MINUTES

MONTANA HOUSE OF REPRESENTATIVES
51st LEGISLATURE - REGULAR SESSION

SELECT COMMITTEE ON EMPLOYEE COMPENSATION

Call to Order: By Chairman Addy, on March 7, 1989, at 4:53 p.m.

ROLL CALL

Members Present: All members were present.

Members Excused: None.

Members Absent: None.

Staff Present: Judy Waldron, LFA
Lois Menzies, Legislative Council
Mary Liedle, secretary

Announcements/Discussion: Rep. Addy announced that Rep. Menahan's pay bill is being signed but he provided the committee with copies of pages 2 through 25. Rep. Addy then announced the committee would open the hearing on HB 543.

HEARING ON HOUSE BILL 543

Presentation and Opening Statement by Sponsor: Rep. Mary Ellen Connelly opened by saying that HB 543 is to assist retired Highway Patrol officers or their surviving spouses or dependents in meeting their health care costs. Currently state law permits all state employees and their spouses and dependents to remain members of employee group benefits plan after retirement, however, they have to pay the entire share themselves. This bill would allow them to pay part of it and have the state pay part of it. Funding would be provided by adding .50 to driver's licenses. The reason for this bill is because of the low pensions these officers receive because they were not allowed by federal law to be on social security. They do not get social security. Since 1984 new retirees are allowed to be on medicare but before that time it was not allowed. These people only have a small pension and most of them did not have high enough salaries to have put any money aside. Because they do not have social security and they did have such a stressful job, we should try to help them in any small way we can.

Testifying Proponents and Who They Represent:

Al Rierson, retired sergeant from Kalispell
Gene Miller, retired captain from Great Falls

Proponent Testimony: (4A 4.28) Al Rierson, a retired sergeant from Kalispell spoke in favor of the bill. He provided the committee with a breakdown of monthly income and expenses for an officer who retired several years ago. (See exhibit 1) As you look at pensions and health care throughout the nation, it's something that the states and the nation are addressing. There is a great deal of concern. School teachers are retiring from the various school districts with their health insurance paid in their retirement. When I had ten years on the patrol, I was concerned about the pension plan and its economic status so I had an actuarial study done. That was in 1959. At that time the people who did the actuarial study for me said that when I retired with 25 years of service (at the end of 1973) they said I should go off with $1000 per month pension and an actual cost of living in order to retain the same standard of living as when going off the patrol. That was a grave concern to me. I said to the captain and sergeant that I almost quit at that time because I could see the picture on the patrol pension plan was not a good one. I didn't think it was a good economic plan. The captain and the sergeant twisted my arm and said we'd try and correct these problems as we went along. Sad as it may be, they were not corrected. I went off the end of 1973 with $483 per month. In 1988 my pension was $604. With expenditures just to keep a household intact, there's only $121 left. That $121 has a buying power of about $60. Many of our older officers are in a sad situation as far as finances are concerned. As I see the legislative process move on here, and see the passing of the bill of the noxious weeds went right through and is moving right on through the process of the legislative assembly, I would hope that this body here reviewing our needs would give us at least as much consideration as noxious weeds. We are confronted with a lot of obnoxious problems out there. I can assure you the officers today are up against more problems today than we were. At the national level there have been over 30,000 officers killed besides hundreds of thousands injured. I hope you will give a favorable recommendation from this committee. From a humanitarian standpoint I cannot plead with you too strongly to give as much recognition to the older officers and widows as you do to noxious weeds.

(4A 10.44) Gene Miller, a retired captain from Great Falls, spoke in favor of HB 543. He said that some of the officers fell through the cracks. Some of the older officers were not eligible to come under the state pay plan and at this time if you didn't belong to the state health plan when you retired, you couldn't get back in. I do not recall ever being told that if I didn't belong when I retired I could never get back in the system again. The second part of this bill would allow some of these officers to get on the plan. These retired older officers are proud people and they would like to stay in their own homes and not have to sell their homes to pay for health bills.

Testifying Opponents and Who They Represent:

Dave Ashley, Department of Administration

Opponent Testimony: (4A 16.27) Dave Ashley, representing the Department of Administration, spoke in opposition to HB 543. Mr. Ashley said the department does not disagree with the retirees perspective. The pensions in Montana state retirement systems have generally not kept pace with inflation during the 80's. In particular, medical costs have been running about three times the annual increase in the consumer price index. However, we need to oppose HB 543 for three reasons. 1) HB 543 is a piecemeal approach to the question of retirees health care. 2) It is a costly bill. 3) The bill is a poor precedent. Mr. Ashley provided the committee with graphs representing the increase in costs compared to the amount of revenue the bill would bring in and an article discussing health costs for elderly Americans. (See exhibit 2) Once a retirement benefit is granted, it cannot be easily taken away. This bill sets a bad precedent. Once a benefit like this is granted to one group, other groups will be before the legislature asking for similar benefits. We've heard several times that the reason this bill is before you is because the Highway Patrolmen do not have social security coverage. This is true, but the committee should have an understanding of the background of this issue. Originally, the Highway Patrol officers were not allowed in the social security system. Then, on March 1, 1974, Mike Mansfield successfully amended the Social Security Act and since that time these individuals have had the right to elect coverage and they have chosen not to do that. Secondly, this system is designed with this exception in mind. The employer contribution to the Highway Patrol retirement system is 26.75% of salary. That compares, for example, with PERS which is 6.417% of salary. This rate results in a benefit of half pay in 25 years for highway patrolmen, whereas in PERS the half pay is available only after 30 years of service. In addition, survivor, disability and death benefits are also higher in the highway patrol system. The average highway patrol officer retires at age 50 with about 15 years before they reach age 65. During this period, most of these individuals return to work in a social security covered job and are eligible for both social security and medicare benefits at age 65. In addition, all highway patrol officers since April 1, 1986 do have medicare coverage.

Questions From Committee Members: (4A 29.58) Rep. Spaeth: I gather the purpose of the bill is to take care of those people who were unable to get on social security. How many people would be affected if we limited the bill to only those who retired before 1977?

Rep. Connelly said she has some amendments that would do that.

(4A 34.40) Rep. Spaeth: What would you amendments do?

Rep. Connelly provided the committee with handouts of the amendments. (See exhibits 3 and 4) One set is clean up amendments for people who are working at other jobs. The other set of amendments would cut off the benefit in 1986 when they could have come on medicare. They don't need to be included in the bill since they can have medicare.

(4A 36.34) Rep. Spaeth: When they had the opportunity to vote to go on social security, why didn't they?

Al Rierson said it was approached through the office as to whether they wanted to budget for the amount of match money. It was a negative signal from the administration. They didn't want to put it in the budget because it would add a considerable amount to the budget.

(4A 41.08) Rep. Swysgood: The concern I have with this bill is the precedent it would set. We'll have a number of others on different retirement systems saying they are facing the same problems. Do you think others would want similar benefits?

Dave Ashley said yes. Even if the bill was limited to 1986, there would be problems with other individuals and systems asking for benefits.

<u>Closing by Sponsor:</u> Rep. Connelly said that these people are not under social security and they have very small pensions. They have given a big part of their lives serving us. If they would have gone on social security before it would have cost the state a large amount of money.

HEARING ON HOUSE BILL 353

<u>Presentation and Opening Statement by Sponsor:</u> Rep. Cobb opened the hearing on HB 353 by briefly explaining the purpose of this bill to study the current system of pay and job classification. There are obviously some problems with the system and this bill would allow for pinpointing the problems and offering suggestions for improvement or change if that is needed.

<u>Testifying Proponents and Who They Represent:</u>

Tom Schneider, Montana Public Employees Association
Terri Minnow, Montana Federation of Teachers and Montana Federation of State Employees
Laurie Ekanger, Department of Administration

Nadine Jensen, AFCSME
Sue Romney, Montana University System

Proponent Testimony: (4B .10) Tom Schneider said that with what is happening with pay, it's obvious that we have some serious problems in how pay is being delivered in this state. We need this study. We need to study institutional pay matrices versus where we're at now. We need to study a step program. We need to study compression, whether it's dollars or percentages. This seems to be the way to do it. We need to have those organizations who could demand to negotiate be involved in this committee so it will work in the end.

(4B 1.34) Terri Minnow said the current system is a disaster for most people. There are problems with retention, problems with accurate compensation and problems with classification just to name a few of the problems. This is a step to try to do something positive for state employees in the future.

(4B 2.16) Laurie Ekanger told the committee there is a great deal of dissatisfaction with the current system. The system was designed in 1974 and hasn't been looked at since. It doesn't meet the needs of the managers nor does it meet the expectations of the employees. There are 13 steps in the system. These are almost an eyesore as they have not been available for three of the last four years. This would demonstrate some pro action to a system that has just been allowed to languish. That would be healthy. The administration does not support a separate appropriation for this bill but they wouldn't oppose having it be absorbed into the pay bill. There was a study commission that was set up on collective bargaining issues by Governor Schwinden in 1981 and that was how that was funded. It is such a small amount that it doesn't have that big an impact, so that's the administration's approach to funding the bill.

(4B 3.47) Nadine Jensen spoke in support of a study on employee compensation and classification.

(4B 4.08) Sue Romney told the committee the Montana University System also supports this bill.

Testifying Opponents and Who They Represent:

None.

Questions From Committee Members: (4B 4.33) Rep. Quilici: I see here in section 4 that the committee shall meet on call of the chairman or at the request of five members of the committee. Why is that particular language in there?

Rep. Cobb said it is because there are nine members and five would be a majority and if the majority wanted to meet they could call a meeting even if the chairman didn't want to meet.

(4B 5.49) Rep. Swysgood: John, how did you arrive at the $90,000 figure for the study?

Rep. Cobb said he would refer the question to Laurie Ekanger as she had a breakdown of costs. Laurie Ekanger said the administration looked at what it the cost for funding the Select Committee on Employee Relations and looked at the kind of research that was done. It is basically based on the study that was done before.

(4B 7.08) Rep. Spaeth: What was the composition of the 1981 Select Committee on Employee Relations?

Laurie Ekanger said it included legislators, labor leaders, some private business people, executive branch representatives and the university people.

(4B 7.37) Rep. Spaeth: Why isn't this committee similar in composition to that previous committee?

Rep. Cobb responded that when the bill was first written it did include specific representation but in negotiating with everyone, the agreement was that the Governor wanted to appoint who he wanted to appoint. If the committee wants to put legislators in there, that is their prerogative and I won't oppose that.

<u>Closing by Sponsor:</u> Rep. Cobb closed.

HEARING ON HOUSE BILL 234

<u>Presentation and Opening Statement by Sponsor:</u> Rep. Spaeth opened the hearing by saying that the bill would change the retirement formula from the current 30-60 to 28-56. What that means is that it would take into account that the state didn't increase state employees wages for the last three years. The wage freeze also froze retirement benefits which, perhaps was not intentional. By doing that it discourages people from retiring in the near future and it also means that future retirees will never catch up. There is a cost but the positive side of the cost is that employee contributions will catch up with employer contributions. The employees are willing to make a greater contribution to help keep their retirement benefits in tact.

<u>Testifying Proponents and Who They Represent:</u>

Ramon White, Gallatin County Commission
Tom Schneider, Montana Public Employees Association
Terri Minnow, Montana Federation of Teachers and Montana

Federation of Public Employees
Dennis Hemmer, a group of nonaligned state employees
Nadine Jensen, AFCSME
Dave Evensen, Montana University System
Representative Vicki Cocchiarella

Proponent Testimony: Rep. Wallin asked that a letter from Ramon White, chairman of the Gallatin County Commission, be submitted as part of the record of testimony in support of HB 234. (See exhibit 5)

(4B 18.31) Tom Schneider told the committee that this bill was before the State Administration Committee for seven weeks. It can be made into a very hard to understand bill by just simply getting into assumptions as to what it does and doesn't do. The bill itself, however, is a very simple bill. It simply changes the formula of the Public Employees Retirement Division from one year over 60, or each year of service over 60, to each year of service over 56. In essence, that just changes the value of each year that one works covered by PERS from 1.666% to between 1.78 and 1.79%. It gives everyone who retires a better retirement benefit by 7%. It does not change the qualification for retirement. If you are not age 60, you still have to complete 30 years of service to receive a benefit without paying a penalty for early retirement.

(4B 29.27) Terri Minnow spoke in favor of HB 234 as the bill helps mitigate the effects of the pay freeze. The cost is minimal and is phased in over five years. The increased cost for employers should be cancelled out by the resulting increase in retirements.

(4B 30.23) Dennis Hemmer asked the committee to support HB 234 for several reasons. The bill would help those people who are impacted by the pay freeze. Those who are getting ready to retire question whether they should retire when their pay and benefits have been frozen for the last three years. There are some potential savings because even if a retirees position is filled right away, the new employee would be hired at a lower step.

(4B 32.02) Nadine Jensen spoke in favor of HB 234. While the bill will not help those who are ready for retirement now, it will help to make up for the pay freeze for those who follow.

(4B 32.41) Dave Evensen said the university system is in support of HB 234 as it provides a good benefit for some of the employees in the university system. For most typical, middle class Americans their retirement benefits are very significant.

(4B 33.24) Rep. Vicki Cocchiarella urged the committee pass the bill so that those people who are retiring within the system get a retirement that's fair to them. It is being paid for more by the employees than the employers and it is a fair bill.

Testifying Opponents and Who They Represent:

Dave Ashley, Department of Administration

Opponent Testimony: (4B 34.14) Dave Ashley opposed HB 234. Although the bill encourages increased savings by employees, it includes provisions that will result in increased expense to Montana's public employers. HB 234 increases both the employee and employer contribution to the retirement system and this costs money. Fully implemented in FY94, the employer contribution rate will be 6.7% of salary, up from the current 6.417%. System wide this amounts to an additional employer cost of $1.2 million annually. The state general fund annual increase is about $440,000. The state income tax revenues would decrease under this bill. Salary which is currently earned and taxed will be tax deferred under this bill. Income taxes will not be assessed until the employees retire. The administration estimates that this will result in reduced income tax revenue of approximately $110,000 during the next biennium. In future bienniums this loss would be greater. HB 234 is not a part of the administration's compensation package. It will eat into the already modest wage proposal that employees would receive next biennium.

Questions From Committee Members: No questions were asked.

Closing by Sponsor: Rep. Spaeth closed.

ADJOURNMENT

Adjournment At: 6:19 p.m.

Kelly Addy

REP. KELLY ADDY, Chairman

KA/ml

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DAILY ROLL CALL

EMPLOYEE COMPENSATION SELECT COMMITTEE

DATE March 7, 1989

NAME	PRESENT	ABSENT	EXCUSED
Representative Addy, Chair	X		
Representative Kasten	X		
Representative Iverson	X		
Representative Quilici	X		
Representative Spaeth	X		
Representative Swysgood	X		

Form CS-30A
Rev. 1985

EXHIBIT 1
DATE 3-7-89
HB 543

Association of Montana Highway Patrolmen and Association of Retired Montana Highway Patrol Officers

President — Michael G. Davis
Vice-President — Cal Wylie
Secretary-Treasurer — K. Scott Wyckman

HB 543

President — Buck Baldry
Vice-President — Robert Pike
Secretary-Treasurer — Frank Willems
Legislative Committee — Gene Miller
Al Rierson

The information in the following cap sheet makes it necessary for us to address the health needs of retired Highway Patrol Officers and their widows.

MONTHLY COST EXPENSE COMPARISON OF 1973 AND 1988

ITEM	1973	1988
Health Insurance	$ 24.00/mo.	$164.00/mo. (for one person)
Mandatory Car Insurance	12.58	35.50
Car License	2.85	8.12
Home Taxes (47 yrs. old)	33.14	82.82
Home Insurance (47 yrs. old)	16.41	33.11
Electricity	14.64	69.17
Heating	18.90	57.50
Water	7.21	24.80
Telephone	8.40	16.25
Total	**$138.13**	**$491.27**
Pension	484.00	604.00
	- 138.13	- 491.27
Monthly Balance After Expenses	$345.87	$112.73

**MONTANA HIGHWAY PATROL OFFICERS ARE NOT COVERED BY SOCIAL SECURITY.

Additional Comparison of Expenses:

ITEM	1973	1988	PERCENTAGE DIFFERENCE
**Hospital Room	20.00 (day)	225.50 (day)	1,028%
**Doctor Visit	5.00	29.00	480%
**Dentist Visit	4.00	34.00	750%

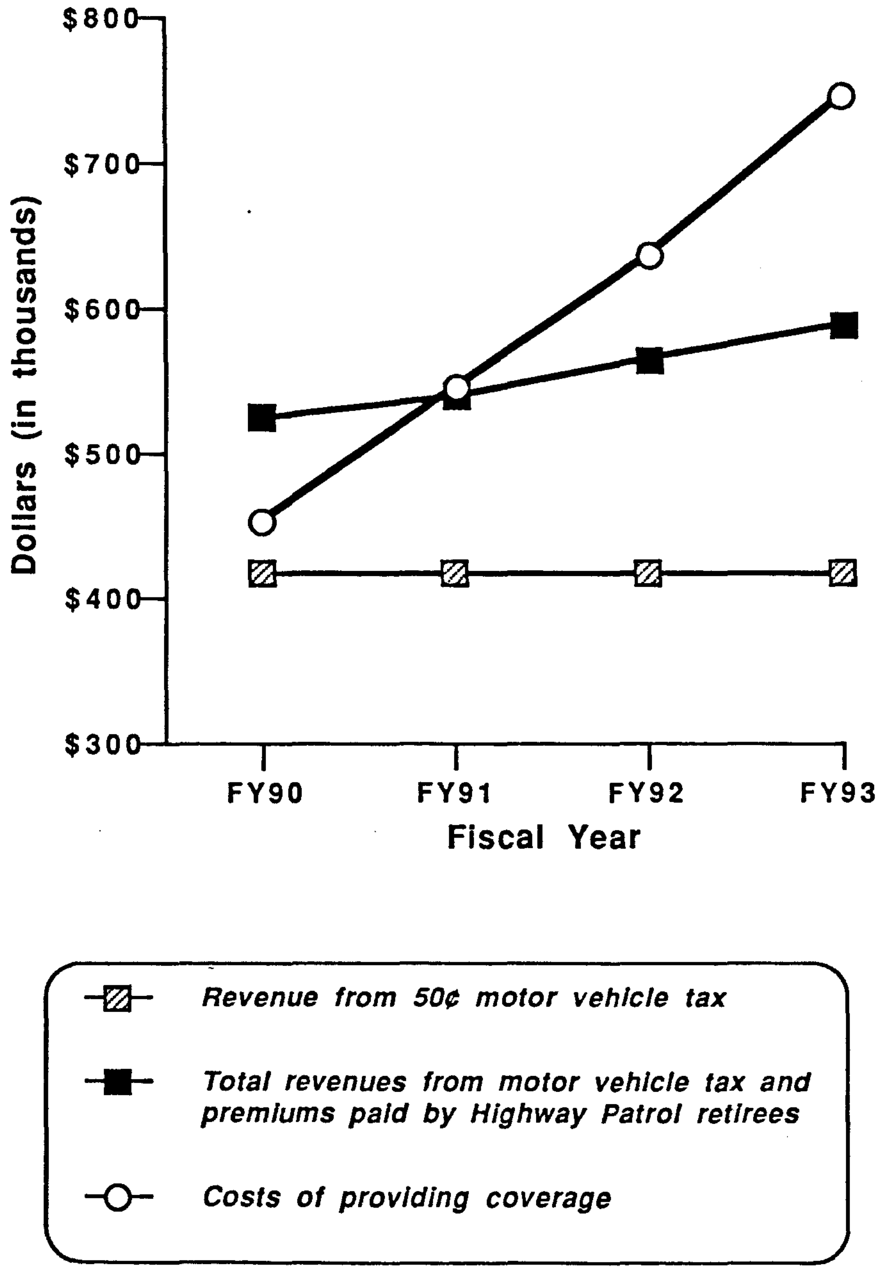
MONTANA HIGHWAY PATROL SUMMARY OF RETIREES
Number of Members in the Various Age Groups and Average Monthly Benefits

Under 55	55-59	60-64	65-69	70-74	75-79	80-84	Over 84	Total
38	37	17	14	8	14	10	1	139
$856	$861	$944	$640	$518	$489	$519	$373	$762 (Average)

**THE COST IS FUNDED BY 50 CENTS ON THE REGISTRATION FEE--WHICH IS EQUIVALENT TO TWO 25-CENT POSTAGE STAMPS.

EXHIBIT 2
DATE 3-7-89
HB 543

HB 543
Projected Costs and Revenues



Total - All Vehicles
(Dec. 27, 1988)
Statistics by County by Plate Type

	Year End Motor Vehicle
(Dec) 1983	891,528
1984	909,040
1985	907,559
1986	912,382
1987	900,979
1988	910,359

The Postretirement Time Bomb

Can corporate America continue to shoulder retiree health-care benefits? Rising medical costs may make it impossible.

BY HILARY ROSENBERG

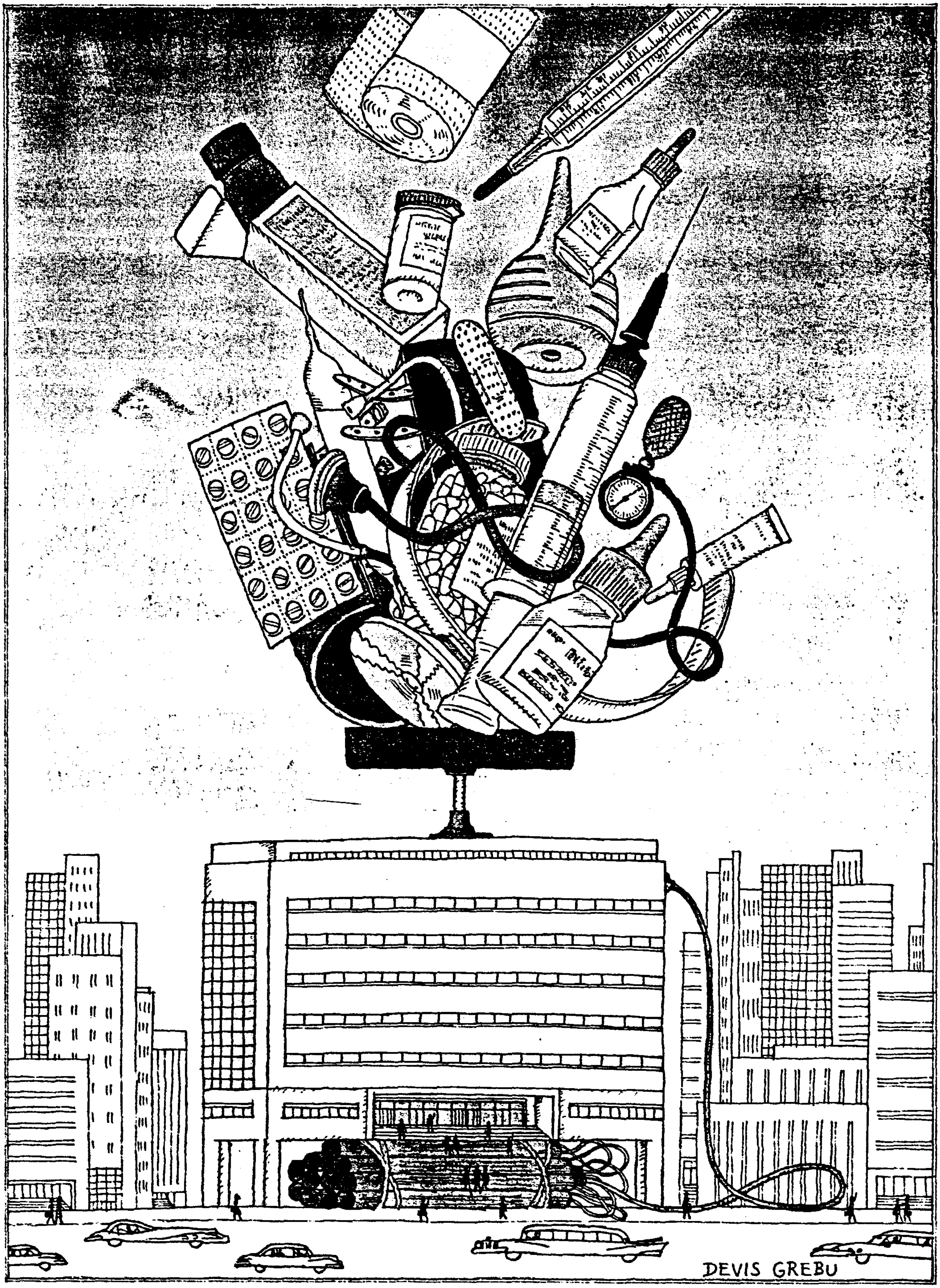
Illustration by Devis Grebu

Fred Van Remortel is not a threatening man. Actually, he's an ingratiating fellow in his late forties whose cloud of white hair and wire-rimmed glasses suggest a high school math teacher. But as a managing director at the benefits consulting firm Brown Bridgman & Company in Burlington, Vermont, he helps corporations confront and deal with a yawning black hole in their back yards—postretirement health-care liabilities. And given the dreadful nature of that subject, it's no surprise that he has at times been the target of a certain amount of animosity.

Consider the visit Van Remortel paid a few years ago to a communications company with huge retiree health costs: "I saw the CFO and the treasurer and I said, 'You guys have got a hell of a problem.' And the treasurer said, 'No. We don't.' And when I asked him what he meant by that, he looked me in the eye and said: 'I think you should leave. We don't *have* a problem, so we're not going to talk about it with you or anybody.'"

Reflecting on that incident and others like it, Van Remortel concludes, "Back then the prevailing thought was that if they ignored the problem, it would go away. Deny, deny, deny."

Unfortunately, there is no denying that while companies have been hiding their heads in the sand, the medical benefits they've long been promising their retirees have mushroomed out of control. Estimates of the total benefits owed to current and future retirees nationwide range from $500 billion to a mind-blowing $2 trillion. To be sure, the retiree health load averages only 25 percent of pension liabilities at major companies. But unlike pensions, almost all these obligations are unfunded, which makes them a ghastly drain on earnings. Indeed, these costs have helped drive such companies as Allis-


DEVIS GREBU

BRET LITTLEHALES

Benefits consultant Fred Van Remortel: Companies used to think "that if they ignored the retiree health-care problem, it would go away."

Chalmers Corporation and LTV Corporation into bankruptcy.

The sheer magnitude of the numbers has drawn growing scrutiny from the outside. Worried about the security of these benefits, Congress is now considering granting new tax incentives that would prompt their funding. The courts have made it clear that retiree health promises cannot easily be reneged upon. And the Financial Accounting Standards Board (FASB) is drawing up new accounting rules that will require prominent display of these benefits on financial statements—a move that will brutally wallop corporate earnings and net worth.

With all these forces closing in, companies today are finally beginning to face the problem head-on. Realizing that they are providing a benefit they can't afford, many are slimming down their postretirement plans to a more manageable size. A few have also started to prefund these liabilities using the limited tax-favored vehicles that are currently available. And more are poised to move if Congress extends new tax incentives. But even if Washington comes through, the cash outlays required for all-out funding could be prohibitive for most companies. The ultimate result may be a new wave of benefit cutbacks that will leave retirees to fend for themselves. Predicts Steven Ferruggia, the director of group actuarial practice at Buck Consultants, "Some companies may terminate retiree health-care benefits rather than face the financial impact of an FASB standard."

Caught off guard

Corporate America got into this bind in a surprisingly short time. When Medicare came along in the early 1960s, most employers began offering retiree health insurance to pick up what Uncle Sam didn't cover. But what was once a small and predictable expense has grown into a monster of frightening proportions. Galloping health-care inflation, an aging work force, medical advances that enable people to live longer, and Medicare cutbacks that have shifted more of the load to employers have all conspired to pump up benefit costs. An even more insidious culprit has been the rise of the early-retirement program, which has greatly increased the number of retirees under the age of 65—leaving companies with the task of fully insuring them until Medicare kicks in.

For a long time none of this worried corporations too much, because they assumed they could drop these plans at will. The fact that the Employment Retirement Income Security Act of 1974 (ERISA) imposes no vesting requirements on postretirement health benefits seemed to support that notion. And sure enough, a few companies have tried to cast off their plans. White Farm Equipment Company and LTV Corporation canceled their postretirement programs when they went belly up in 1980 and 1986, respectively. And a financially strapped Bethlehem Steel Corporation reduced its benefits coverage in 1984.

Then came the lawsuits. Federal district and appeals courts indicated that companies cannot reduce or terminate postretirement insurance unless they have reserved the right to do so in their plan documents and employee booklets. For employers that is certainly preferable to the lower-court judgment in the White Farm case—reversed on appeal—implying that companies could not alter benefits for retirees no matter what precautions they take. However, the future remains uncertain, since "different courts can make different interpretations," says Robert Sandler, a partner at the Milwaukee-based law firm Reinhart, Boerner, Van Deuren, Norris & Rieselbach.

As if all that weren't bad enough, the FASB sword hanging over companies' heads threatens them even more directly. Today the majority of corporations treat the cost of retiree health benefits as mere operating expenses. But the FASB believes that retiree health care is a form of deferred compensation, just like pensions. And once the board's new standards take effect sometime in the next few years—the proposed rules are due out in 1989—postretirement benefits will get essentially the same accounting treatment as pensions: unfunded liabilities will be logged on the balance sheet, and accrued benefits will be charged to earnings. All in all, says Richard Ostuw, a vice-president at Towers, Perrin, Forster & Crosby (TPF&C), "the new accounting will ruin everybody's day."

It has already cast a pall over many executive suites. In fearful anticipation of the draft rules, companies have been flocking to their consultants during the past year to gauge the dimensions of the expected damage. On the balance-sheet side, the news is more than depressing. One automobile maker will shoulder an unfunded liability on the order of $7 billion, according to a consultant. Allied-Signal Corporation's estimated burden exceeds $2 billion, half its market capitalization.

Similarly, Herbert Nerling, an assistant treasurer at E.I. du Pont de Nemours & Company, reports that his organization's retiree health load is "somewhat less than half" of its total pension liability, which amounted to $7.3 billion at the end of 1987. At Southwestern Bell, the recently refigured obligation is "significantly higher" than the $1.5 billion calculated in 1986, notes Craig Campbell, the associate director for benefit planning. And at companies that tend to have small pension obligations—such as banks and insurance companies, which generally have low pay scales—the number for postretirement benefits outstrips the pension liability. Overall, the blow to net worth will be severe. The consulting firm Milliman & Robertson estimates that major companies with generous plans could see their net equity per employee decrease by one-half once the rules take full effect.

Companies with generous plans could see their net equity per employee decrease by one-half.

What the accounting changes will do to earnings is also, in a real sense, sickening. In evaluations of 75 of its clients, TPF&C found that postretirement costs under the new rules will be dramatically higher than current expense figures; the median company's costs will spurt from $300 to $2,600 per active employee per year, jumping from 1 percent to 10 percent of payroll. That translates into an earnings reduction of 10 percent on up—and sometimes annihilation. And since the market judges management by an earnings barometer, this could in turn mean that stock prices and credit ratings will get royally hammered.

Having seen the numbers—and recovered their wits—corporations are now searching for ways to mitigate the upcoming blast to their financial statements. The option getting the most attention these days is postretirement plan redesign aimed at curtailing expense and liability figures. Most plans are still in the study stage, and in the end, predicts TPF&C's Ostuw, "a large group will continue to provide what they're providing now." But, he adds, "I believe that the majority will take some action." His firm alone is already working with 10 of this nation's 100 largest firms on overhauling their retiree plans.

Before they lay a finger on their plans, however, companies are taking measures to protect themselves from possible lawsuits: they have reserved the right to alter their programs in all benefit-plan documents and employee booklets, and some employers are reinforcing that message in exit interviews with retiring workers. In this way, observes William Danish, a consultant at Kwasha Lipton, "corporations are attempting to remove any promise of permanence." That done, companies are going ahead with benefit changes for all workers, including older ones and retirees.

Here's a rundown of the redesign steps being taken, many of which mirror companies' cost-cutting efforts in their medical plans for active workers.

■ **Utilization controls.** By encouraging retired employees to use outpatient care and cost-efficient alternatives such as HMOs and preferred-provider organizations, companies hope to bring down their long-term medical costs. FMC Corporation, for one, has jacked up the co-payment retirees must make on hospital services from 10 to 20 percent of the total bill. And Owens-Corning Fiberglas is actively exploring cost-containment alternatives such as hospital utilization reviews and case management for both retirees and active employees.

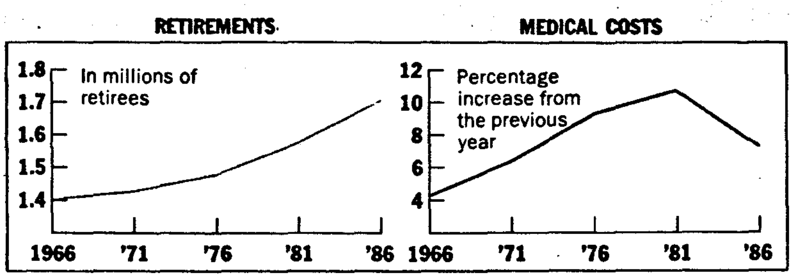
■ **Cost-shifting.** For the majority of medical services, many companies have long paid the difference between the total cost and the amount covered by Medicare. But growing numbers are now pegging the reimbursement rate to that of active employees, which sometimes requires retirees to pick up part of the tab—a so-called carve-out system. This switch can cut projected liabilities almost in half.

Some large companies are also indexing their plan deductibles to Medicare deductibles or the inflation rate, requiring that retirees help make up cuts in Medicare coverage and raising employee contributions to premiums. Along with its recent shift to a Medicare carve-out program, McKesson Corporation, for one, requires retirees to pay some of the premium. And starting this year, employees who pick up their gold watches from the Equitable Life Assurance Society must dig into their pockets to finance part of their health-care premiums if they have less than 30 years under their belts. The fewer the years of service, the smaller the company's contribution—and workers with less than 10 years must pay their own way. Consultants say linking contributions to length of service may reduce liabilities by 10 to 20 percent.

Companies that prefer luring to pushing are taking a different approach: giving retirees the option of joining a new, lower-cost medical plan that has sweeteners designed to draw them in. The new plan might soften the blow of increased yearly deductibles, for instance, by offering a long-term care benefit or higher lifetime maximum coverage than the old plan. Giving retirees a choice in the matter might, of course, be the best way to avoid litigation.

■ **Benefit takebacks.** A few companies are rescinding premium subsidies for future retirees. Nonunion workers who joined International Paper Company after October 1987 have to carry the full cost of their health-care coverage when they retire. And although they will be able to buy coverage through the company plan—guaranteeing insurability and group rates—this step still goes a long way toward a cancellation of postretirement health benefits. As a result, International Paper's retiree health liability will dwindle to nothing over time.

RETIREMENT COSTS TO CORPORATIONS



More Americans than ever have retired during the last 20 years. At the same time, medical costs have exploded, putting a huge burden on corporate health-care programs.

SOURCES: SOCIAL SECURITY ADMINISTRATION; HEALTH INSURANCE ASSOCIATION OF AMERICA

■ **Defined-dollar plans.** More than any other tactic, corporations are investigating a new type of plan that grants retirees a cash allowance to cover their health-care needs. Unlike traditional schemes that promise a specified set of benefits, inflation and all, this method furnishes a set amount of cash, transferring the inflation risk to retirees. By periodically reviewing the size of the grant, "the employer decides how much of inflation it will cover," says Thomas Kluhman, a consultant with TPF&C. "The company is in control." He has found that these "defined dollar" plans can cut long-term liabilities by 25 to 50 percent, depending on how much inflation the employer shoulders.

The best-known defined-dollar program is one that Pillsbury introduced in 1987 for its nonunion workers. When they retire, employees are granted benefit credits to use in purchasing health care through the company's flexible-benefit plan. The number of credits awarded is linked to a retiree's length of service—1,400 per year of service, each worth $1—and Pillsbury can revise the credit level each year for both new and current retirees. (The first year it made no change.) If the company does not increase credits to match a rise in insurance premiums, retirees may have to choose less generous options.

Less publicized is a similar benefits program launched in January 1988 at North Carolina National Bank Corporation (NCNB). Under the new system, the company creates medical expense accounts for retirees to which it annually contributes a specific dollar amount (to be reviewed every five years for possible increase) for every year of service—up to a maximum of 30 years. Any cash not spent rolls into the following year's account, and medical expenses in excess of account balances must be made up by retirees. "We have substituted a known cost for an unknown level of future liabilities," says Mary Lou Foltz, NCNB's benefits manager.

Planning ahead

Of course, the aim of all this tinkering is to get projected obligations down to an affordable level. Many corporations would like to prefund as much as they can afford. "A company cannot look ahead 15 to 20 years and know with certainty that it will have the cash to cover the liability," says Donald Phillips, the director of investment management at Ameritech. "Prudent management suggests that you should prefund." Indeed, Ameritech, NCNB, and others—including several utilities—plan to create reserves. But companies are just as concerned about the tax and investment implications of funding as they are about the benefit-security issue. And given the lame choice of postretirement trust vehicles currently available, most figure they're better off keeping their assets at work in the company.

For the lack of attractive options corporations can thank Congress, which whacked the 501(c)(9) tax-qualified trust—also known as a voluntary employee beneficiary association (VEBA)—over the head in its 1984 tax act. VEBAs once enjoyed all the tax privileges of pension trusts and as such were perfect for funding retiree health benefits. But to counter widespread misuse of the trusts as tax shelters, Washington planted a minefield of new taxes and restrictions. Tax-deductible pay-ins are limited by the fact that inflation can no longer be taken into account in calculating funding, for instance. And investment earnings on VEBAs are now fully taxable.

These changes have dramatically reduced the widespread appeal of this approach. IBM, for example, halted contributions to its postretirement VEBAs after 1984. But Northrop Corporation and 3M continue to use the VEBAs they set up several years ago. "We're still contributing, but only what we can get

Shaky Balance Sheets

New accounting standards for postretirement benefits will cause headaches for most companies.

If the Financial Accounting Standards Board (FASB) were to fall off the planet tomorrow, companies would no doubt celebrate with whole truckloads of champagne. And who could blame them? The new accounting rules that the FASB is cooking up for postretirement medical benefits will have a devastating impact on financial statements—and consequences far more extensive than those caused by the recently revised pension accounting standards, which were also hotly opposed by corporate America. For its part, however, the board matter-of-factly contends that it's simply trying to keep things on the up-and-up.

"We aren't the ones who made the [retiree health] promise," says Diana Scott, the head of the FASB's postretirement project. "We're just asking companies to live up to that promise." Although the rules should get through their comment period and reach final form in 1989, they may not take effect until 1992 or later. When they do, companies may be forced to recognize the liabilities all at once—an option some board members favor.

But as Richard Ostuw, a vice-president at Towers, Perrin, Forster & Crosby, points out, "That would make a lot of companies insolvent." To avoid such an outcome, the FASB will probably follow the route it took with its pension accounting rules and allow corporations a three-year transition period for postretirement benefits to be phased into financial statements.

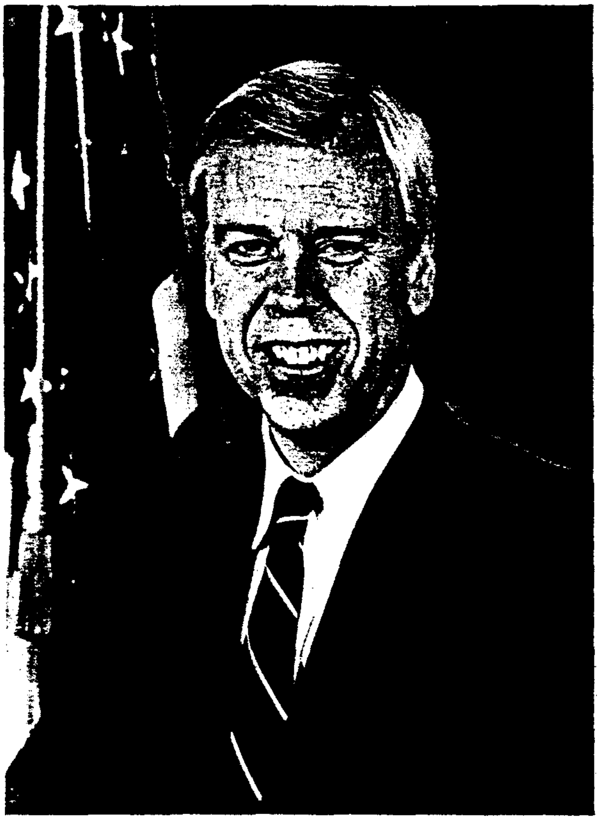
Implementing the standards will undoubtedly be complex. Each year companies will have to charge to their earnings a two-part amount. One part is the current value of the portion of expected future benefits allocated to employees that year. This figure will tend to increase every year as employees move closer to retirement and will hit companies with aging work forces particularly hard. The second part is the amortization of benefits earned in the years before the new rules. As for the balance sheet, the liability will reflect benefits expected to be provided to current retirees and those active employees who are "expected to become entitled to coverage," notes Scott.

So to figure their starting liability, companies will have to determine their total obligations to current retirees (figured on a projected basis) and add in the benefits active employees have accrued so far (also figured on a projected basis). Thereafter they'll make annual adjustments to that figure by adding in new benefits accrued by active workers that year, less cash payments to retirees. And finally, they'll want to catch a plane bound for Nairobi before their accountants' bills roll in.

—Hilary Rosenberg,
Institutional Investor

as a tax deduction, and that has cut contributions in half," reports Richard Lohrer, Northrop's vice-president for trust investments. And in light of the desperate need to fund retiree health benefits, numerous other companies—Ameritech among them—are now considering tapping 501(c)(9)s despite their many disadvantages.

Another option is the 401(h) trust. Put simply, this is a retiree health-care trust within a pension trust, into which companies are permitted to funnel 25 percent of their pension contributions. Sounds nice, but this is hardly enough to fund mountainous liabilities at a time when overfunding has reduced pension pay-ins to a trickle. What's more, uncertainty surrounds the 401(h) because it puts postretirement benefits in the domain of pensions, which means they "may be subject to pension law," notes Kwasha Lipton's Danish. For these reasons, very few companies have used the 401(h).



Representative Rod Chandler (R-Wash.) wants companies to make tax-deductible contributions to a government-sponsored retiree health plan.

With companies longing to prefund and the tax-incentive routes all but closed, a number of insurance brokers are hawking a funding vehicle that has been around for years—corporate-owned life insurance (COLI), which is also catching on as a means of securing excess benefit promises to executives. "We're responding to what we see as the squeaky wheel," says John Lander, the president of Baker & Lander, a Boston-based insurance broker. In fact, notes Michael Gulotta, the president of Actuarial Sciences Associates (ASA), the benefits-consulting subsidiary of AT&T, "the insurance industry has carved itself a little niche here."

How do COLIs work in this context? A company buys life insurance on workers or retirees or both, naming itself the beneficiary. Then it can either let the policy's cash value build as an asset to offset the postretirement liability or borrow from the policy to pay health-care costs. COLIs have two advantages: interest on borrowing is partly tax-deductible, and the buildup of cash value (that is, the investment earnings on policy assets) is not taxed. When retirees die, the company collects on the policies and is thus reimbursed for its premium expenses.

COLI commissions can be costly, however, and Congress recently put limits on interest deductibility. Moreover, only the cash value minus loans will be allowed on the balance sheets—which could leave little to offset postretirement liabilities. And Washington is now considering a tax on any withdrawals or borrowings from life insurance policies.

But even with their drawbacks, COLIs are attracting more interest than other options. Lander knows of about 30 companies that have bought into the concept, most within the past year, and says at least 40 more are seriously contemplating a like move. One user is the Equitable, which partially funded its liability with life insurance last year. "We'd prefer to have a tax-deductible vehicle, but since none is available, we wanted to start funding," says Robert Sjogren, the vice-president of corporate benefits.

The best of both worlds

Also catching the corporate world's eye is a new type of variable life policy—a VEBA trust hybrid, the brainchild of Brown Bridgman & Company. The idea is to use VEBA contributions to buy the variable policy, which allows for aggressive investment of the bulk of policy premiums. As it grows, the trust collects death benefits that pay for retiree health costs. This mixed marriage gives companies the best of both worlds: tax deductions on VEBA pay-ins plus a tax-free buildup of investment earnings in the life policy. "The popular conception that [the 1984 tax bill] put VEBAs out of business just isn't true," asserts Van Remortel. Brown Bridgman not only is marketing this product itself but has also hooked up with Salomon Brothers, which is shopping the idea around to its corporate clients. Meanwhile, Lehman Management Company, also marketing a version of the product, had won a few tentative commitments by mid-April 1988.

But right now most corporations are just window-shopping for prefunding methods, hoping that Congress will come through with a more appealing pension-trust type of vehicle sometime soon. They shouldn't hold their breath, however, because although there is great concern in Washington over postretirement benefits, there's also little consensus on how to deal with the problem.

Some years back, there was a lot of talk in Congress of passing ERISA-like legislation that would mandate vesting and minimum funding standards. But now that idea is virtually dead. Companies oppose it out of a belief that mandatory funding would spell trouble for cash flow. Labor unions fear the cost involved would prompt employers to slash benefits or wages or both. Says United Auto Workers associate general counsel Alan Reuther, "There's a direct trade-off between the security of benefits and the adequacy of benefits." And even lawmakers cringe at the thought of the deep gash that new tax deductions would make in the Treasury's revenue collections.

That's why the only pending postretirement legislation being taken seriously by Congress is a bill, sponsored by Representative Rod Chandler of Washington State, that features voluntary funding. Under it, companies could make tax-deductible contributions to a so-called Voluntary Retiree Health Plan whose assets and investment earnings would accumulate tax-free until they were paid out in the form of retirement benefits. Some companies, however, are vehemently opposed to the vesting standards included in the bill, because they don't want to be locked into provid-

NANCY J. PIERCE

Mary Lou Foltz, the benefits manager for North Carolina National Banking Corporation, helped promote a flexible health-care plan for the company.

ing these benefits. Labor unions don't like the voluntary approach any better than mandatory funding—fearing that since only the healthiest companies would be likely to fund, retirees at weaker firms would be left dangling in the breeze. Congress, meanwhile, is turned off by the bill's $1 billion to $4 billion price tag over five years. And in any event, both lawmakers and retiree advocates have other priorities, including extending medical insurance to the 37 million Americans who have none and expanding Medicare to cover catastrophic illnesses.

In an effort to push a prefunding measure through, Chandler is revising his bill. The new version drops the vesting requirement and proposes revenue sources to offset the cost. Moreover, it allows companies to transfer surplus pension assets into a separate retiree health trust that gives companies a way to start funding these obligations, says Gulotta of ASA, whose parent company is one of a group of 35 lobbying for this option. The draft of the new accounting standards expected in 1989 should give voluntary funding new momentum. These rules "will be the single most important motivator for Congress to focus on this question," predicts Phyllis Borzi, the employee-benefits counsel on the House Labor-Management Relations subcommittee, "because CEOs and CFOs will come to Congress and tell it how important this is."

If a truly attractive tax-favored vehicle does eventually become available, how many corporations would use it?

Contends Du Pont's Nerling, "There's no question in my mind that Du Pont and a lot of major companies would fund." Perhaps. But it's more likely that a great many would not want to bear the expense of five to seven times current cash costs in the initial years of the program—even though prefunding can reduce benefit costs over the long haul—and hence would opt for no or only minimal funding.

"Companies have been so overwhelmed by the costs on a pay-as-you-go basis," sighs Dale Grant, a senior vice-president at Martin E. Segal Company, "that the idea of putting in more money to fund is beyond their comprehension." That means these benefits would continue to weigh down financial statements, surely leading to drastic benefit cuts or terminations farther down the road.

But that probably wouldn't be the end of this issue, no matter how much companies might like it to be. Benefit reductions and cancellations would no doubt enrage millions of retirees and lead them to press for reinstatements through still more bitter lawsuits. And what about the moral question here? Can corporations in all good conscience turn their backs on loyal former employees, leaving them to face wildly escalating medical costs on their own? Even if they tried to, workers would be likely to put inordinate pressure on Washington to rectify the situation. And then Congress just might turn around and mandate the provision of minimum benefits and vesting standards that would bleed companies dry.

As Representative Chandler and many others see it, that's precisely why corporations must begin facing the music today. Paring back benefit promises to realistic levels, buying the notion of funding, and supporting the enactment of some sort of new tax-favored trust vehicle are absolute necessities. The only other alternative—limping down the pay-as-you-go path—is no alternative at all in view of the terrible toll it will ultimately exact in terms of devastatingly high benefit costs, human suffering, and damaged employee relations. "Companies should be thinking about the bottom line in the year 2020," concludes Chandler emphatically, "because there isn't going to be any bottom line if we don't do something now." ■

THE WRITER

Hilary Rosenberg has been a staff writer for *Institutional Investor* since 1986. She previously worked as a writer for *Barron's* and as an associate editor at *Financial World*.

COMPARISON OF MONTANA PUBLIC RETIREMENT SYSTEMS

SYSTEM	CONTRIBUTION RATES		SOC.SEC.	RETIREMENT ELIGIBILITY	BASIC BENEFIT FORMULA
PERS	Employee Employer	6.0% 6.417%	Yes	Regular: age 60 w/ 5 yrs. service age 65, regardless of serv. 30 yrs service, any age Early: age 50 w/ 5 yrs. service 25 yrs service, any age	1.66% x FAS* x years of service (FAS = Final Average Salary = Average of highest consecutive 36 mos. salary) 1.66% x FAS x years of service x Early retirement factor
TEACHERS'	Employee Employer	7.044% 7.428%	Most	Regular: age 60 w/ 5 yrs. service 25 yrs. service, any age Early: age 50 w/ 5 yrs. service	1.66% x FAS x years of service 1.66% x FAS x years of service x Early retirement factor
JUDGES'	Employee State Dist.Crt. Fees Supreme Crt.	6.0/7.0% 6.0% 31.0% 1/4 court fees	Yes	Regular: age 65 w/ 5 yrs. service Involuntary: any age w/ 5 yrs. service	3.33% x FAS x yrs of service to 15 plus 1.00% x FAS x yrs in excess of 15 Same as above, actuarially reduced from age 65
HIGHWAY PATROL	Employee Employer + license fees	7.59% 26.75%	No	Regular: age 50 w/ 20 yrs. service Early: any age w/ 5 yrs. service	2% x FAS x yrs of service Same as above, actuarially reduced from age 60
SHERIFFS'	Employee Employer	7.00% 7.67%	Yes	Regular: age 55 w/ 25 yrs. service Early: age 55 w/ 20 yrs. service Involuntary: 10 yrs service, age 55	2% x FAS x yrs of service to 25 + 1.35% x FAS x yrs in excess of 25 up to max. of 60% FAS 2% x FAS x yrs of service, actuarially reduced from age 65 or 25 years service Same as early retirement
GAME WARDENS'	Employee Employer + fines	7.90% 7.15%	Yes	Regular: Age 50 w/ 20 yrs. service Involuntary: 10 years service, age 55	2% x FAS x yrs of service 2% x FAS x yrs of service
POLICE	Employee Employer State	6.0/7.5% 13.02% 15.06%	No	Regular: Age 50 w/ 20 yrs service	2.5% x Final Comp. x yrs of service to 20 + 1% x Final Comp. x yrs in excess of 20, up to a max of 60% of salary
FIRE-FIGHTERS'	Employee Employer State	6.0% 13.02% 22.98%	No	Regular: Age 50, w/ 10 yrs service	2.5% x Final Comp. x yrs of service to 20 + 1% x Final Comp. x yrs in excess of 20, up to a max of 60% of salary 2.0% x Final Comp. X yrs of service, up to a max of 60% (Post-7/1/81 hire)

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EXHIBIT 3
DATE 3-7-89
HB 543

Amendments to House Bill No. 543
Second Reading Copy

Requested by Representative Connelly
For the House Committee of the Whole

Prepared by Lois Menzies
February 18, 1989

1. Title, line 16.
Strike: "A"
Insert: "CERTAIN"
Strike: "OFFICER'S"
Insert: "OFFICERS'"
Strike: "HIS"
Insert: "THEIR"
Strike: "SPOUSE'S"
Insert: "SPOUSES'"

2. Title, line 17.
Strike: "DEPENDENT'S PREMIUM"
Insert: "DEPENDENTS' PREMIUMS"

3. Page 1, line 25.
Strike: "Retired"
Following: "officers"
Insert: "retired before March 31, 1986,"

4. Page 2, line 8.
Following: "for"
Insert: "certain"

5. Page 2, lines 15 through 18.
Strike: "a" on line 15 through "(b)" on line 18

6. Page 2, line 19.
Strike: "September" through "1989"
Insert: "March 31, 1986"

7. Page 2, line 22.
Strike: "(c)"
Insert: "(b)"

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4

EXHIBIT 4
DATE 3-7-89
HB 543

Amendments to House Bill No. 543
Second Reading Copy

Requested by Representative Connelly
For the House Committee of the Whole

Prepared by Lois Menzies
February 18, 1989

1. Page 2, line 8.
Following: "for"
Insert: "certain"

2. Page 2, line 9.
Strike: "The"
Insert: "Subject to the restriction in subsection (3), the"

3. Page 3.
Following: line 3
Insert: "(3) A retired officer otherwise qualified under subsection (1) who is employed in a position covered by a retirement system under Title 19 and his spouse and dependents may not receive the partial premium payment provided for in this section until the retired officer terminates his employment in the covered position."

4. Page 6, line 18.
Strike: "state treasurer"
Insert: "department of justice"

5. Page 6, lines 20 and 21.
Strike: "department" on line 20 through "]" on line 21
Insert: "state employee group benefit plan's reserve fund"

hb054303.alm

County of Gallatin

Bozeman

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EXHIBIT 5
DATE 3-7-89
HB [redacted] 234

March 6, 1989

Representative Norm Wallin
House Appropriations Committee
Capitol Station
Helena, MT 59601

Dear Representative Wallin:

We urge your support of House Bill 234, an act increasing member and employer contributions to the Public Employees Retirement System. This bill would be beneficial to our employees because it would increase their retirement benefits. Cost to the taxpayer would be minimal and will not even be realized until July of 1992 when the employer contribution rate is increased.

Thank you for your consideration.

Sincerely,

GALLATIN COUNTY COMMISSION

Ramon S. White, Chairman

Jane Jelinski, Member

A. D. Pruitt, Member

vj