UPDATE
March 14, 2007

EMPLOYERS EXPLORE NEW STRATEGIES FOR RETIREE MEDICAL PROGRAMS

When the Medicare Part D prescription drug benefit was launched in January 2006, employers faced a wide range of new opportunities in a restructured health care marketplace for employees and retirees. Today, companies continue to evaluate their options in terms of the structure, subsidization and overall commitment to their retiree medical programs. Many organizations have made broad changes to these programs, and the presence (or absence) of insurance alternatives for retirees in the private marketplace has had a significant impact on employer direction and strategy.

A nationwide survey developed by Towers Perrin and conducted by the International Society of Certified Employee Benefit Specialists (ISCEBS) aims to track these changes and the forces influencing them. Now in its third year, the survey was conducted in January and drew responses from 157 companies and nonprofit organizations.

PRE-65 STRATEGIES

For pre-65 coverage, the marketplace story is relatively simple. The absence of viable private market options leaves employers with minimal flexibility. While many employers (66%) continue to tweak plan design and cost sharing on a regular basis for their pre-65 plans, fewer than one in four (23%) would consider moving to a retiree-pay-all structure, and fewer still (12%) would consider cessation of pre-65 coverage. Although the general trend is moving toward the erosion of traditional forms of retiree medical coverage, it is also apparent that some employers are starting to recognize that this development is not without consequences, as older employees defer retirement. This in turn is having an impact on broader efforts to manage the workforce and attract talent.

At the same time, employers continue to explore options to address the growing cost and health concerns of their pre-65 retiree populations. Among the most popular strategies are health and wellness promotion, targeted communications and the implementation of low-cost/high-efficiency plans. These plans are separate from the account-based arrangements that couple a high-deductible health plan (HDHP) with a health savings account (HSA), as shown in *Exhibit 1.*

EXHIBIT 1

How employers are helping employees gain awareness of coverage cost

(multiple selections allowed)

Health promotion, wellness and disease management	27%
Communications on retiree cost	21%
Low-cost/high-efficiency plans	17%
Financial planning resources	15%
Account-based health plans (HSA/HDHP)	10%
Other	2%
No action taken	11%

Although only 10% of respondents had used an account-based approach as a means to help employees make the financial transition from active employment to pre-65 retirement, a much larger proportion (35%) indicated that they had implemented or are considering the implementation of an HDHP coupled with an HSA for their pre-65 retiree population. These plans, enabled under the Medicare Modernization Act (MMA), have become increasingly popular with employers as an effective means to help provide increased financial security to people as they make the transition from employment to retirement. In addition to their tax advantages, these plans allow individuals over age 55 to make additional pretax "catch-up" contributions that can help build up their savings for postretirement medical expenses.

POST-65 STRATEGIES

The post-65 retiree medical world is more complicated, but also offers a wider array of choices for employers and retirees. With the abundance of private offerings in the marketplace, plan design is far from the only strategic lever here. Sponsorship, funding and subsidization are also at play, allowing employers to adjust their level of commitment to each, often resulting in savings while giving retirees more flexibility — and responsibility — in managing their health care costs.

Nearly 40% of respondents offering post-65 coverage indicated that they had implemented or are considering an employer-specific Part D plan for their retirees. Nearly 30% of employers offering post-65 coverage have implemented or are considering a Medicare Advantage HMO or PPO option for their retirees.

Most employers chose to "stay the course" for their post-65 drug coverage in 2006, which often meant that they were eligible for the Retiree Drug Subsidy (RDS) available under the MMA. In order to qualify for the subsidy and obtain payments from the Centers for Medicare & Medicaid Services (CMS), employers must complete an online application and submit their claims data on a regular basis.

With a full year behind us, the RDS process appears to have yielded mixed results among employers. Fully 81% of respondents experienced problems throughout their first year on the RDS Web site, and 12% of employers indicated that they have decided to abandon the RDS process in favor of alternatives as a result of these problems. Moreover, many employers still had not collected any 2006 subsidy payments as of January 2007. On the other hand, more than half (56%) of RDS employers reported receiving payments close to their expectations, while only 16% indicated that they were receiving less than they had expected.

SUCCESSFUL ROLLOUT

A groundswell of plan offerings in the private market in the beginning of 2006 led to significant retiree confusion around options, cost and coverage. This confusion was especially notable under Part D stand-alone coverage. After this early disruption, it appears that the problems have been worked out and enrollment for 2007 went more smoothly. At this point, carriers have simplified their Part D plan options, although the number of national carriers has increased. Part D plans are now thriving in the individual marketplace, alongside Medigap plans and Medicare Advantage plans.

OPPORTUNITIES FOR EMPLOYERS

One notable development for 2006 and 2007 is the increasing interest in Medicare Advantage Private Fee-For-Service (PFFS) offerings, particularly in rural areas. These plans did not make a huge splash upon their original entry into the post-65 market, but their impact is visible and growing. Enrollment growth has been striking. Enrollment in July 2005 was approximately 120,000. By mid-2006, enrollment had grown to 764,000, and as of February 2007, PFFS plans had approximately 1.3 million beneficiaries enrolled.

According to CMS, enrollment in Medicare Advantage plans grew from 7.5 million in 2006 to 8.3 million in 2007, a jump of 10%. Most of this increase came in PFFS plans, where enrollment swelled by 450,000. The flexibility of provider choice coupled with the cost-effectiveness of these plans make them particularly attractive to individuals. Employers have been slower to respond, with only 3% acting to implement these plans in 2006 or 2007. However, another 15% are considering the PFFS option for 2008 or later. We believe this represents an opportunity for significant savings over a traditional self-insured, post-65 program for organizations with suitable geographic and demographic profiles.

Employers are also becoming more aware of the potential advantages of Medigap plans, which have been present in the individual post-65 market since their establishment by the federal government in the early 1990s. MMA added two new plans to the Medigap menu while curtailing the provision of drug benefits for future Medigap enrollees. The upshot is that there are a number of Medigap options (A through L) that can act as a useful building block for organizations wishing to establish an effective post-65 health care program. In our survey, 15% of employers indicated that they had already implemented a Medigap option for their retirees in 2006 or 2007, and another 16% are considering such an option for 2008 or later. While employers can choose to sponsor Medigap options, individual plans can also be an attractive option under a premium reimbursement arrangement in which employers can cease plan sponsorship in favor of making money available for private coverage.

The number of leading carriers in the individual post-65 market has been relatively constant, according to CMS enrollment figures. However, there's more variation among employers in terms of the carriers contracted to administer or insure retiree medical coverage. Our survey found that many employers use multiple vendors within their post-65 programs, with Blue Cross/Blue Shield plans the leading choice *(Exhibit 2)*.

EXHIBIT 2

Many different carriers support employer retiree medical programs

(multiple selections allowed)

Aetna	25%
UHC	23%
Medco	23%
Wellpoint/Anthem	23%
CIGNA	14%
Caremark	12%
Express Scripts	10%
Kaiser	7%
Humana	3%
Other Blue Cross/Blue Shield plans	40%
Other plans	22%

DECISION DRIVERS

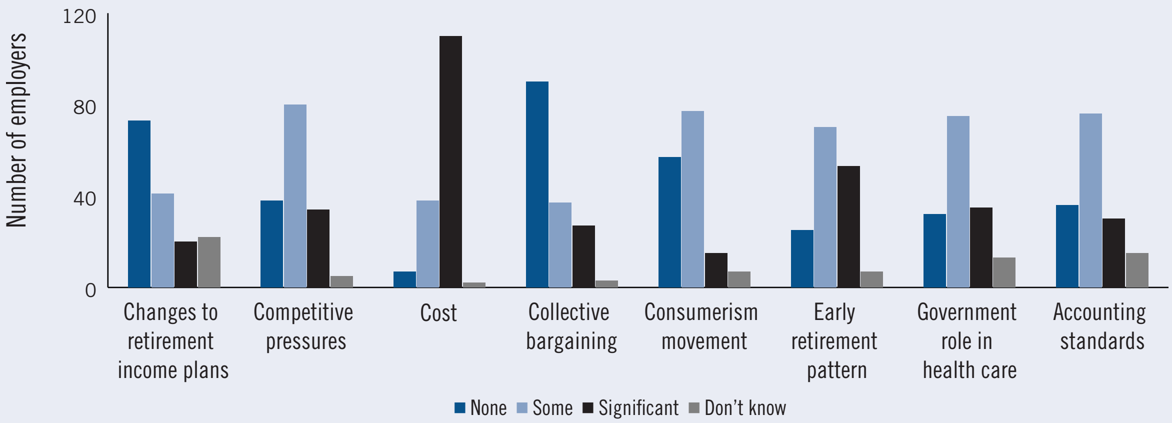
In last year's survey, 63% of respondents indicated that they had not decided how to respond to the new Medicare Part D prescription drug benefit or how to incorporate it in their retiree medical programs beyond 2006. This year's survey indicates that employers have taken a closer look at their longer-term goals and opportunities in efforts to help retirees meet their health care needs. While organizations may not have confirmed their approach for 2008 and beyond, they have begun to further explore options and, in many cases, have implemented some of those options for 2007 and 2008.

Not surprisingly, escalating cost remains a significant driver behind the decisions employers make with regard to their retiree medical programs. Another major force impacting retiree strategy is early retirement patterns. Many employers are coming to the realization that, in the absence of an adequate subsidy toward pre-65 retiree medical coverage, some employees who would otherwise retire choose to remain in active employment for the sake of their health care benefits. Given the high cost and difficulty of obtaining individual pre-65 coverage, this behavior is not surprising. A well-subsidized pre-65 employer program can help in this situation and make it easier for employers to pursue workforce strategies that permit older employees who would prefer to retire to do so.

Many other forces play a role in employer decision making around retiree health care, including competitive pressures, consumerism, the government's expanding role in health care and changing accounting standards *(Exhibit 3).*

EXHIBIT 3

Impact on retiree medical change



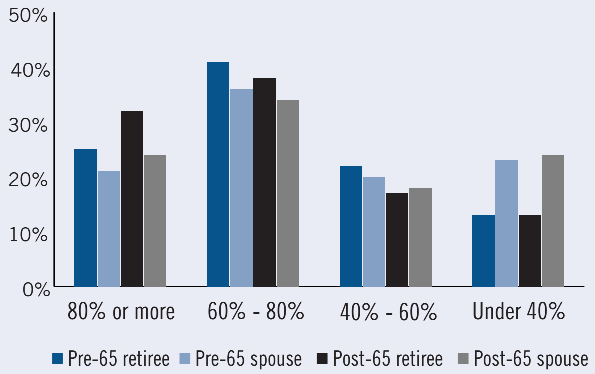
CONTRIBUTION STRATEGIES

Nearly half (46%) of respondents report that pre-65 coverage is subject to a cap on company subsidy, and plan costs for 61% of those employers have reached the cap. For post-65 coverage, 53% of respondents have capped their subsidy, and 62% of those have reached the cap. When initially adopted, many employer subsidy caps were not expected to hit for some time, and therefore their impact was largely related to accounting and finance. However, now that costs for so many companies are reaching the caps, the implications of this dynamic are widespread. For post-65 coverage, employers with capped plans should consider whether continuing their current arrangement makes sense in light of the eroding value of the company subsidy compared to the plans available in the private marketplace. On the pre-65 side, the rising share of costs for beneficiaries can have a dramatic impact on the affordability of coverage, thereby influencing retirement patterns and workforce renewal.

Retiree contributions as a percentage of cost are relatively consistent across age groups (pre-65 versus post-65) and covered members (retirees and spouses). The largest segment of respondents subsidizes between 60% and 80% of the 2007 cost of coverage, and many continue to subsidize more than 80% of coverage for all members.

EXHIBIT 4

Employer subsidization of retiree medical coverage



FUTURE OUTCOMES

Overall, employers appear to be pursuing strategies that maintain existing commitments to retirees and grandfathered active employees, while continuing to explore alternatives that may result in lessened administrative and financial commitments. Nearly half (47%) of respondents still provide some form of retiree medical coverage to new hires, although 83% of all respondents apply different terms (eligibility, subsidy, plan designs) to different retiree groups. Additionally, over one-fourth (27%) of respondents report that their pre-65 retirees pay the full cost of coverage. That proportion increases to 29% on post-65 coverage.

Some employers have taken an "in between" approach to the management of post-65 plan sponsorship and subsidization. Given the current strength of the post-65 market, many plan sponsors have determined that the most effective use of their retiree medical dollars is to hand them over to retirees in the form of a premium reimbursement account. This allows retirees to purchase the individual plans of their choosing in the private market. Although few (2%) respondents indicated that they had already implemented such an approach, 14% said they were considering it for 2008 or later. This approach effectively takes employers out of the plan sponsorship and administration roles while allowing retirees to choose the coverage that best suits their individual needs. The wide availability and variety of post-65 options in the private market lends itself well to this strategy.

Our survey suggests that, when viewed collectively, most employers remain committed to some type of long-term retiree medical strategy that blends plan sponsorship and subsidization. Although more than a third (34%) of respondents are willing to make changes to their existing program, only 16% would consider a full exit from the retiree medical world *(Exhibit 5)*.

EXHIBIT 5

Employers' long-term strategy regarding retiree medical coverage

(multiple selections allowed)

Continue sponsorship and subsidy for current retirees, actives and new hires	34%
Maintain existing financial commitment to current retirees and grandfathered active employees	44%
Changes may be necessary to reduce cost for current program	34%
Exit pre-65 retiree sponsorship and subsidization only	12%
Exit post-65 retiree sponsorship and subsidization only	8%
Exit both pre-65 AND post-65 retiree sponsorship and subsidization	16%
Other	7%

The retiree medical environment continues to undergo sweeping change. As evidenced by this survey, employers are still moving carefully in acting upon these changes. It is clear that employer-sponsored retiree medical coverage is with us for a while, especially in the case of grandfathered retirees. In the meantime, the opportunity for employer action is growing, and the onus is on employers to continue to evaluate their options and make the decisions that best suit their workforce, retiree population and overall benefit strategy.

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