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A judge's misunderstanding of Medicare

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Judge Sarah Taft-Carter's decision to freeze the City of Providence's plan to move retired police and firefighters into Medicare is counter to the interest of both taxpayers and retired police and firefighters.

At base, Medicare is a financing vehicle for retiree health benefits for those who have paid into Social Security. It is possible for Providence to offer the exact same benefits its retirees currently receive, but have a portion of the cost absorbed by Medicare. This approach would help to make the benefit plans, and the city's financial viability, more sustainable.

Case law suggests that changes to retiree health benefits must be done in a way that is consistent with contractual obligations, or those contracts must be shed in bankruptcy. In the past few months the issue of retiree health benefits has come to the fore in the recent bankruptcies of Central Falls, Eastman Kodak, Hostess Brands and American Airlines. Sadly, without the proper planning and understanding of retiree-benefit issues, this is where Providence's issues may ultimately be resolved.

While the City of Providence would probably not achieve the stated $6 million in immediate savings if the city were to make Medicare the primary payer with an additional supplement plan to match the existing level of benefits, the approach would yield substantial cost savings over time. Importantly, any reduction in the cost of retiree health benefits would serve to reduce the associated other post-employment benefit (OPEB) liability and associated annual costs.

In this regard, Judge Taft-Carter's assessment of the impact of a $6 million reduction in benefit costs is severely flawed. The judge relates the annual savings of $6 million to the aggregate unfunded retiree-health-benefit liability. Just as the city's (OPEB) liability is a multiple of its annual benefit cost, an annual savings of $6 million would reduce Providence's OPEB liability by many times this amount. Depending on actuarial assumptions, the OPEB reduction is generally 12 to 15 times the savings. This implies a $6 million annual savings may translate into a $72 million to $90 million OPEB liability reduction.

Cost trend decreases also have a very substantial impact on a plan's annual required contribution (ARC) and unfunded OPEB liability. Again, depending on actuarial assumptions, a1percent reduction in cost trends may decrease the accrued liability by 12 to 16 percent, the normal cost by 20 percent or more and the ARC by 16 percent or more. Because these costs impact the city's income statement, cash flow and balance sheet, and by extension the city's bond ratings, a reduction in plan costs has a significant positive collateral impact.

Fundamentally, the issue before the judge is a question of equity and economics. The City of Providence may have overreached in its attempt to reduce retiree-health-benefit costs by shifting more costs onto retirees. However, if the city is constrained in its ability to provide those benefits as cost-effectively as possible, it will be forced into increasingly drastic actions over time.

Under a mandate that benefits must be provided by Blue Cross Blue Shield, the city cannot benefit from price competition available in the broader marketplace. If any business is known to have a mandatory sole-source supplier, what incentive is there for that supplier to be price competitive?

By removing this constraint, Providence will be better able to fulfill its promise to retirees as cost-effectively as possible. The inclusion of providers better equipped to offer Medicare supplement plans than Blue Cross Blue Shield of Rhode Island may lead to better alternatives than those outlined in the decision.

While health benefits for active employees require a network of providers, 97 percent of all doctors accept Medicare, according to the Center for Medicare and Medicaid Services (CMS). This built-in network is the same for all carriers offering Medicare supplement plans. This is a critical point because it means that Blue Cross Blue Shield of Rhode Island has no network advantage over other carriers in the Medicare market.

Going forward, Providence should be permitted to have its employees pay into Social Security and mandate that all retirees enroll in Medicare when first eligible to avoid paying late-enrollment penalties. For existing retirees, the city should be allowed to offer comparable benefits to the existing Blue Cross Blue Shield plan by switching to a Medicare supplement plan and paying the associated penalties. For those retirees where the economics do not justify the late penalties, generally the oldest retirees, the city should keep them on the existing plans for life.

A well-structured, competitively bid Medicare supplement plan designed to fulfill Providence's obligation as an employer that can save money, enhance sustainability and reduce the risk of financial distress is clearly in the public interest and also in the interest of public-sector retirees.

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