Health and Income Security for an Aging Workforce

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Health and Income Security for an Aging Workforce is a project of the National Academy of Social Insurance. It examines challenges to the nation's system of health and income security as Baby Boomers pass through the second half of their work lives. The project takes a cross-cutting look at the people, the risks to health and income security they face between mid-career and retirement age, and the programs that protect them.

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Recent Trends in Retiree Health Benefits and the Role of COBRA Coverage

by Paul Fronstin and Virginia Reno

Summary

Employers are cutting back on retiree health benefits and requiring more cost sharing from former employees to pay for these benefits. Yet the proportion of retirees who say they have employment-based coverage has been stable in the 1990s. Because some of the cut-backs in retiree health benefits are applied only to newly hired workers, the impact on retirees may become evident only gradually over the next few decades as boomers retire. To what degree is COBRA coverage, which retirees pay for themselves, becoming a substitute for employer-subsidized retiree health benefits? Questions about the role of COBRA for early retirees and disabled individuals remain — including how they pay for it and what they do for coverage when COBRA ends.

Retiree health benefits were originally offered in the late 1940s and the 1950s, when business was booming and there were few retirees in relation to the number of active workers. The benefits emerged as part of collective bargaining agreements, and employers were willing to provide them because the cost was a small proportion of total compensation.

With the enactment of Medicare in 1965, employers' obligations for retiree health benefits became smaller because employers were able to integrate these benefits with Medicare. Financing the supplemental benefits was of little concern. In more recent years, however, slower growth in the active work force, coupled with increasing life spans, left many employers with higher ratios of retirees to active workers. At the same time, advances in health care technology and rising health care costs caused retiree health liabilities to rise.

Today, retiree health benefits are of two types. *Early retiree benefits* generally provide bridge coverage until workers become eligible for Medicare at age 65, while *Medicare supplemental benefits* for retirees age 65 and older cover some of the costs that are not covered by Medicare. The plans for early retirees cost more on average. In 2000 the average annual cost of retiree health benefits for those under age 65 was $5,537 compared to $2,319 for retirees age 65 and older (William M. Mercer, 2000a).

Employers Are Reducing Retiree Health Benefit Obligations

In December 1990, the Financial Accounting Standards Board (FASB) approved Financial Accounting Statement No. 106 (FAS 106), *Employers' Accounting for Postretirement Benefits Other Than Pensions.* It dramatically changed the way most private companies accounted for their retiree health benefits. It required companies to record unfunded retiree health benefit liabilities on their financial statements in order to comply with generally accepted accounting standards, starting with fiscal years that began after December 15, 1992. This new listing of liabilities far exceeded the costs that had appeared on companies' balance sheets prior to FAS 106. This development made the funding of retiree health benefits unappealing to many companies.

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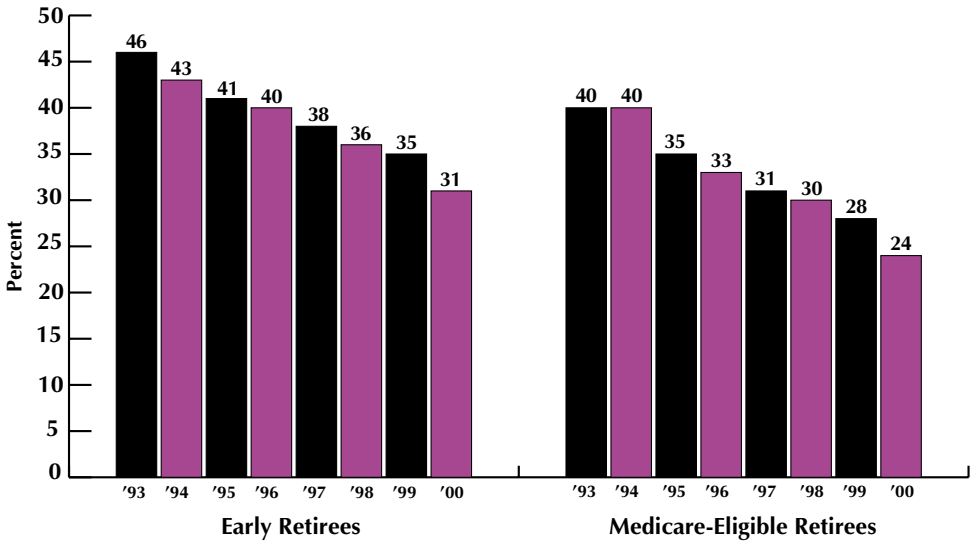
Chart 1
Percent of Employers that Offer Retiree Health Benefits, 1993-2000
(Employers with 500 or more employees)



Source: William E. Mercer, Inc. 2001.

After FAS 106 was adopted, many employers began a major overhaul of their retiree health benefit programs. Some dropped them completely, while others kept their benefits but scaled back their obligations to them. An annual survey of employers with 500 or more workers shows that the percentage offering health benefits to early retirees declined from 46 percent in 1993 to 31 percent in 2000 — a 15 percentage point decline in seven years (Chart 1). A survey of even larger employers — most of whom had 1,000 or more workers — shows that the percentage offering health benefits to early retirees declined from 88 percent in 1991 to 76 percent in 1998 — a 12 percentage point decline over seven years. The coverage rates are higher for the largest employers because they are more likely to offer the benefits. Nonetheless, both studies show a decline of roughly two percentage points a year in the share of large employers offering retiree health benefits.

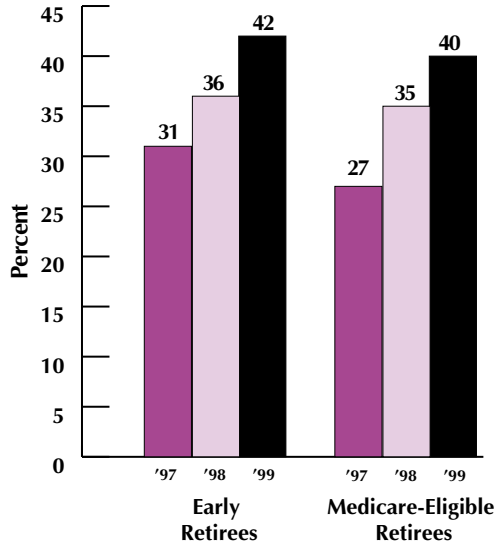
The decline in the proportion of large employers offering retiree health benefits reflects two different developments. One is that some employers are, in fact, dropping the benefits. A second development is a change in the composition of large employers. That is, as newer companies grow to become large employers they include more who never offered retiree health benefits in the first place. The newer companies may not even have been in existence when retiree health benefits were being introduced in the 1950s, 60s and 70s. When a constant sample of large employers is considered, the decline in the proportion offering retiree health benefits is smaller: the percentage offering benefits to early retirees declined seven percentage points from 1991 to 1998 (McArdle, et.al., 1999).

Employers that continue to offer retiree health benefits have made changes in the benefits package to reduce their liability. The most common change is in cost-sharing provisions, with employers asking retirees to pick up a greater share of the cost of coverage. Of large employers (with 500 or more employees) who offered retiree health benefits, the proportion who required early retirees to pay 100 percent of the premium rose from 31 percent in 1997 to 42 percent in 1999 — an 11 percentage point increase over just three years (Chart 2).

Health Coverage Rates of Early Retirees Remains Stable

While a declining percentage of large employers are offering retiree health benefits, it is not yet evident that fewer retirees have health coverage. Among persons age 55-64 who describe themselves as retired,

Chart 2
Percent of Large Employers with Retiree Health Benefits that Require Retirees to Pay the Full Cost of Coverage, 1997-1999
(Employers with 500 or more employees)



Source: William E. Mercer, Inc. 2000.

health insurance coverage rates were quite stable over the past five years, according to the Current Population Survey (CPS) (Chart 3). As Chart 3 also shows, between 1994 and 1999, there were no statistically significant changes in their sources of health insurance:

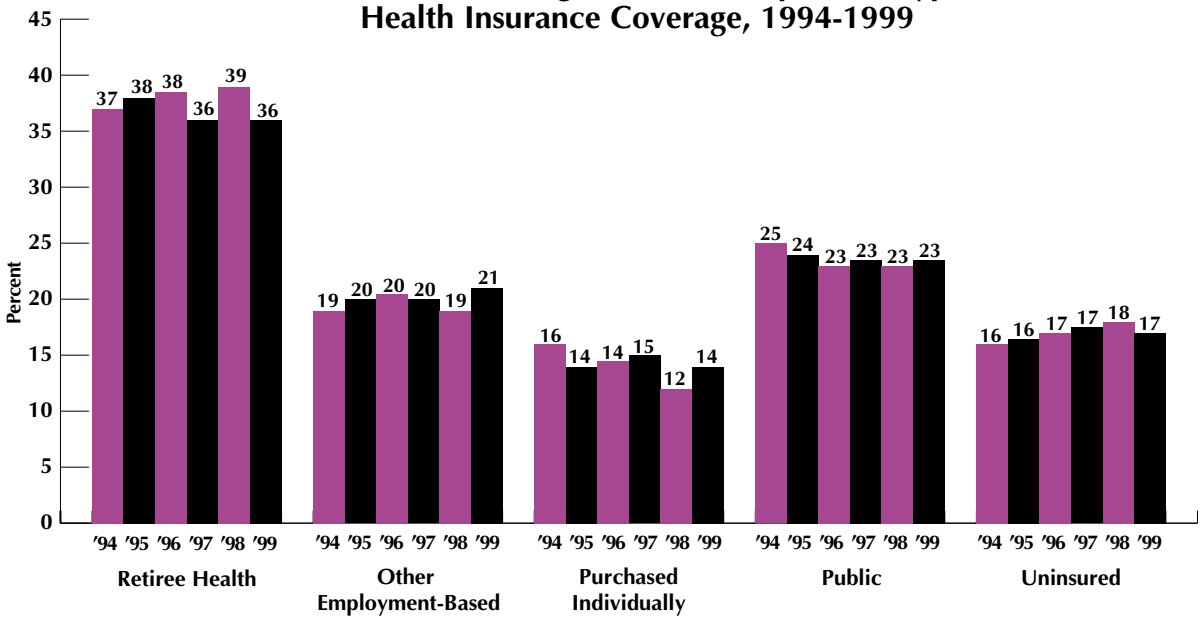
- The proportion with coverage from their own former employer remained between 36 and 39 percent,
- Those reporting other employment-based coverage (typically from a spouse's plan) accounted for between 19 and 21 percent,
- Individually purchased coverage was reported by 12-16 percent,
- Public coverage from Medicare, Medicaid, veterans' benefits or other public programs was reported by 23 to 25 percent, and
- The uninsured were 16-18 percent.

Some persons in the CPS who report their main activity as "ill or disabled" may in fact be retired. Trends in their sources of health coverage are presented in Chart 4. As with retirees, there is no statistically significant change in insurance coverage for ill and disabled 55-64 year olds between 1994 and 1999.

What Might Account for the Different Trends?

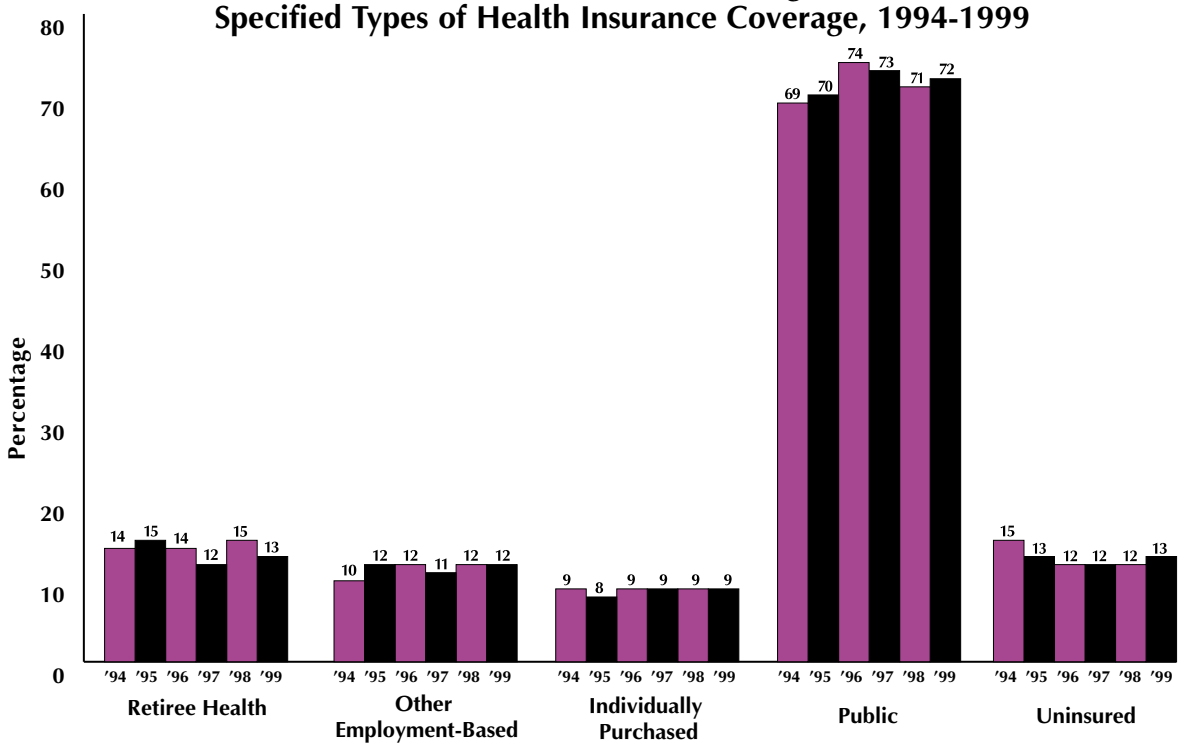
The apparent inconsistency between fewer employers offering retiree health benefits, on the one hand, and fairly stable rates of employment-based coverage among retired or disabled individuals, on the other hand, could reflect several developments.

Chart 3
Percent of Retirees Age 55-64 with Specified Types of Health Insurance Coverage, 1994-1999



Source: Author estimates from the March Current Population Survey, 1995-2000.

Chart 4
Percent of Ill and Disabled Persons Age 55-64 with Specified Types of Health Insurance Coverage, 1994-1999



Source: Author estimates from the March Current Population Survey, 1995-2000

First, recent employer cut-backs may not be reflected in the experience of recent retirees because the new rules were applied only prospectively. For example, if only newly hired workers are subject to cut-backs in employers' health plans, then few recent retirees would be affected. Employers may in fact have limited cut-backs to recent hires because of contractual obligations to provide retiree health benefits to current employees. For instance, a number of employers tried to cut retiree benefits, but, in general, the courts have ruled that while an employer has a right to terminate or amend retiree health benefits, the employer must prove that such a right has been reserved (or stated) in specific language in the plan documents. It may be several more years before cut-backs that affect only new hires would affect large numbers of retirees.

Second, a possible offsetting trend is a slight growth in the share of the work force who are employed by large firms (of more than 1,000 employees), which remain the most likely to offer these benefits. Between 1994 and 1999, the portion of the work force working for these large firms rose from 38.3 percent to 39.6 percent (Fronstin, 2001).

Finally, the sources of health coverage reported by recent retirees could reflect increased use of continuation coverage that employers are required to offer by the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). The CPS does not allow researchers to distinguish between COBRA coverage and retiree health benefits. Thus, it is possible that purchase of COBRA coverage is filling a gap formerly met by retiree health benefits that were subsidized by employers.

COBRA requires employers who offer health insurance plans to allow former employees continued access to group health insurance for up to 18 months after the employee terminates employment. All employers with 20 or more employees are required to offer this continued coverage if they offer a health plan. The COBRA coverage must be identical to that available to the worker while employed. The retiree can be required to pay up to 102 percent of the premium, however (Fronstin, 1998). A recent survey found that average annual premiums for employment-based health coverage for active employees were about $2,400 for individual coverage and about $6,300 for family coverage (Gabel, et.al., 2000).

While COBRA coverage is available to most former employees for only 18 months, individuals who qualify for Social Security disability insurance can extend their COBRA coverage until Medicare becomes available. Medicare coverage for these disabled individuals begins 29 months after they stopped working because of disability. To receive the extended coverage, the disabled individual must have been awarded Social Security disability benefits and must notify the former employer (within 60 days after the Social Security benefit award) that he or she wants to purchase the extended coverage.

COBRA coverage for disabled individuals during months 19-29 costs more to purchase. Disabled individuals can be required to pay up to 150 percent of the premium for months 19 through 29. Based on the average premiums shown above, this extended COBRA coverage would cost about $3,600 a year for individual coverage or $9,450 for family coverage. These premium costs loom large in relation to the typical disabled-worker benefits that Social Security pays. Social Security benefits are meant only to partially replace lost earnings to help meet basic living expenses. At the end of 1999, the average benefit for persons newly awarded disability benefits was $793 a month, or just over $9,500 a year (Social Security Administration, 2000).

In most states disabled individuals who have limited income and asset holdings can get Medicaid coverage before Medicare begins. The Medicaid benefits are jointly financed by state and federal funds. Some state Medicaid program helps disabled individuals purchase COBRA coverage (or extended coverage) from the former employer as a way to reduce Medicaid expenditures during that period.

Questions for Further Research

Further research is needed about the interaction between COBRA continuation coverage and retiree health benefits for early retirees. Questions remain about the extent to which early retirees or disabled individuals use COBRA continuation coverage *versus* retiree health benefits.

Little is known about the extent to which disabled individuals purchase basic COBRA coverage, or the extended coverage, or how they pay for it. To what extent do individuals have help from other public programs to pay for COBRA coverage?

To the extent that early retirees or disabled individuals have to pay a larger share of the full costs of retiree health benefits, these benefits begin to resemble COBRA coverage — with one important exception. While early retiree health benefits usually continue until age 65, COBRA coverage lasts only 18 months (or 29 months for disabled individuals). When retirees rely on COBRA coverage, what do they do for health coverage if COBRA coverage ends before they reach age 65?

Questions about the interaction among retiree health benefits, COBRA and public programs pose important policy and philosophical questions about the respective roles of employers, federal and state programs, and individuals and their families in filling gaps in health coverage for older individuals who have lost their connection to work.

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