS AFFECT STATE AND LOCAL PENSION REPORTING? 5 (2012), available at <http://crr.bc.edu/wp-content/uploads/2011/11/slp_23.pdf> (noting that in the context of GASB 67 and 68, the elimination of the ARC benchmark “represents a loss in analysts’ ability to assess how close plan contributions are to those required to keep the system on track”).

to cease offering retiree health benefits and to shift pre-Medicare retirees onto the public exchanges newly available under the ACA. Although the coming years will undoubtedly bring significant changes to the form and financing of public sector retiree health benefits, the expanded individual access to health insurance through the exchanges, the federal subsidies upheld by *King v. Burwell*, and the prefunding efforts spurred by GASB 75 should ultimately mitigate the economic and legal uncertainty that plagues many public plans today.

