Postretirement Benefits Other Than Pension

Postretirement Medical Accrual for Employers
By Jeff Adams   November 24, 2014

Pension and Postretirement Benefits Other Than Pension that are offered by an employer to its current or former employees are required to be accrued on the employer's financial statement. This article has a general discussion of the accrual for Postretirement Benefits Other than Pension and then a more detailed discussion of the health actuarial components of the valuation. Health actuaries are generally involved in setting the Per Capita Benefit Cost and Trend components of the valuation while pension actuaries are responsible for the rest of the valuation, which is actually the majority of the valuation. Adams Actuarial LLC does not perform pension valuations nor does it perform the pension calculations involved in the valuation of Postretirement Benefits Other than Pension. For pension actuarial services please go to Harper Danesh LLC.

Employers must accrue a liability amount for Postretirement Benefits Other than Pension if it offers those benefits to its current or former employees. This accrual is designed to help ensure that that these benefits will be available to current and future retirees when the retirees need it. Unfortunately, however, as a result of this rule and the resulting high cost to employers, many employers have eliminated postretirement medical benefits. Common benefits that might be offered to retirees by employers include medical, vision, dental, and life insurance.

The seriatim method is used to calculate the postretirement liability, that is, the liability is calculated for each individual and then added together. Under GAAP (Generally Accepted Accounting Principles) methodology, the employer must accrue the value of an employee's postretirement benefit during his or her working lifetime. Withdrawal and death decrements may be used in the valuation along with an early retirement table. Employees who withdraw before accruing a postretirement benefit or die would have their liability eliminated. An early retirement table would be used to account for persons who become entitled to postretirement benefits and retire before the Normal Retirement Age. Under Statutory Accounting Principles only current retirees and employees currently eligible to retire have a liability, this liability being the full actuarial present value of their future postretirement benefits.

Gains and losses occur when assumptions change from year to year or when actual results differ from those assumed in the prior year's valuation. Reductions in withdrawal, mortality, or discount rates would result in losses while increases in these components would result in gains. The exception is if a life benefit is being valued, in which case an increased mortality rate would probably cause a loss as it would imply more persons would receive a death benefit. To lessen liability swings from year to year, gains and losses are amortized in both the GAAP and Statutory valuations.

The Per Capita Benefit Costs appearing in a valuation are the benefit costs per retiree for the fiscal year for which the valuation is to be made. In certain situations this cost per retiree may reflect more than one person on the retiree's policy. Trends are used in conjunction with the Per Capita Benefit Costs to determine benefit costs for future years.

For postretirement medical benefits, premium rates for insured plans or equivalency rates for self-insured plans areusually used as Per Capita Benefit Costs. In most cases these Per Capita Benefit Costs are age-graded to reflect the current age of the retiree. In cases where retirees are covered under a fully community-rated plan where employer costs are not affected in current or future years by the ages if its employees or retirees, I believe that the Per Capita Benefit Costs should not be age-graded and may be set up as the actual premiums currently being paid to the insurer (although the new ASOP 6 has incorrectly changed this so that even community-rated plans are age-graded). For example, if Joe Johnson is an age 64 retiree and the employer pays the Family rate of $8,000 per year in a pure community rate to the insurer for coverage then the Per Capita Benefit Cost to value Joe Johnson and his wife should be the $8,000 premium rate for the first year, trended forward using the trend table for subsequent years. Actuaries will, nowever, need to follow ASOP and age-grade Per Capita Benefit Costs even if the plan is Community Rated. The Actuarial Standards Board's rationale for this change is that at any point, the group may change to a lower cost experience-rated benefit plan that is not community-rated. This logic makes no sense as future plan changes are not allowed to be assumed in these postretirement valuations. Hopefully the Actuarial Standards Board will see the light and eliminate this change in the handling of community-rated groups.

Also, if an employer gives its retirees flat dollar amounts with which the retiree may buy medical insurance then age-grading is not used. Dental and vision benefits tend to be valued without age-grading since these costs tend not to substantially by age.

A trend table is used to value benefits such as medical and dental where costs will increase each year. A trend table contains three notable attributes which are the Initial Trend, the Ultimate Trend, and the Scale-Down Period. The Initial trend is just a reasonable estimate as to how much the Per Capita Benefit Costs will increase in the first year. For example, if a 2014 valuation contains a Per Capita Benefit Cost of $4,000 and the expected 2015 cost is $4,400 then the Initial Trend would be 10%.

The Ultimate Trend is the trend that the health care (or other) system will reach in a mature state after the scale-down period. This Ultimate Trend should be within a reasonable range of the estimated Gross Domestic Product ("GDP") growth rate, generally 1.0% to 3.0%. The idea is that health care as a percent of GDP will not increase indefinitely. At what point health care will stop growing as a percent of GDP remains a question and is an increasing issue in the United States. Initial estimates from the early 1990s of that ceiling being 20% to 25% no longer seem realistic as health care as a percent of GDP is currently at 17% and rising. Also, the ultimate trend should be reasonable as compared to the discount rate used in the valuation, generally within 1.5% to 3.0%. For example, if the expected GDP growth rate is 3.0% and the Discount Rate used is 7.0% then an Ultimate Trend of 5.0% is not unreasonable.

The Scale-Down Period is the length of time it takes to get down to the Ultimate Trend. A reasonable Scale-Down Period is generally between 8 and 12 years.

An employer may want to pass changes in assumptions by its auditor to make sure it is auditable before implementing any change.

There may be methods to lessen the postretirement liability for Benefits Other than Pension. These methods may include changes in assumptions, such as adding a withdrawal decrement or reducing the Scale-Down Period. The liability may also be reduced by actual changes in benefits such as substituting a Medicare Risk benefit for a commercial carve-out high premium plan or changing to a fixed contribution model where contributions to retirees for medical coverage increase at an amount strictly determined by the employer and are stipulated in writing.