



Imagining a Different Future

A Consortial Approach to Post-Retirement Health Benefits

Colleges and universities today are in the crosshairs of several challenging economic trends. Budget and planning discussions are often dominated by the effects of precipitous drops in endowment values, escalating financial aid commitments, ever-rising technology costs, and enormous maintenance backlogs for aging physical plants, to name a few of the more obvious issues. Less obvious, but not without significance in terms of budgetary effects, are the implications of changing faculty retirement behavior. Faculty are retiring later than ever, and they report that one of the primary considerations in planning for their retirement is availability of and access to post-retirement health benefits. Linda Evers Cool and Kenneth Cool, co-directors of the Mellon College Retirement Project, assess the effects of the aging of faculty and describe a consortial approach to providing post-retirement health-care benefits that makes good financial sense for both institutions and individuals.

Demographic Trends

In the 1960s and early 1970s, colleges and universities scrambled to hire additional faculty to teach the baby boom generation. As a result, these institutions now have a population of full-time faculty that is aging at a rate higher than that experienced by the U.S. labor force. Clark and Hammond have noted that during the past decade, in the wake of earlier expansions, the proportion of professors under the age of 45 declined from 41 to 34 percent. In effect, colleges and univer-

sities may be the first wave of employers to confront the need for long-range retirement planning that will, sooner or later, engage the nation as a whole.

Two additional factors skewing the age of the professoriate upward are the fact that faculty begin their careers later than the average American worker due to the need to attain credentials (i.e., graduate degrees and relevant post-doctoral experience) and the tenure system, which leads to very high workforce stability after the initial six to eight years of employment. Indeed, less than 15 percent of the entire

U.S. labor force is 55 years old and over, whereas that age group comprises over 30 percent of the higher education work force.

Regulatory Effects on Institutions

Federal legislation has also entered the demographic equation. In 1994, an amendment to the Age Discrimination in Employment Act (ADEA) revoked the mandatory retirement age of 70 for tenured faculty. Prior to the enactment of that legislation, predictions as to its effect ranged from no change in faculty retirement behavior to catastrophic perturbations in the academic labor market because tenured faculty might never retire. Thus far, most institutions have not encountered significant numbers of senior faculty members who elect “employment until death.” Instead, for the most part, the World War II generation has retired upon eligibility for Medicare and Social Security: age 65 has remained their benchmark.

Subsequent faculty cohorts, however, may be adapting to the changed regulatory environment and other financial market factors. Our recent study involving faculty from over 110 colleges suggests that age 65 is a much weaker milepost than it used to be for individuals planning their retirement in the near future. Age 70 may be starting to take its place as the normative benchmark.

Another change in federal legislation affecting faculty retirement decisions is that since 2000, individuals eligible to receive Social Security pension payments have been able to continue working full-time with no earnings penalties. This new regulation will almost undoubtedly serve as a perverse incentive for retirement. Indeed, it was well known among the faculty we interviewed, who were making plans to continue working at least one or two years beyond Social Security eligibility to cash in on what they perceived as an unexpected “windfall.”

The budgetary implications for institutions retaining large numbers of senior faculty—who before 1994 would have had to retire but instead are now working and living longer—are significant. At a typical liberal arts college, the cost in salary and benefits for a post-65 senior faculty mem-

ber is over \$55,000 more each year than for a junior faculty replacement. The effects of senior faculty members’ higher salaries are widely recognized. Not so obvious are their higher health-care costs. Again, changes in federal legislation have had important effects. TEFRA regulations adopted in 1982 require that employers meet the full cost of employees’ health care even though they may be eligible based on chronological age (i.e., 65 or older) for Medicare. Federal policy makes the employer the responsible primary payer for contributing health-care coverage until post-65 employees actually retire. Thus, not only does the institution forego the approximately 60 percent of health costs otherwise picked

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up by Medicare, but it also continues to absorb the higher claims costs of older, less-healthy employees, which are passed along in the rising health insurance premiums charged to the institution for its entire work force.

Perhaps the greatest effect on institutional budgetary planning stems from the Financial Accounting Standards Board (FASB) ruling in 1990 that outlined accounting practices for post-retirement health care. The controversial statement, known as FAS 106, in essence ruled that post-retirement medical insurance is a form of deferred compensation that employers must recognize on their books. This meant, in effect, that a significant portion of an organization’s assets would have to be set aside year by year—notionally or in cash—to meet future obligations for retirees’ health-care expenses. While aimed largely at the for-profit sector to help ensure that future obligations to employees’ retirement benefits are met, FAS 106 sent shock waves across college campuses and magnified the era’s preoccupation with close fiscal examination of all growing cost centers. FAS 106 became one more reason to cap or reduce

costly and uncontrollable benefit outlays and thereby shift more of the burden to employees' checkbooks.

Since FAS 106 was issued, the number of for-profit employers and colleges and universities offering post-retirement health benefits has declined. Of 110 liberal arts colleges we surveyed in 2001, 33 percent offered no subsidization, no access to a group plan, and little information about Medicare and supplemental health-care planning before retirement. The other two-thirds still offering some level of benefit face serious financial challenges in meeting their current and near-term commitments and have taken significant measures to cap, reduce, or eliminate the benefit for future generations of employees.

The Decision to Retire

Given the demographics of a bulging generation of older faculty and the regulations promulgated from outside higher education, institutions and individuals alike will need to generate rational, long-term strategies for faculty development in which integrated approaches to retirement planning figure prominently.

In an analytical review of over 50 research papers published since 1990 on the subject of health insurance in the national workplace, Jonathon Gruber and Brigitte Madrian offer what may be the most important point to consider when thinking about post-retirement health benefits:

The question on which there is probably the greatest consensus is that health insurance is a key determinant of the decision to retire. This is perhaps not surprising given the high and variable level of medical costs for those near the age of Medicare eligibility. The studies reviewed suggest that the availability of retiree health insurance raises the odds of retirement by 30 to 80 percent. This consistent conclusion emerges from very different approaches using very different data sets.

The Mellon College Retirement Health Plan

At a time when the normative practices of retirement are shifting, we believe that an innovative approach to post-retirement health insurance may be an attractive retire-

ment incentive. With the support of The Andrew W. Mellon Foundation, we formed an interdisciplinary study group comprised of highly regarded college administrators and national experts on health insurance issues to investigate new approaches to providing supplemental health insurance for retired faculty and staff of national liberal arts colleges.

By size and geography, liberal arts colleges typically find themselves at a competitive disadvantage in the health insurance marketplace. Many small colleges reported during our investigations that they felt lucky to find any interested health insurance carrier and had to accept whatever terms the market brought to their doorstep. It therefore seemed appropriate to aggregate these smaller groups into one large alliance that could bargain more effectively for insurance rates by spreading the risk among a far larger pool of individuals and by lowering administrative costs.

Our principal objective was to determine how we might build upon the defined benefit of Medicare by embracing a new kind of defined contribution approach to the supplemental insurance product. We asked how we might improve upon the so-called Medigap plans now offered in the private, individual insurance market. Three design features that address drawbacks in current Medicare coverage figured centrally in our thinking: How can we provide affordable prescription drug coverage? How can we offer a catastrophic coverage dimension extending Medicare-covered services? And how can we design a portability dimension to health care for an increasingly mobile retiree population?

Equally important, we investigated affordable funding strategies, particularly approaches that might confer greater tax advantages than existing 403(b) retirement plans. In the wake of FAS 106, we proposed to substitute a prefunding mechanism in the form of a predictable defined *contribution* approach rather than the traditional defined *benefit* plans over which institutions increasingly have little fiscal control. In essence, prefunding means that employers and employees can contribute in today's dollars toward meeting retirees' future health-care needs. Setting aside dollars now, during the working years, offers several important advantages. It allows colleges to plan rationally

in the current operating budget for a benefit that may not be exercised by the employee for another 20 or 30 years. It allows the contributors, both employers and employees, to benefit from long-term earnings growth on the accumulating assets. The prefunding approach also confers significant tax-advantaged treatment of contributions, earnings, and distributions made through a VEBA trust.

The Mellon Steering Committee, working closely with its consultants, designed three different health plan options that wrap around the basic provisions of Medicare

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and meet the funding criteria outlined above. Two of the plans provide Major Medical coverage, one with a high and one with a low deductible. The third plan provides just prescription drug coverage.

Based on our consultants' massive database built from their work in the health-care financing and actuarial fields, the costs of each plan were calculated and compared to current costs for similar post-retirement benefits at a typical liberal arts college. Each of the proposed plans meets the critical test of institutional affordability: A small college today could meet the benefit obligation of the most generous of the plans—Major Medical with a low deductible—on a go-forward, defined-contribution basis for typically less than 1 percent of annual payroll over a 40-year period.

Conclusion

We are convinced that consortial pooling of post-retirement health care may satisfy multiple objectives—giving older employees an attractive retirement incentive while providing that benefit in a more predictable and affordable fashion for institutions. Ultimately, this initiative, like TIAA-CREF's success in the pension arena, should have far-reaching consequences for protecting the medical security of retiring college employees in their older years, for ensuring them reasonable financial access to and choice among post-retirement medical insurance plans, and for encouraging those employees to retire in a timely and appropriate fashion in the absence of mandatory age restrictions.

The key outstanding question is how many institutions will come together and embrace this kind of innovation in a rapidly aging labor market. We envision starting the consortium with liberal arts colleges and eventually expanding it to include other larger, private institutions. Additional potential participants include nonprofit foundations, museums, and research institutes. Our goal is to launch the initial post-retirement health benefits consortium by July 2004.

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