



OUR PEOPLE · YOUR ASSET

Funding of Private Healthcare Funding Trends in Employer Post Retirement Subsidies

Lara Wayburne: NMG Actuarial & Specialised Consulting



- ▶ Historically the costs of PRMA were accounted for pay-as-you-go
- ▶ Since the 1990s IAS 19 has required SA companies to make provision on balance sheets while employees are still in service
- ▶ Need to account for:
 - ▶ Liability – present value of future post-employment subsidy payments
 - ▶ Expense – increase in liability before deducting benefit payments
- ▶ Not necessary to include liability for subsidy during employment as this is a cost of employment



- ▶ Generally dealing with a defined benefit obligation that is long term in nature, very sensitive to changes in market conditions
- ▶ Many companies have taken a number of actions to limit or remove the liability including:
 - ▶ closed their subsidy book to new entrants – BUT there is the existing liability on the balance sheet
 - and/or
 - ▶ purchased annuities to remove the liability altogether
 - and/or
 - ▶ replaced benefit obligations with lump sums
- ▶ History has given a few examples where healthcare funding directly off the balance sheet has presented challenges – GENERAL MOTORS...

Subsidy examples



- ▶ % of total contributions
- ▶ % of benchmark plan contributions
- ▶ Rand subsidy
 - ▶ Increasing or not (CPI, salary inflation, HCCI)
 - ▶ Per dependant or per member
- ▶ % of contributions up to a cap
- ▶ Minimum subsidy
- ▶ Dependent on length of service
- ▶ Cut-off dates

Subsidy examples cont.



- ▶ Disability / ill-health retirement:
 - ▶ Not always covered
 - ▶ Insurer often used to provide benefit (no liability for employer)
 - ▶ Could be same as post-retirement subsidy or not
 - ▶ May stop at normal retirement age
 - ▶ Often equal to pre-retirement subsidy until NRA

- ▶ Death-in-service:
 - ▶ More likely to be subsidised for life of surviving spouse
 - ▶ May be at a different level to post-retirement subsidy

Reducing employer subsidies



- ▶ The cost of providing for and recognising post-employment subsidies caused employers to cease to offer the subsidies to new employees.
- ▶ The subsidy cut-off dates for new entrants for most employers was around the late 1990s / early 2000s.
- ▶ The population with post-employment medical aid subsidies is therefore closed and is reducing.
- ▶ This significant source of health care funding from employers is ultimately going to disappear and place a financial burden on pensioners.

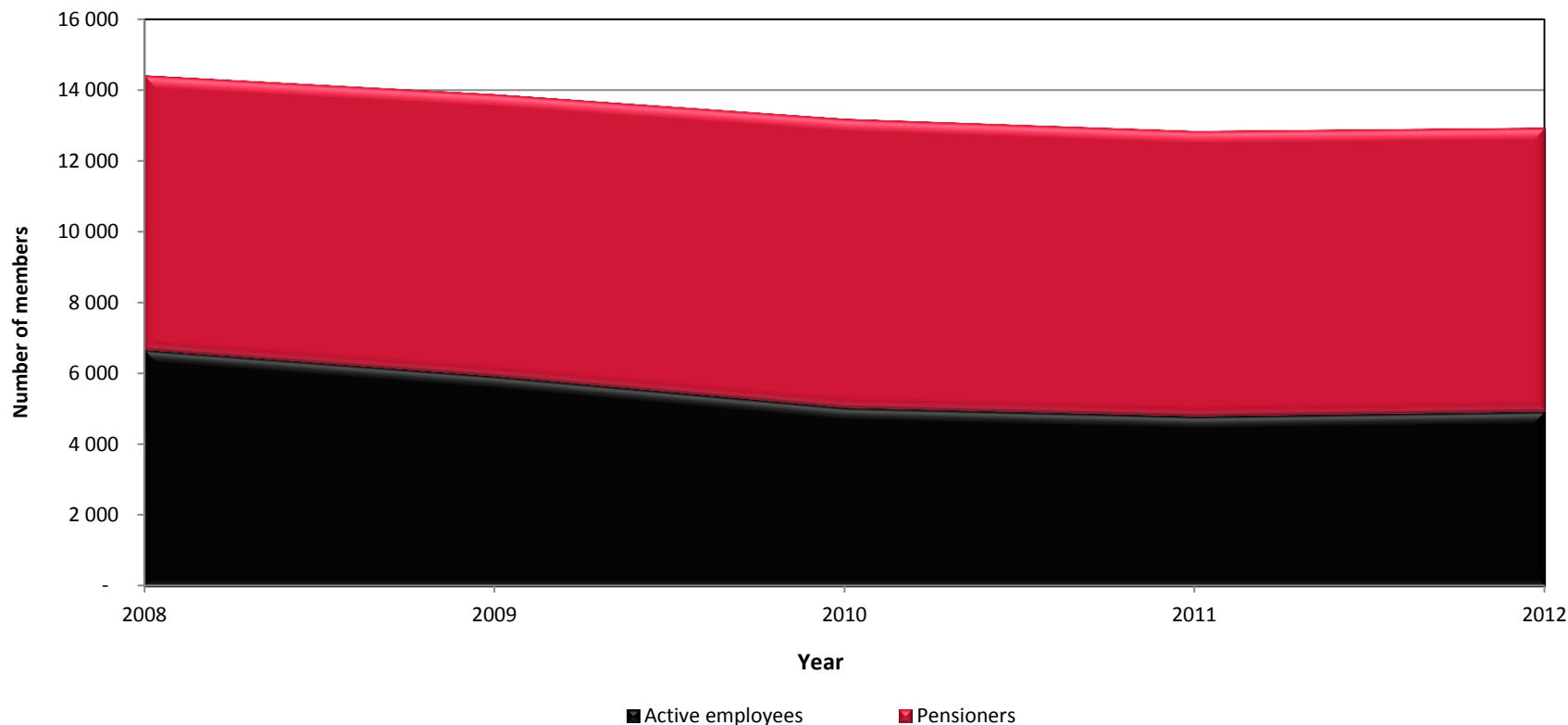


- ▶ NMG analysed the book of its largest PRMA clients in terms of number of members eligible for / or in receipt of a subsidy from their employer over a 5 year period.
- ▶ For these employers, the subsidy was closed to new entrants specifically between the period 1997 – 2002.
- ▶ Employers are predominantly based in mining, resources, construction industries.
- ▶ Employers in these sectors tend to be relatively paternalistic towards their employees.

Reducing book



- ▶ The total number of members included in the valuations is shown below:



- ▶ The total number of PRMA members has decreased by 10.2% (2.7% pa)
- ▶ The number of employee members has decreased by 26.1% (7.3% pa)

Subsidy levels

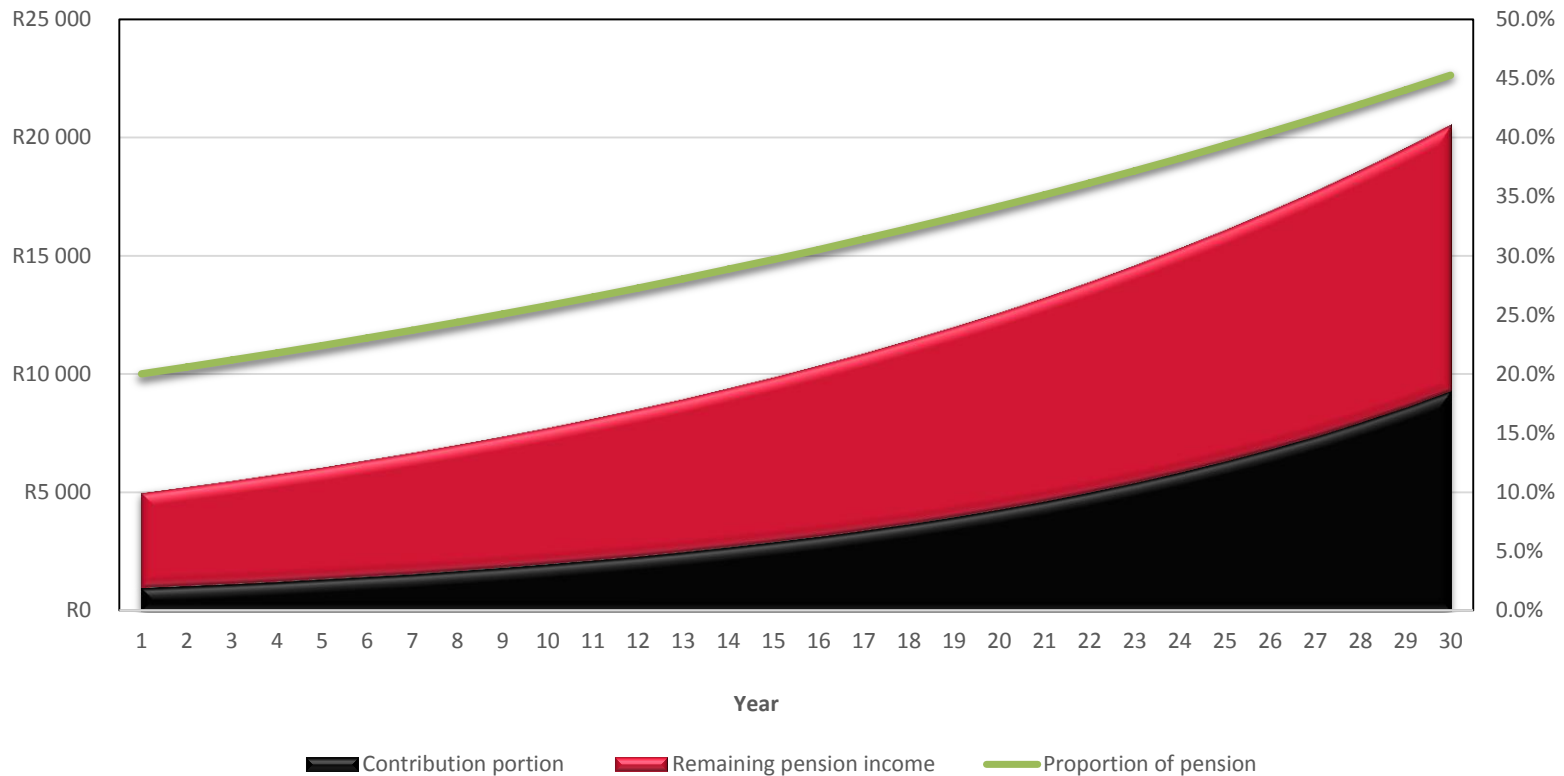


- ▶ The subsidised proportion of contributions has remained the same for the majority of the employers (average proportion is 70%-80%)
- ▶ However, the absolute amount and proportion of contributions comprises a larger proportion of pension income each year.
- ▶ Some subsidy policies are also structured to give reducing subsidies to new retirees – in the case of one employer the proportion of pensioners on a 100% subsidy decreased from 78% in 2008 to 66% in 2012
- ▶ In 2008: 2.9% of pensioners left the total considered PRMA population
- ▶ In 2012: 3.1% of pensioners left the PRMA population (at least 1% of these were due to affordability reasons)

Sample case



- ▶ CPI – 5%
- ▶ HCCI – 8%
- ▶ Subsidy – 60%
- ▶ Initial pension – R5,000
- ▶ Initial contribution – R2,500

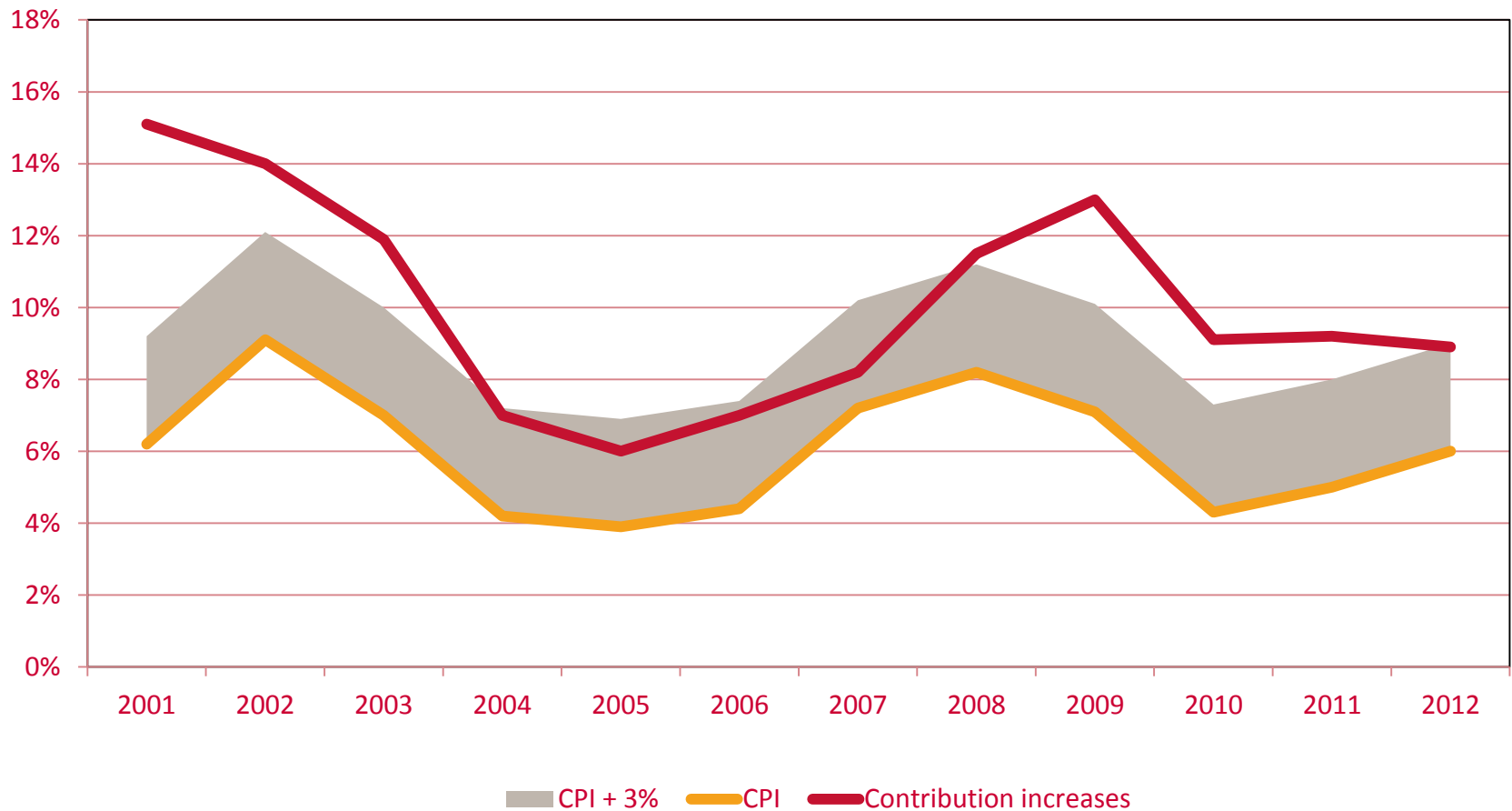


- ▶ The subsidy % remains constant but the portion of pension spent on contributions increases significantly



- ▶ Active population reducing more significantly compared to the pensioner population through resignations, terminations (and mortality).
- ▶ The PRMA member population is decreasing through mortality as well as through affordability.
- ▶ Even those pensioners that have subsidies are struggling to afford their share of contributions if they are not subsidised at or near 100%.
- ▶ This leads to buy-downs and resignation from scheme membership.
- ▶ This effect is worsening as contribution increases continue to outstrip inflation (or pension increases).

Contribution increases vs CPI

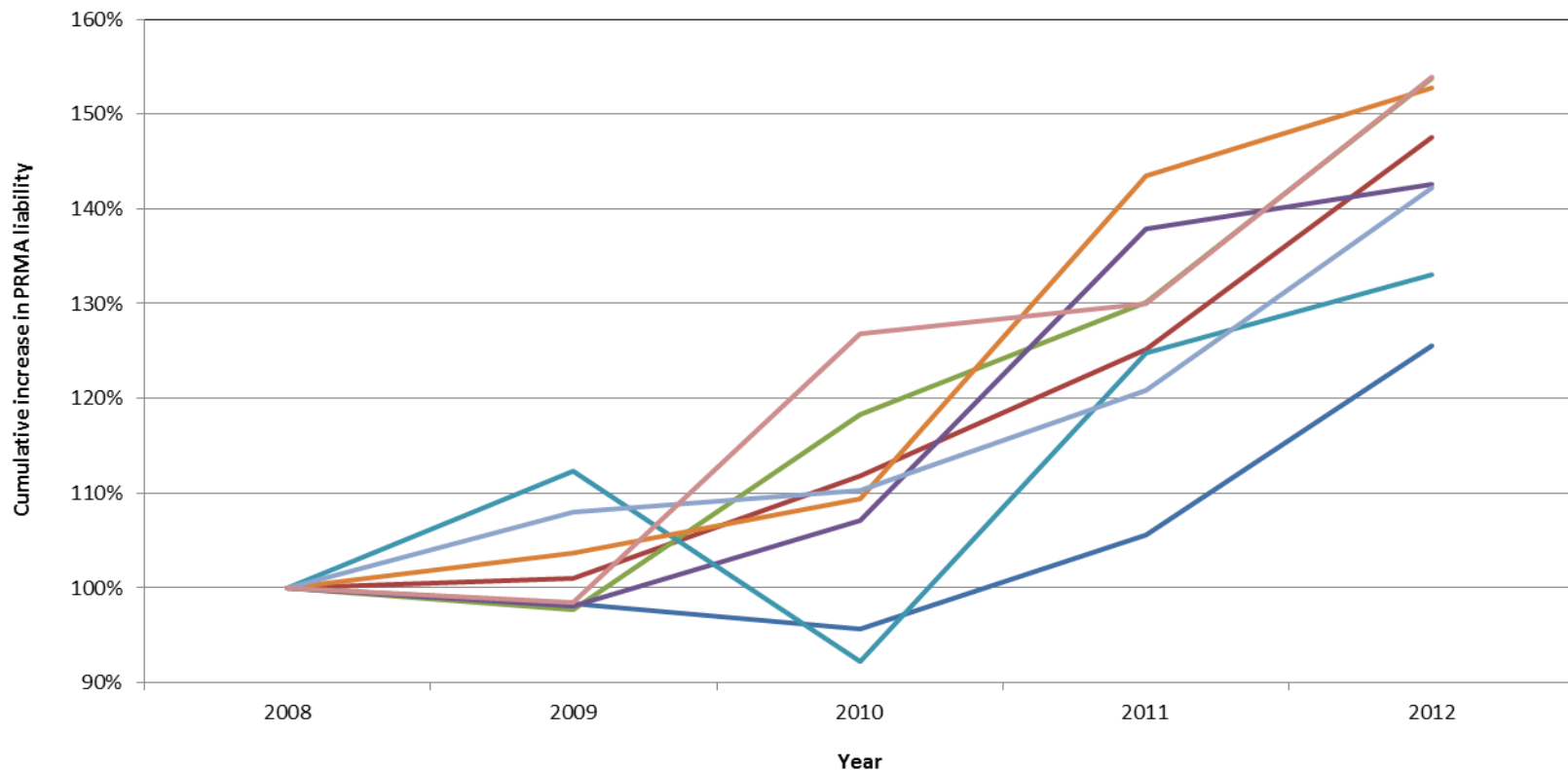


► Contribution increases have averaged approximately CPI+3%

Increasing liabilities - overall

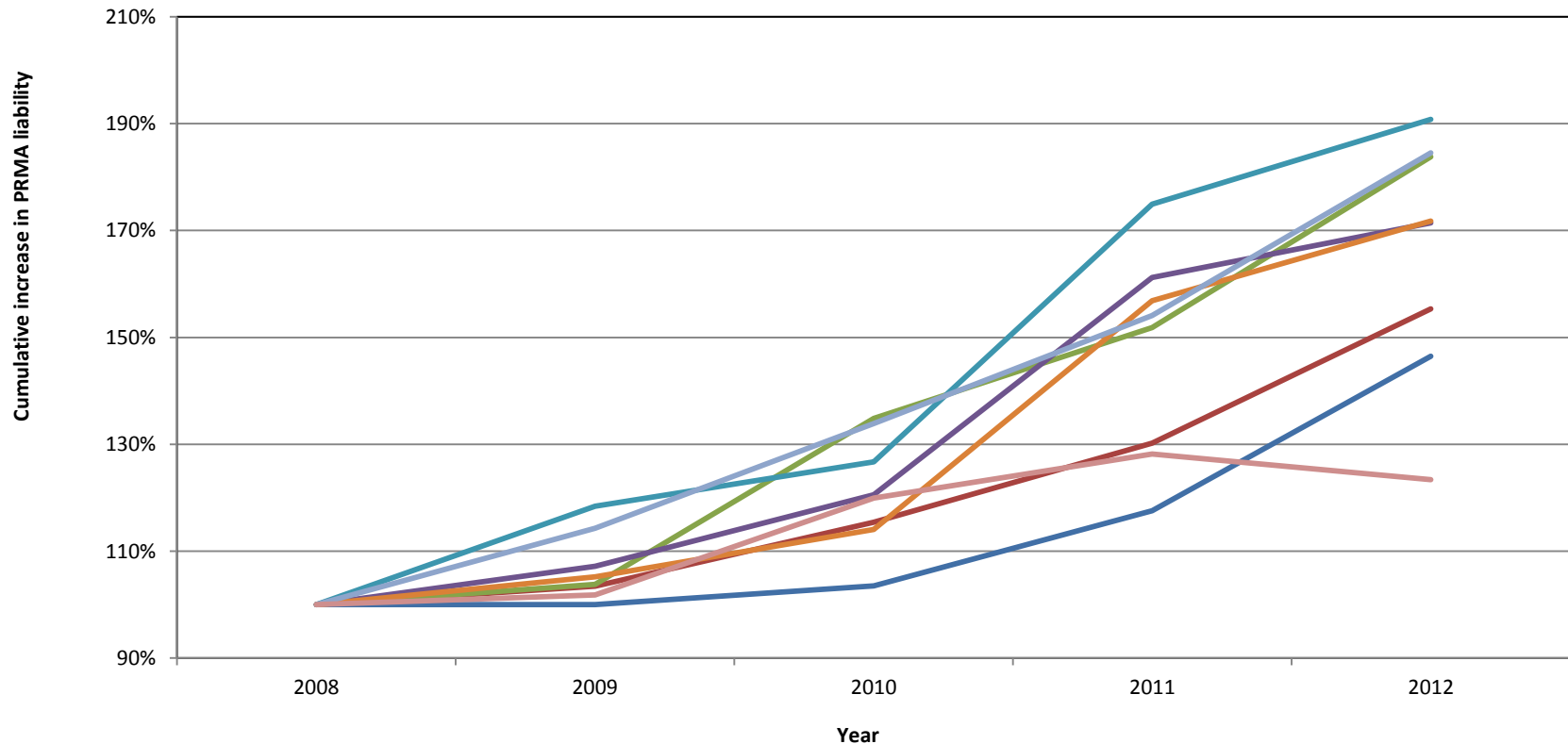


- ▶ The trend in recent years has been significant increases in PRMA liabilities
- ▶ Recent cumulative increases on 8 of NMG's largest PRMA clients below:



- ▶ Average annual increase of 9.65% - worrying for employers

Increasing liabilities – per member



► Average annual increase of 12.7% - worrying for employers

Why are liabilities increasing?



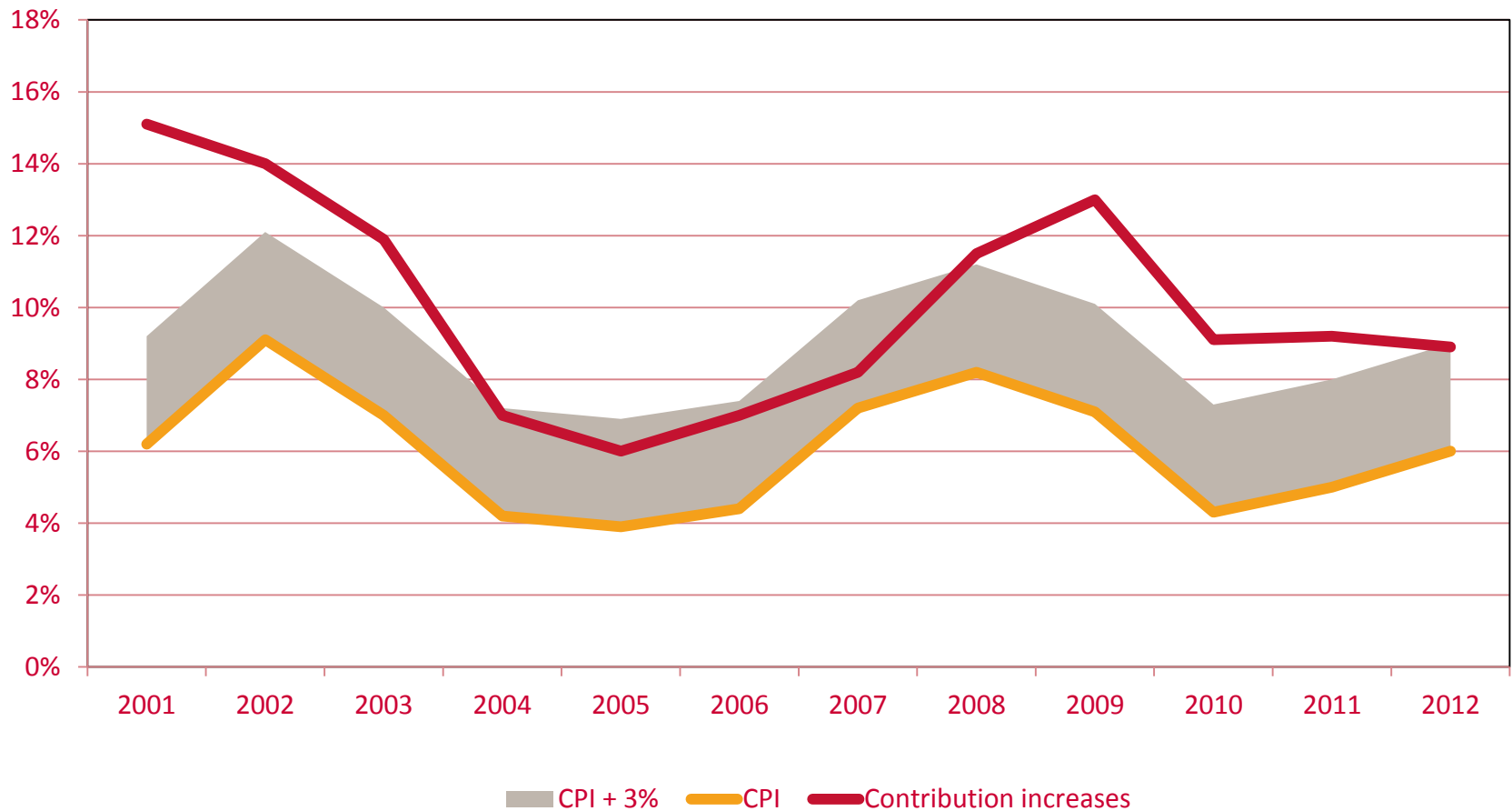
- ▶ Liabilities are expected to increase due to interest and accrual
- ▶ And decrease when benefit payments are made

- ▶ Liabilities increase beyond expected when assumptions are not in-line with actual experience

- ▶ The primary drivers behind increase in liabilities recently:
 - ▶ High medical scheme contribution increases
 - ▶ Changes in SA market conditions
 - Bond yields and interest rates have decreased
 - Real yields and long-term CPI have been relatively stable

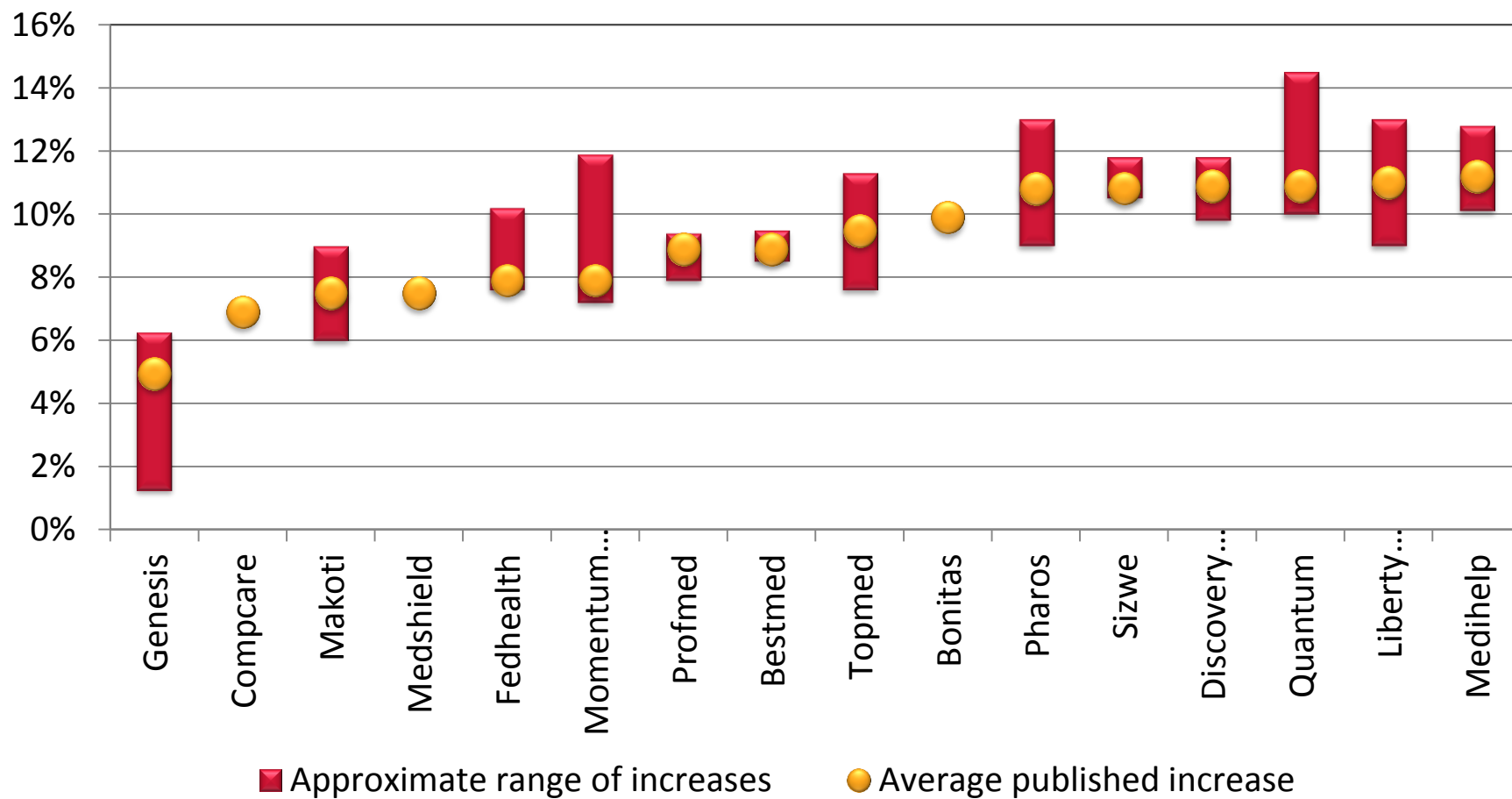
- ▶ Impact of DMT

Contribution increases vs CPI

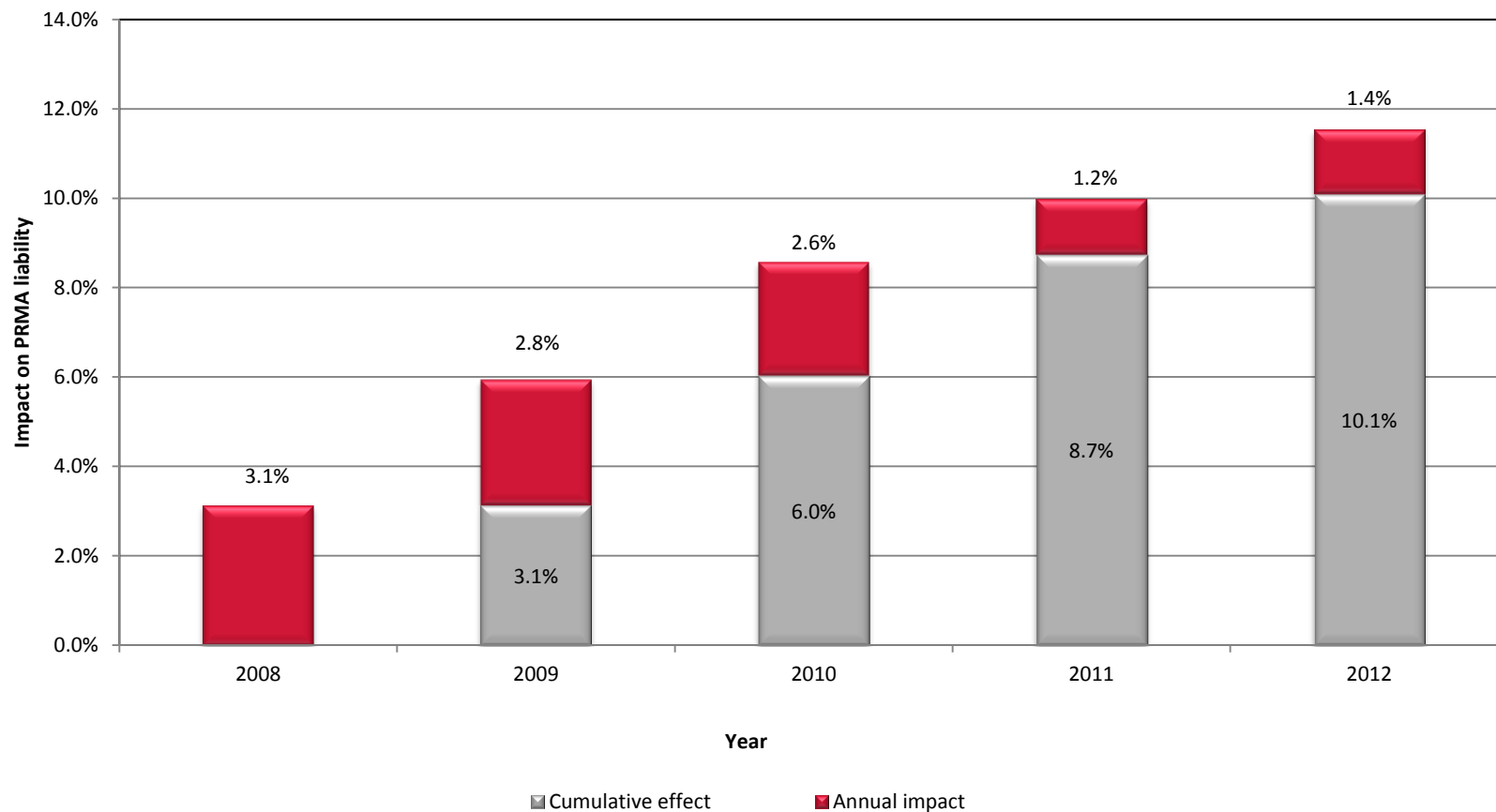


► NMG assumes gap of 1.5% above CPI (long-term assumption)

2013 Increases

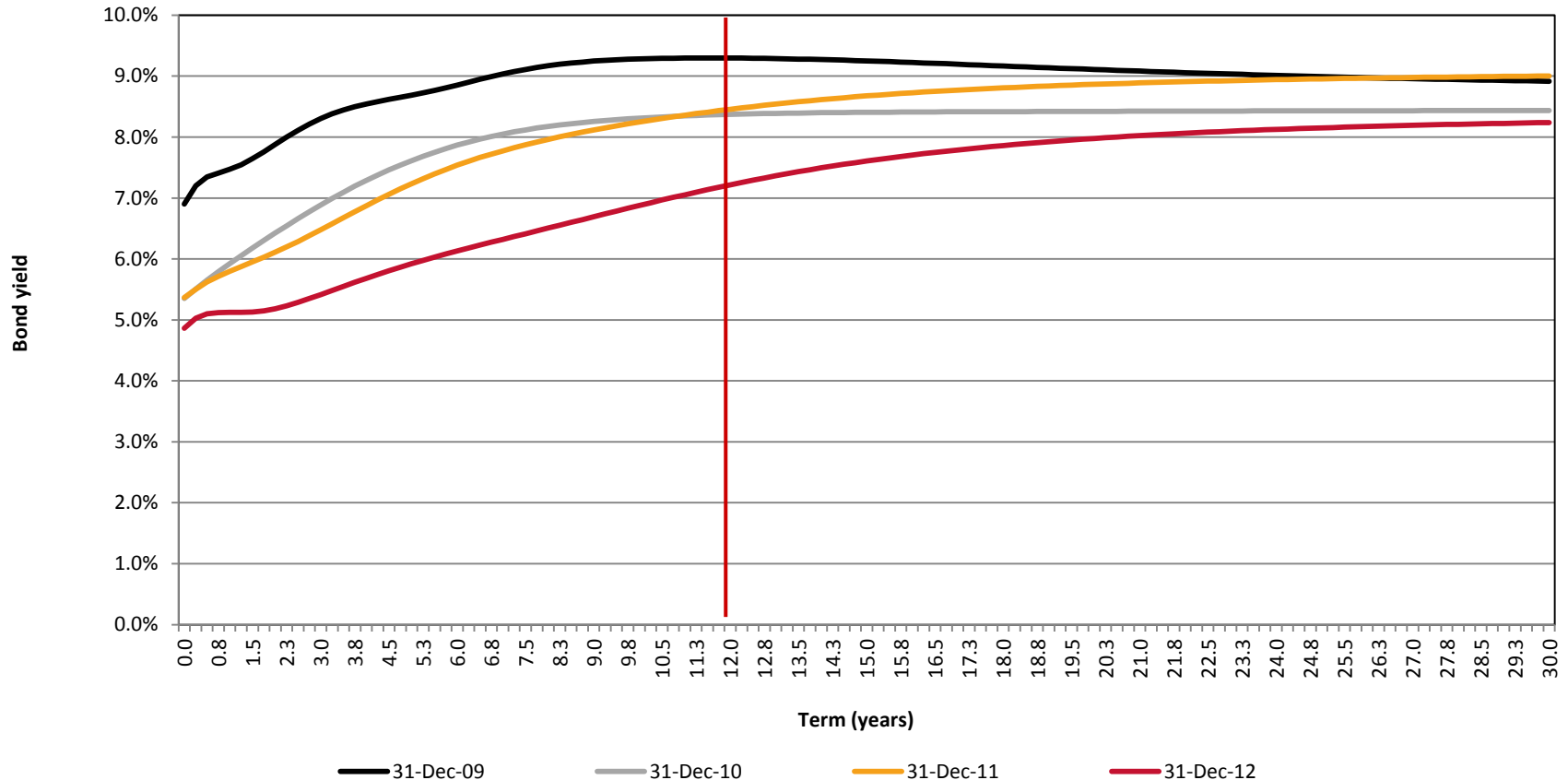


Impact on PRMA liability HCCI actual versus expected



► Cumulative impact of 11.7% on liabilities since 2008

Change in SA bond market

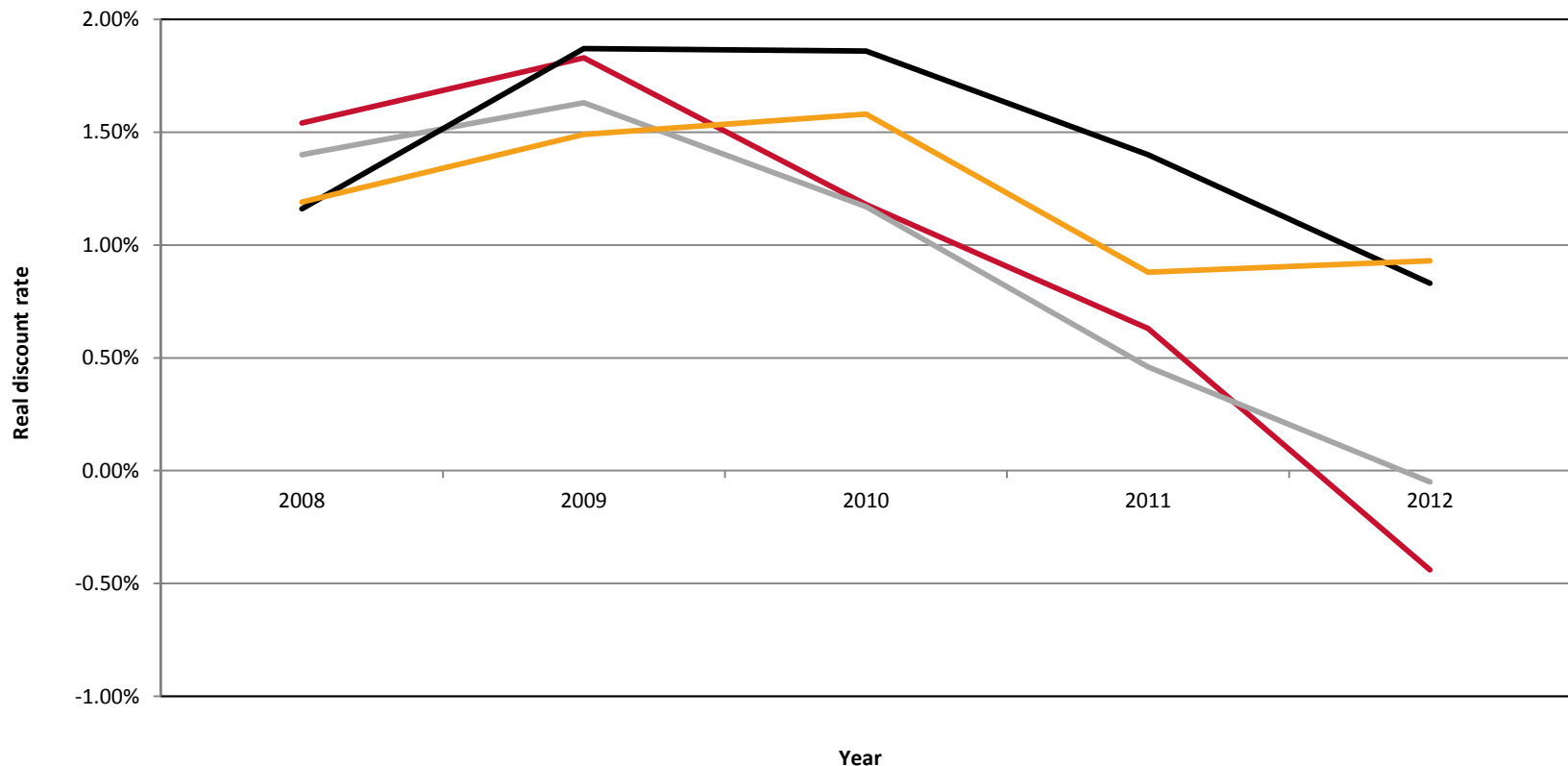


- ▶ Drop in short term yields more significant for short DMT liabilities
- ▶ 2.1% decrease in yield from 2008 to 2012 at 12 year term

Trends in real discount rate



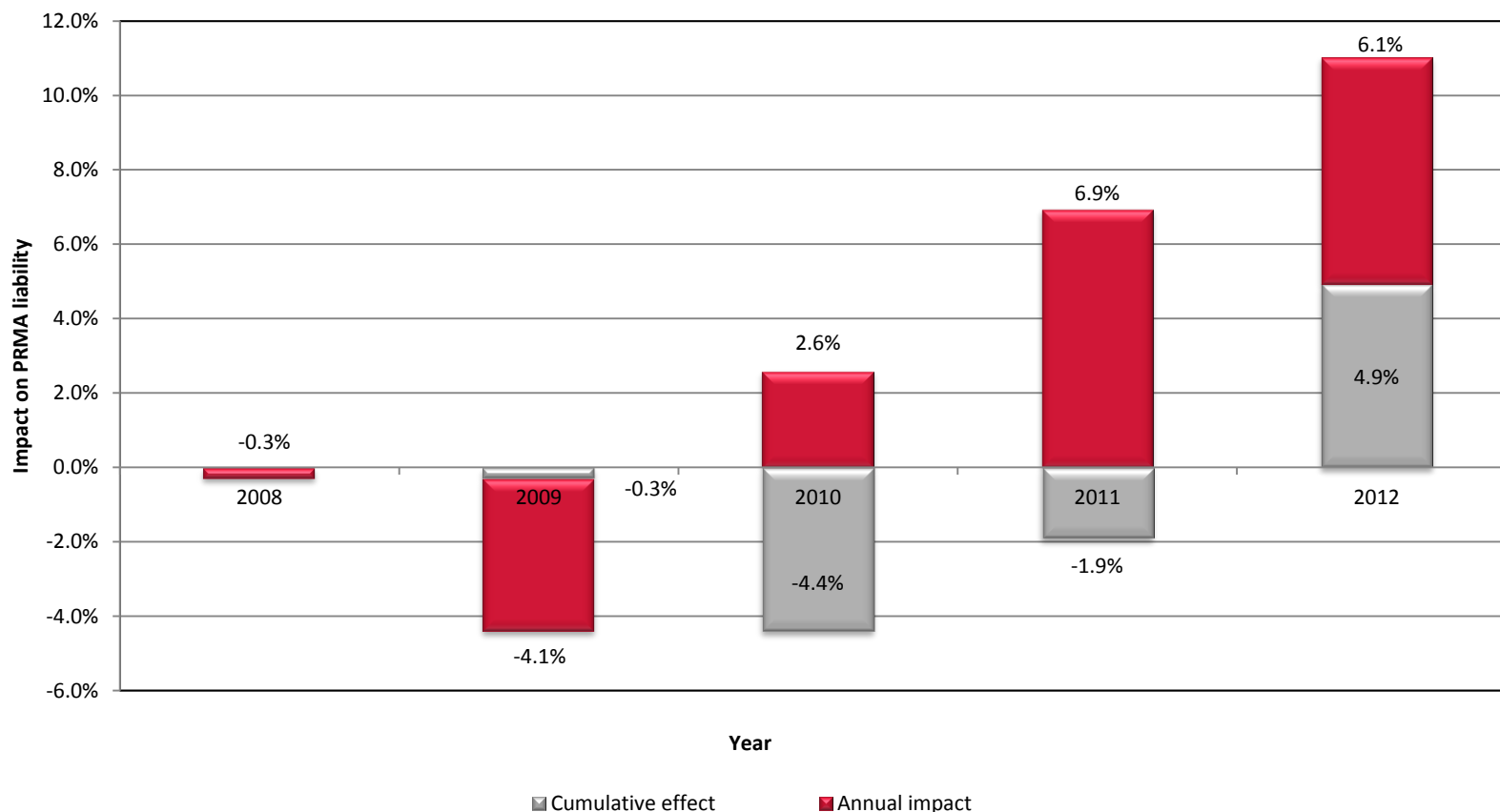
- ▶ Real discount rate (discount net of HCCI) has the largest impact on liabilities



- ▶ Large decrease in real discount rate in last two years – leading to increased liabilities
- ▶ Negative real discount rates are becoming common

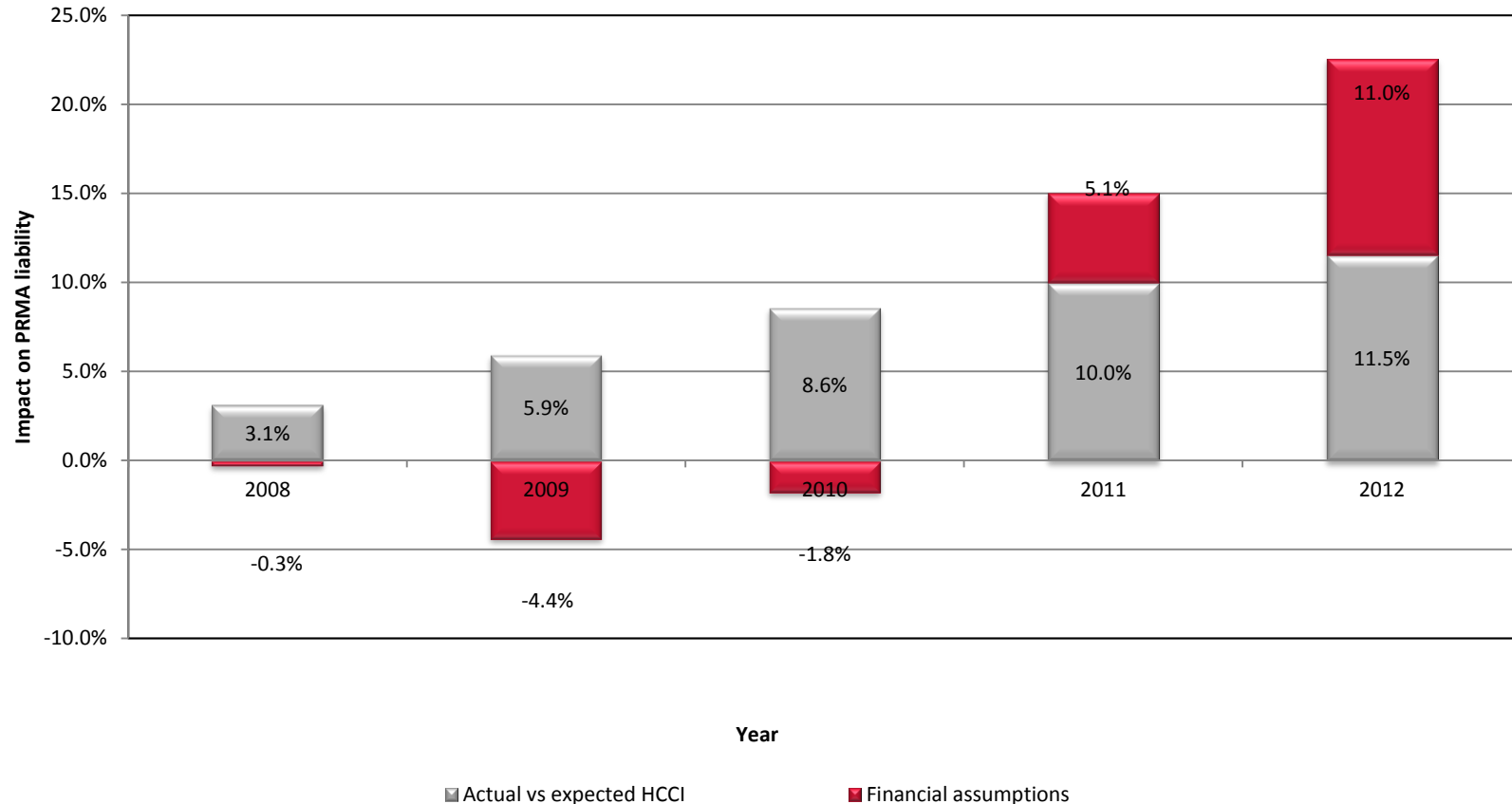
Impact on PRMA liability

Interest rates actual versus expected



- ▶ Cumulative impact of 11.3% on liabilities since 2008
- ▶ Large impact in last 2 years

Combined cumulative impact



► Combined cumulative increase of 23.8% on liabilities

Impact on medical schemes



- ▶ Employer subsidies used to be a significant enabler of medical scheme contribution affordability
- ▶ Reducing subsidies, fewer people being eligible for subsidies and cost to company approach has removed financial obligations from employer to employee impacting funding for both active and pensioner populations
- ▶ Impact on affordability at older ages for those who have not self funded
- ▶ Medical schemes may experience the following due to affordability constraints:
 - ▶ Drop out of the medical scheme risk pool altogether
 - ▶ Benefit option buy down thus leading to overall worsening of option performance
 - ▶ Impact on potential new joiners

Impact on individuals



- ▶ Affordability impact is significant
- ▶ Salary inflation not as high in private sector compared to previous years
- ▶ Impetus to self fund (existing poor levels of retirement savings)
- ▶ Benefits are not necessarily secured thus in the event of company insolvency or liquidation, members may not have a claim
- ▶ Annuity buy-outs:
 - ▶ Not obliged to spend annuity payments on medical scheme contributions
 - ▶ Annuity increases not necessarily in line with contribution increases therefore there may be an increasing burden on pensioners over time

Employer and broader impact



- ▶ Employers have played a significant role in healthcare funding
BUT this role has reduced significantly over the past decade and continues to do so
- ▶ Role of employers in healthcare funding is evolving as they look at ways to manage these (significant) liabilities and risk
- ▶ Assets available to back liabilities, affordability and complexity of outsourcing
- ▶ Pensioners relying on public healthcare services adds more burden on the state
- ▶ Market volatility
- ▶ Pension fund impacts – pressure on retirement savings



OUR PEOPLE · YOUR ASSET

Questions ?