



## **The PEEHIP Funding Crisis in Alabama Executive Summary**

### **The Problem**

Alabama, like almost every other state, is carrying massive unfunded liabilities for state education employee health benefits that are requiring massive payments to remain solvent. According to a July 2010 report by the Retirement Systems of Alabama (RSA), more than \$11.9 billion in healthcare benefits have been promised to the more than 133,000 members of the state's Public Education Employee Health Insurance Program (PEEHIP) and 147,000 of their dependents.

States typically provide generous healthcare benefits to employees. In addition, legislators often use a "back door" approach to rewarding employees by increasing benefits such as health insurance programs with continued benefits for retirees when they cannot provide pay raises.

In Alabama, the cost to the state for these unfunded liabilities is currently \$864.5 million a year. To help offset these liabilities, in 2007 the state legislature finally directed the state to begin setting aside assets to pay for these benefits. By the end of fiscal year (FY) 2009, the state had saved only \$670 million of the \$11.9 billion needed to pay these obligations, leaving \$11.2 billion unfunded. If this gap is not closed, members will likely see a reduction or even loss of healthcare benefits, significantly increased premiums and copays, or both. Or worse, taxpayers will have to foot the bill.

Alabama is not alone in this crisis. According to a February 2010 report by the Pew Center on the States, the total liability of states for healthcare and other non-pension benefits was \$587 billion in FY 2008, with just \$32 billion—about 5 percent of the total cost—set aside to help pay it.

### **Our Solution**

Alabama's PEEHIP program needs an immediate comprehensive strategy for cost containment and pre-funding of PEEHIP benefits for future retirees. Of the three options available—raising taxes, reducing government spending, and reforming PEEHIP—only the latter two have the potential to both save the state money and keep the state's economy from further harm.

## Specific Recommendations

- Increase premiums to an across-the-board percentage. Suggested premiums (and their consequent savings per year) could be a flat 20 percent for all groups (\$72.2 million), regional averages (\$99.6 million for active members; \$237.3 million for all members), and national averages (\$52.5 million for active members; \$254.2 million for all members).
- Many spouses of state employees are also employed, and most have access to health insurance at their place of business. These spouses could be encouraged to keep their own coverage, shifting these costs away from taxpayers and to the private sector. For retired state employees, the state could consider paying nothing for non-Medicare family coverage and let the spouse's insurance cover them until they qualify for Medicare benefits.
- Adopt the "rule of 85" requiring retirees to have a combination of age plus service equal to 85. A "rule of 80" could be adopted for those longer-term employees currently members of the RSA where they would retire at a younger age but for a reduced pension and for a significantly increased premium cost. PEEHIP members within 24 months of their 25-year retirement could be grandfathered and asked to pay an increased portion of the PEEHIP premium.
- For non-Medicare retirees, provide only half of the premium for singles and families to discourage retiring prior to Medicare eligibility when the premiums significantly decrease.
- Pay a smaller portion of the non-Medicare eligible family member premium and require the member to pay the remainder. Thus, members with spouses who have other insurance would benefit by choosing single-only coverage, and the state would save almost \$50 million a year by not paying the increased cost of family premiums.
- Adopt a reasonable annual percentage increase to the PEEHIP drug deductible to reflect the increases in prescription drug costs thereafter.