UPDATE

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EMPLOYERS WITH RETIREE DRUG BENEFITS CHARTING DIFFERENT COURSES FOR 2007

Entering 2006, the story line for employers sponsoring post-65 retiree medical programs turned out to be relatively uneventful when it came to responding to the Medicare Part D prescription drug benefit that became available at the beginning of the year. Most companies decided to continue their own plans and collect the federal subsidy. For 2007, it looks like the Part D story will become more complex.

There's increasing evidence that employers are rethinking their prescription drug strategies for both Medicare-eligible and non-Medicare-eligible retirees. Fewer appear committed to taking the federal subsidy again in 2007, and more seem interested in alternative approaches. At the same time, most organizations aren't sure yet what they'll do next year.

These are among the central findings of a nationwide survey developed by Towers Perrin and conducted by the International Society of Certified Employee Benefit Specialists (ISCEBS). The survey, which was conducted in January and drew responses from 169 companies and nonprofit organizations, updates a similar inquiry by Towers Perrin and ISCEBS last year to find out how plan sponsors were responding to the new Medicare drug benefit.

The findings come at a time when the availability of employer-sponsored retiree medical programs, implementation of the new Medicare prescription drug benefit and rising prescription drug costs continue to stir a lot of interest in the media and the public at large. The Bush administration is making employer-sponsored health care plans, including those for Medicare-eligible retirees, a key component of its current policies to promote affordable health care.

The Towers Perrin/ISCEBS survey found that nearly two-thirds (63%) of the respondents said they had not decided on how to respond to Medicare Part D beyond 2006. More than a third — the remaining 37% — said they had made up their minds. This puts the majority of plan sponsors in the undecided camp in terms of a long-term Part D strategy. By contrast, nearly two-thirds (65%) of respondents said they opted to continue their prescription drug plans and collect the federal subsidy in 2006.

Perhaps even more striking is what those companies that do have a Part D strategy in mind for 2007 had to say. Fewer than half (42%) in this category said they plan to maintain current benefits and collect the federal subsidy. The remainder indicated that they are considering a variety of alternative approaches — none of which involves continuing to collect the subsidy. The two most popular choices are to offer a supplemental plan in coordination with Medicare Part D plans available in the market and to arrange to offer a specific Part D plan. More than one in 10 respondents (12%) indicated that they planned to eliminate all retiree medical coverage in 2007 or eliminate prescription drug coverage *(Exhibit 1)*.

EXHIBIT 1

Anticipated 2007 Part D Strategies of Plan Sponsors

Strategy	%
Maintain current benefits and collect subsidy	42%
Integrate (coordinate) with Part D plans	20%
Arrange to offer a specific Part D plan	13%
Eliminate drug coverage and offer Medicare Parts A and B coverage	7%
Continue the plan without subsidy	5%
Eliminate all retiree medical	5%
Eliminate employer plan and reimburse premium payments	3%
Other	5%

GAINING EXPERIENCE IN 2006

Now that the new Medicare prescription drug benefit is a reality in the marketplace, employers are clearly in a better position to assess their Part D strategies in the context of their broader HR programs for rewarding employees and retirees. They have more information, and some experience, in deciding what approach will work best for them over the long haul.

For those employers that opted for the subsidy, there is increasing clarity about operational compliance with the regulations issued by the Centers for Medicare & Medicaid Services (CMS) than before the new prescription drug benefit officially became available on January 1. Information has arrived on *how* employers will be paid their subsidy, although CMS has announced that actual payments are unlikely to begin before July for most employers. Most employers have given Part D-eligible plan participants their creditable coverage notices, and employers have until March 31, 2006 to report their compliance on that count to CMS. Overall, from a compliance and plan administration standpoint, employers with prescription drug plans appear to be fairly knowledgeable about what's required to meet Part D rules.

Based on increasing health care costs, it is not surprising that most employers we surveyed (82%) used their federal subsidy entirely to reduce their own cost. Only 14% opted to share the cost reduction or use the subsidy entirely to reduce the cost for retirees *(Exhibit 2)*.

EXHIBIT 2

How Plan Sponsors Used Their Part D Subsidies in 2006

Solely used to reduce employer cost	82%
Cost reduction was shared	8%
Solely used to reduce retiree cost	6%
Other	4%

Generally speaking, the Part D vendor marketplace has met or exceeded the expectations of most employers. The types of prescription drug plans available in regional markets for Medicare-eligible employees and retirees include a variety of designs in terms of copayments, premiums and other basic features, and 2006 pricing turned out to be relatively attractive to plan participants. Insurance companies, pharmacy benefit managers (PBMs) and other vendors formed significant alliances to market and deliver Part D plans.

This is not to say the Part D rollout has been entirely smooth — it clearly hasn't. Medicare beneficiaries had a hard time evaluating different drug plans, formularies, drug prices and pharmacies. Many retirees struggled with — or were unable to use — the Web tools made available by the government and insurers. In addition, most large employer PBMs appeared unprepared and reluctant to provide employer-arranged prescription drug plans.

Overall, enrollment to date by individual Medicare beneficiaries has been less than projected in the wake of numerous start-up challenges and administrative issues as well as what is perceived by many as an overwhelming number of choices. Of course, the initial open period continues through May 15, 2006, and CMS contends many initial administrative snags are being remedied.

Despite the initial confusion and administrative difficulties that accompanied the launch of the new Medicare drug program, the Towers Perrin and ISCEBS research confirmed that most employers helped their retirees avoid the confusion because they maintained their current prescription drug benefits and collected the subsidy in 2006. Some employers did take different approaches for various groups of retirees *(Exhibit 3)*.

EXHIBIT 3

Medicare Part D Courses of Action by Plan Sponsors in 2006

Maintain current benefits and collect subsidy	65%
Continue the plan without the subsidy	10%
Integrate (coordinate) with Part D plans	10%
Arrange to offer a specific Part D plan	5%
Eliminate drug coverage and offer Medicare Parts A and B coverage	3%
Eliminate employer plan and reimburse premium payments	1%
Eliminate all retiree medical	1%
Other	5%

Most employers also told their Medicare-eligible population that if they chose to enroll in a Medicare prescription drug plan (PDP) or a Medicare Advantage plan with prescription drugs (MA-PD), they could not continue to qualify for a company-sponsored drug benefit. Fully 41% said retirees could not continue in their employer's medical plan if they enrolled in a PDP, while another 25% said retirees could continue in the medical portion of the plan but not the drug portion. More than a quarter (28%) said retirees could continue in the employer plan if they enrolled in a PDP.

FUTURE UNCERTAINTIES

Looking ahead to 2007 and beyond, our survey indicated some major uncertainties and concerns among employers with respect to prescription drug coverage for their Medicare-eligible populations. Confidence in the Medicare Part D program over the long term appears tenuous. About 60% of employers believe that in the future Medicare Part D will be changed to eliminate private plans, and the price of prescription drugs will be controlled by CMS. More employers believe Part D will be repealed (16%) than believe that private plans will be successful in controlling prescription drug costs.

ACCOUNTING ISSUES

Perhaps the biggest hurdle on the more immediate horizon for plan sponsors is the accounting changes that the Financial Accounting Standards Board (FASB) is considering for pension and other postretirement benefits, including retiree medical benefits. Most of the employers in our survey indicated concern about potential earnings volatility as a result of the FASB proposal, with almost a third (30%) anticipating either a "significant" or "very significant" effect (*Exhibit 4,* next page).

EXHIBIT 4

Plan Sponsors' Estimates of the Impact of Potential FASB Accounting Changes on Volatility of Expense

Very significant effect	8%
Significant effect	22%
Some effect	27%
Little effect	11%
No material effect	10%
Don't know	22%

This is consistent with other recent Towers Perrin research that found that changes in the accounting rules for pensions and other postretirement benefits planned by FASB could have a major financial impact on many companies by requiring them to recognize an additional liability on their balance sheets. The FASB project, undertaken last November, will be addressed in two phases. Phase l focuses on the balance sheet, and Phase ll involves a comprehensive reexamination of all aspects of accounting for pensions and other postretirement benefits.

Given the accounting backdrop and other challenges associated with sponsoring retiree medical plans in general, it is not surprising that there is a growing interest among employers in Medicare Advantage plans as part of their overall strategy. In our survey, while only 20% of respondents said they offered retirees these plans in 2006, 38% said they either will offer the plans or are considering doing so in 2007.

PFFS OPTION

One approach that is catching the interest of some employers is to offer Medicare Advantage private fee-for-service (PFFS) plans, which have been authorized since 1997. These plans are now more financially attractive to insurers as a result of increased CMS reimbursements to Medicare Advantage plans under the Medicare Modernization Act. PFFS plans are insured and administered by private insurers but provide indemnity-type coverage that does not restrict beneficiaries to a network of providers.

PFFS plans have the potential to deliver considerable cost savings to plan sponsors, especially to companies with significant retiree populations, in part because they bring Medicare services to beneficiaries more efficiently through a single claim administration process for Parts A and B coverage and the claims arising from the employer's supplemental plan. Additional savings may be available to the extent that retirees' participation in Medicare Advantage plans relieves the employer of certain costs associated with the supplemental plan. In fact, PFFS plans can be designed as a full replacement for the supplemental plan.

Unlike other Medicare Advantage plans, PFFS plans are not required to cover outpatient prescription drug coverage through a mandatory Part D benefit. The benefit can be delivered in an arrangement administered by the insurer under terms set by the employer or through a stand-alone Part D plan with the insurer and an employer wraparound.

These choices offer employers a lot of flexibility in fashioning a Part D benefit strategy to meet their needs, including a transition strategy and the option of an exit strategy if they eventually decide on that course. At this point, however, these plans are not on the radar screen for most employers. In our survey, only 13% of respondents said they were considering them.

ABOUT TOWERS PERRIN

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The firm has served large organizations in both the private and public sectors for 70 years. Our clients include three-quarters of the world's 500 largest companies and three-quarters of the *Fortune* 1000 U.S. companies.

Towers Perrin has offices in 25 countries.

Our businesses include HR Services, Reinsurance and Tillinghast.

The HR Services business of Towers Perrin provides global human resource consulting and related services that help organizations effectively manage their investment in people. We offer our clients services in areas such as employee benefits, compensation, communication, change management, employee research and the delivery of HR services.

ABOUT THE INTERNATIONAL SOCIETY OF CERTIFIED EMPLOYEE BENEFIT SPECIALISTS

The International Society of Certified Employee Benefit Specialists (ISCEBS) is a nonprofit educational association whose members have earned the Certified Employee Benefit Specialist (CEBS) designation, which is cosponsored by the International Foundation of Employee Benefit Plans and the Wharton School of the University of Pennsylvania. For more information on the Society or CEBS, please visit the ISCEBS Web site at *www.iscebs.org*.