Retiree Healthcare Challenges and the Affordable Care Act

EACUBO
March 20, 2014
Agenda

- Recent trends in retiree health benefits
- Retiree health benefits after Medicare Modernization Act (2003)
- Retiree health benefits after the ACA (2010)
- Savings needed for healthcare in retirement
- Defined Contribution Retiree Health Plans
- Question & Answer
# Retiree Healthcare Market Overview

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<th>Plan Features</th>
<th>Major Players</th>
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▪ Creates FASB 106 or GASB 45 unfunded liabilities                                                                                                              | ▪ Employers sponsoring group insurance plans  
▪ Insurers  
▪ Brokers  
▪ Consultants                                                                                                                                                    | |
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▪ Private exchanges                                                                                                                                             | |
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▪ Employer-sponsored with employer and/or employee contributions in invested tax-advantaged accounts  
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▪ No unfunded liabilities  
▪ Access to retiree health insurance plans may be provided  
▪ Can accommodate pay-as-you-go subsidies for cohorts grandfathered into DB arrangements                                                                                                                                 | ▪ TIAA-CREF RHP  
▪ Emeriti Retirement Health Solutions  
▪ Other mutual fund & insurance companies                                                                                                                       | |
| Access Only      | ▪ Access to employer sponsored or endorsed group insurance plans paid entirely by retiree                                                                                                                                                                                                                                                  | ▪ Insurers  
▪ Private exchanges                                                                                                                                                                                                       | |
| No Benefit       | ▪ No allowance for, or access to, employer-sponsored or endorsed retiree health insurance                                                                                                                                                                                                                                                   | ▪ Individuals are on their own upon retirement                                                                                                                |
FASB & GASB

Financial Accounting Standards Board (FASB) Statement No. 106 (FAS 106)

- 1990 accounting rule change that required employers to report their retiree health benefit liabilities

Governmental Accounting Standards Board (GASB) Statements No. 43 and 45 (GAS 43 and 45)

- Imposed new accounting standards on public-sector sponsors similar to the FAS 106 standards
Fewer employers offering benefits

When offered, retirees paying more
- Spending caps
- Defined contribution approaches
- Access-only plans

More difficult to qualify for benefit
- Higher age and service requirements
- New hires often not eligible
Percentage of Large Private Sector Employers That Terminated All Subsidized Benefits for Future Retirees, 2002-2006

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>13%</td>
</tr>
<tr>
<td>2003</td>
<td>10%</td>
</tr>
<tr>
<td>2004</td>
<td>9%</td>
</tr>
<tr>
<td>2005</td>
<td>12%</td>
</tr>
<tr>
<td>2006</td>
<td>9%</td>
</tr>
</tbody>
</table>

* In 2002, survey asked employers about changes made to plan during previous two years. In 2003-2006, employers were asked about the past year.

Percentage of Private-Sector Establishments Offering Health Insurance to Retirees, 1997-2011

Distribution of How Employers Subsidized Early Retiree Health Benefits, 2005-2010

Pre Medicare Modernization Act (MMA) in 2003

Retirees had no ability to obtain comprehensive medical coverage outside of employer provided plans

- Post-65 retirees could purchase Medicare, Medicare Advantage, and Medicare Supplement—however, they had no access to reliable Rx coverage
- Pre-65 retirees had no reliable access to post-employment health coverage (other than COBRA and, ultimately, Medicare)
- Increasing costs meant that employers often offered retiree medical plans that were too extensive—and too expensive—for retirees’ needs

Post MMA

Post-65 retirees now have access to prescription drug coverage outside of the employment relationship (Medicare Part D)

Events over the last 10 years have changed the retiree medical landscape in the US.
ACA extends the changes made by MMA – beginning in 2014

Pre-65 retirees (along with those still actively employed) will have access to health insurance with many important protections

- Guaranteed issue
- No medical underwriting or preexisting conditions limitations
- Limits on age-based premium spikes (3:1 ratio)
- All options meeting minimum coverage standards
- Premium and out-of-pocket subsidy may be available from federal government (based on income)

ACA also gradually closes the so-called “donut hole” for post-65 retirees
## Changes to Retiree Health Benefits From 2011 to 2012

<table>
<thead>
<tr>
<th>Change</th>
<th>Early Retirees</th>
<th>Medicare-Eligible Retirees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased retiree contribution to premiums</td>
<td>73%</td>
<td>75%</td>
</tr>
<tr>
<td>Increased retiree plan design cost-sharing requirements</td>
<td>34%</td>
<td>31%</td>
</tr>
<tr>
<td>Tightened restrictions on new retiree eligibility</td>
<td>12%</td>
<td>11%</td>
</tr>
<tr>
<td>Introduced an HSA-compatible HDHP</td>
<td>12%</td>
<td>N/A</td>
</tr>
<tr>
<td>Terminated subsidized benefits for some or all future retirees</td>
<td>11%</td>
<td>14%</td>
</tr>
<tr>
<td>Introduced a new premium subsidy cap for a group that was previously uncapped</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>Terminated subsidized benefits for some or all current retirees</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>Moved to a pure defined contribution subsidy approach through a health reimbursement arrangement (HRA)</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>Facilitated retiree purchase of individual medical insurance</td>
<td>3%</td>
<td>9%</td>
</tr>
<tr>
<td>Introduced Medicare Advantage plans</td>
<td>N/A</td>
<td>6%</td>
</tr>
<tr>
<td>Terminated Medicare Advantage plans</td>
<td>N/A</td>
<td>3%</td>
</tr>
</tbody>
</table>

Source: Aon Hewitt, 2012 Hot Topics in Retirement, 2012
Individuals are Increasingly Responsible for Healthcare Costs in Retirement
Savings Needed for Healthcare Expenses in Retirement Depend on Various Factors

- Retirement age
- Availability of insurance to supplement Medicare
  - Source of supplemental coverage
  - Premium for supplemental coverage
  - Annual premium increases
- Health status
- Out-of-pocket expenses
- Rate of return on savings
- Medicare Part B Premium – means tested
Observations used to determine asset targets for having adequate savings 50%, 75% and 90% of the time

Separate estimates for men and women

Joint estimates for married couple

Estimates for persons with Medigap Plan F & Medicare Part D
## Retiree Health Savings Model

### Median Drug Expenses Throughout Retirement

<table>
<thead>
<tr>
<th>Men</th>
<th>Median Drug Expenses Throughout Retirement</th>
<th>90th Percentile of Drug Expenses Throughout Retirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median</td>
<td>$65,000</td>
<td>$96,000</td>
</tr>
<tr>
<td>75% percentile</td>
<td>96,000</td>
<td>137,000</td>
</tr>
<tr>
<td>90% percentile</td>
<td>122,000</td>
<td>172,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Women</th>
<th>Median Drug Expenses Throughout Retirement</th>
<th>90th Percentile of Drug Expenses Throughout Retirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median</td>
<td>$86,000</td>
<td>$124,000</td>
</tr>
<tr>
<td>75% percentile</td>
<td>111,000</td>
<td>158,000</td>
</tr>
<tr>
<td>90% percentile</td>
<td>139,000</td>
<td>195,000</td>
</tr>
</tbody>
</table>

Source: EBRI Notes, October 2013.
<table>
<thead>
<tr>
<th>Married Couple</th>
<th>Median Drug Expenses Throughout Retirement</th>
<th>90th Percentile of Drug Expenses Throughout Retirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median</td>
<td>$151,000</td>
<td>$220,000</td>
</tr>
<tr>
<td>75% percentile</td>
<td>207,000</td>
<td>295,000</td>
</tr>
<tr>
<td>90% percentile</td>
<td>255,000</td>
<td>360,000</td>
</tr>
</tbody>
</table>

Source: EBRI Notes, October 2013.
Between 2011 and 2013, savings targets fell

- 1-2% for those with median drug expenses
- 6-12% for those with drug expenses at the 90th percentile

Savings targets will continue to fall as Part D coinsurance in donut hole falls to 25% between now and 2020

Source: EBRI Notes, October 2013.
Part D Donut Hole Generic Drug Coinsurance, per ACA

Source: PPACA.
# Key Provisions of ACA Affecting Post-65 Retirees

## 2014 Medicare Part D (Rx) coverage strengthened

<table>
<thead>
<tr>
<th>Drug Spend</th>
<th>Pre-ACA</th>
<th>Post-ACA (after transition)</th>
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<tr>
<td>$0-$310</td>
<td>Deductible; No coverage</td>
<td>Deductible; No coverage</td>
</tr>
<tr>
<td>$310-$2,850</td>
<td>75% coverage; 25% copay</td>
<td>75% coverage; 25% copay</td>
</tr>
<tr>
<td>$2,850-$4,550</td>
<td>No coverage; “donut hole”</td>
<td><strong>2.5% brand drug coverage</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>28% generic drug coverage</strong></td>
</tr>
<tr>
<td>Over $4,550</td>
<td>95% coverage; 5% out-of-pocket</td>
<td>95% coverage; 5% out-of-pocket</td>
</tr>
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Source: PPACA

By 2020: 75% coverage; 25% copay
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<td>$0-$295</td>
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<tr>
<td>$295-$2,700</td>
<td>75% coverage; 25% copay</td>
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<tr>
<td>$2,700-$6,154</td>
<td>No coverage; “donut hole”</td>
<td>75% coverage; 25% copay*</td>
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<tr>
<td>Over $6,154</td>
<td>95% coverage; 5% out-of-pocket</td>
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* By 2020

Old version see slide 19 above for new
Evolving Landscape – Defined Contribution Plans

Defined Amount Retiree Health Plans

Private insurance exchanges (for Medicare-eligible retirees)

- Access to a variety of Medicare Supplement and Part D Plans
- HRA is used when employer offers a subsidy
  - Typically a flat dollar employer allotment
  - Premium increases are retiree’s responsibility
- Serves to only cap FAS and GASB liabilities, not eliminate them
- Potential retiree confusion over insurance options
- Limited out-of-pocket medical expense benefit

ACA created new opportunities for defined contribution plans
Evolving Landscape – Defined Contribution Plans

**Defined Contribution Retiree Health Plan**

- Similar to a 403(b) or 401(k) plan
- Accumulate tax advantaged funds throughout the working years
- Used to pay health benefits in retirement on a tax free basis
- Plan design flexibility
  - Contribution rates/vesting & entitlement rules
- Always fully funded – no FAS or GASB liability
- Provides resource for pre and post 65 year old retirees
- Aids in the recruitment, retention and retirement of employees

ACA created new opportunities for defined contribution plans
HSAs as a Retirement Savings Vehicle

- Must enroll in HDHP to make contribution to HSA ($1250/$2500)
- Triple tax advantage – contributions, growth and distributions all tax-free
- Pre-tax contributions limited to $3,300 per individual/$6,550 per family in 2014
- $1,000 “catch-up” contribution allowed for individuals 55+
- No “use-it-or-lose-it” rule

**HSAs not sufficient to cover medical expenses in retirement**
- Contributions limited by law
- Used for high deductible each year
- Minimal investment choice (so far)
- Savings in other vehicles will be necessary
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Retiree Healthcare Market Overview
Market Dynamics for Employers

Institutional dynamics for plan sponsors

- Management of aging workforce (changing demographics)
- Evolution of competitive total compensation packages (recruitment and retention)
- Restructure of unsustainable financial model
- Cost shifting to employees
- Strategic design of benefits to promote retirement readiness (encouraging timely retirements)
- Impact of delayed retirements
- Transition strategies are available for legacy benefits and unfunded liabilities
- Will to make the paradigm shift from DB to DC
Retiree Healthcare Trends in a Post ACA Environment

Q&A
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