REVIEWING/REDESIGNING YOUR RETIREE MEDICAL PROGRAM

Case Study: Colgate University

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1 Understanding your FASB/GASB Liability
2 An Approach to Review/Redesign
3 Plan Design Considerations
4 Colgate’s Case Study
5 Questions
Input Data

Member Data

Financial Data

Plan Provisions

Actuarial Assumptions

- Investment return
- Health cost increases
- Life expectancy
- Retirement
- Turnover

Project Benefits/
Calculate Liability

Annual Financial
Statement Costs

Implementation
Valuation Basics

Member Data

Financial Data

Plan Provisions

Actuarial Assumptions

- Investment return
- Health cost increases
- Life expectancy
- Retirement
- Turnover

SIBSON CONSULTING
**What is The Expected Cost of Doing Nothing**

*Summary of Present Value of Future Benefits and Cashflow (Current Plan)*

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Baseline</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Results for All Groups</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Total Present Value of Benefits</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Actives</strong></td>
<td></td>
</tr>
<tr>
<td>Group 1: Eligible within 10 years</td>
<td>$13,778,258</td>
</tr>
<tr>
<td>Group 2: Actives over 40, not</td>
<td>$9,444,152</td>
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<tr>
<td>eligible w/in 10 years</td>
<td></td>
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<tr>
<td>Group 3: All actives who have not</td>
<td>$3,002,773</td>
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<tr>
<td>attained age 40</td>
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<tr>
<td><strong>Total Actives</strong></td>
<td><strong>$26,225,183</strong></td>
</tr>
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</table>

(Results in Millions)

<table>
<thead>
<tr>
<th>Active Baseline</th>
<th>All Groups</th>
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<tbody>
<tr>
<td>Cash Flow</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>0.082</td>
</tr>
<tr>
<td>2012</td>
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<tr>
<td>2013</td>
<td>0.193</td>
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<tr>
<td>2015</td>
<td>0.311</td>
</tr>
<tr>
<td>2020</td>
<td>0.823</td>
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<tr>
<td>2025</td>
<td>1.538</td>
</tr>
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<td>2030</td>
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<td>2045</td>
<td>3.737</td>
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<tr>
<td>2050</td>
<td>3.446</td>
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</table>
Projection of Present Value of Future Benefits: Closed Group
1. Understanding your FASB/GASB Liability
2. An Approach to Review/Redesign
3. Plan Design Considerations
4. Colgate’s Case Study
5. Questions
Strategy and Design Process
Challenges/Issues

➢ Costs are influenced by factors outside the institution’s control

➢ Workforce management:
  • Rich plans may encourage costly early retirement
  • Poor plans may encourage employees to “linger” in active employment, increasing costs (especially post 65) and slowing any renewal initiatives

➢ Trade-offs required—some objectives (e.g., desire for a single plan for all) need to yield to others deemed more important (e.g., reducing expense)

➢ Practical difficulties:
  • Litigation associated with mandating new or less generous benefits to existing retirees
  • Uncertainty of success in applying proposed changes to collectively bargained groups, if any
  • Benefit changes can create “classes”
    – Haves and have-nots
Strategy: How do retiree health benefits fit into your *Employee Value Proposition*?
Retiree Benefits Evaluation

*Current State*

- Understand EVP and how it relates to retiree health
- Review:
  - Current benefit plans and structure
  - Current costs
  - Demographics of current and future retiree population
  - Competitive practices
  - Communications
- Does the current state reflect the desired EVP?
Establish Parameters

- What is an acceptable cost for these types of programs?
  - For you? For your retirees?

- How do you want your program to compare to your competitors?

- What aspects of the program are available to change versus what is “untouchable”?
  - Review what promises have been communicated to retirees and actives

- Human Resources, Finance, Leadership and Faculty and Staff buy-in to ensure agreement around desired state
Develop objectives and guiding principles around EVP and parameters

**Examples of Guiding Principles**

- Benefit programs need to be competitive to all segments of the University population
- Retirement benefits should provide reasonably comprehensive security for faculty and staff
- Retiree health benefits need to be tied closely to a total reward strategy
- Need to offer a retiree health plan that is sustainable in the long-term
- Ensure that changes to the retiree health program should have no impact on retirement patterns

**Examples of Objectives**

- Protect current workforce
- Offer choice and flexibility
- Maintain strong competitive position
- Controllable, predictable employer cost
- Minimal insurance risk
- Prudent allocation of employer cost subsidy
Objectives for Redesign of Post-Retirement Healthcare

- Limit the change for current retirees and those close to retirement through grandparenting
- Provide employees with time to plan for changes to the university’s approach to post-retirement healthcare benefits
- Implement changes that have minimal impact on retirement patterns
- Ensure that the new approach is financially sustainable while providing Colgate retirees with access to retiree healthcare insurance during retirement
- For actives that are currently not close to retirement, one option explored was a defined contribution approach
Implementation

- Develop preliminary analysis to determine if “desired” state and “tolerance” cost level addresses long term objectives
- Refine analysis and plan design in order to achieve long term objectives
1. Understanding your FASB/GASB Liability
2. An Approach to Review/Redesign
3. Plan design considerations
4. Colgate’s Case Study
5. Questions
Benefit Design Strategy to Manage Liabilities

The Three “R”s of Cost Containment:

1. Redefining Eligibility Requirements
   - Tie eligibility to service levels
   - Consider institutional goals for work force planning
   - Review spouse coverage rules

2. Restructuring Benefits
   - Create tier for new hires
   - Reduce benefits for future retirees
   - Review Medicare Coordination Method
   - Review Prescription Drugs
     - Leveraging Medicare D
     - PDP vs. Subsidy
     - EGWP with a Wrap
     - Eliminate Rx plan

3. Rethinking Cost Sharing
   - Move to a flat dollar employer share
   - Increase retiree contribution
   - Tie benefit levels to service levels
   - Defined Contribution approach
     - Fund while employees are active
   - Cost effective, equitable strategies must take the following into consideration:
     - Subsidy
     - Plan Design Provisions
     - Dollar Cap
     - Medicare Integration
     - Eligibility Requirements
     - Marital Status
     - Age/Service
     - Salary
Medicare Part D
Key Changes

STANDARD MEDICARE PRESCRIPTION DRUG BENEFIT

2010

- 15% paid by plan; 80% by Medicare
- 100% paid by enrollee
- 25% paid by enrollee
- 75% paid by plan
- Initial coverage limit
- Deductible
- Catastrophic coverage

2020

- 15% paid by plan; 80% by Medicare
- 25% paid by enrollee
- 75% paid by plan
- Initial coverage limit
- Deductible
- Catastrophic coverage

BRANDS: 50% discount
25% paid by plan

GENERICS: 75% paid by plan

5% paid by enrollee

15% paid by plan; 80% by Medicare
5% paid by enrollee

100% paid by enrollee

100% paid by enrollee

Medicare Part D
Key Changes
The benefits of this approach are as follows:

- Would limit the future FAS 106 liability
- Allows both employer and employee to contribute to their retirement over the course of their employment
- Gives employees control over the value of their benefits

Accounts similar to the current retirement plan would be established:

- Medical plan coverage can be linked to the accounts depending on the vendor/model selected
### Defined Contribution Health vs. Defined Contribution Income

<table>
<thead>
<tr>
<th></th>
<th>Defined Contribution Healthcare</th>
<th>Defined Contribution Income</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employer Contributions</strong></td>
<td>Employer contributions are on a tax favored basis, grow tax free, <strong>tax free</strong> when disbursed. Must be used on qualified health expenditures</td>
<td>Employer contributions are on a tax favored basis, grow tax free, <strong>taxable</strong> when disbursed and may be used on any expense</td>
</tr>
<tr>
<td><strong>Employee Contributions</strong></td>
<td>Employee contributions are permitted on a post-tax basis, grow tax free, come out tax free, and are <strong>unlimited</strong></td>
<td>Employee contributions are permitted on a pre or post tax basis, grow tax free, taxable at distribution, and are subject to <strong>IRS limits</strong></td>
</tr>
<tr>
<td><strong>Vesting</strong></td>
<td>Vesting is permitted <strong>beyond 6 years</strong> (i.e., attainment of age 62 and 15 years of service)</td>
<td>Vesting can be <strong>3 years 100% or 6 years graded</strong></td>
</tr>
<tr>
<td><strong>Annual Institution Contributions to Employee Accounts</strong></td>
<td>Contributions are a <strong>flat amount per covered employee</strong></td>
<td>Contributions are based on a percentage of payroll. <strong>Individual contributions reflect the salary, not the average salary of the covered group</strong></td>
</tr>
<tr>
<td><strong>Non-Discrimination</strong></td>
<td>Using a grantor trust, <strong>select discriminatory contributions can be made</strong>. Funds must be used to purchase insurance</td>
<td>Must pass <strong>non-discrimination testing</strong></td>
</tr>
<tr>
<td><strong>Account Upon Death</strong></td>
<td>Transfers to qualifies tax dependents. Upon the death or loss of status of the last tax qualified dependent, <strong>the institution balance can be used to offset future plan costs, or dispersed to all plan participants.</strong> Employee contributions must be allocated to other plan participants</td>
<td>Can transfer to the <strong>deceases estate</strong></td>
</tr>
</tbody>
</table>
## VEBA Tax Advantages

### Emeriti Health Accounts

<table>
<thead>
<tr>
<th>Source</th>
<th>Trust</th>
<th>Emeriti Plan</th>
<th>Contributions</th>
<th>Earnings</th>
<th>Payout</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer</td>
<td>Employer VEBA</td>
<td>Required</td>
<td>Pre-tax</td>
<td>Tax-free</td>
<td>Tax-free</td>
</tr>
<tr>
<td>Employee</td>
<td>Employee VEBA</td>
<td>Strongly Encouraged</td>
<td>After-tax</td>
<td>Tax free</td>
<td>Tax free</td>
</tr>
<tr>
<td>Voluntary*</td>
<td>Employee VEBA</td>
<td>Optional</td>
<td>Pre-tax</td>
<td>Tax free</td>
<td>Tax free</td>
</tr>
<tr>
<td>Employer</td>
<td>Grantor Trust</td>
<td>Optional</td>
<td>Pre-tax</td>
<td>Tax-free</td>
<td>Tax-free</td>
</tr>
</tbody>
</table>

### Tax Treatment

- **Employer VEBA**: Required contributions are pre-tax and the earnings are tax-free. The payout is also tax-free.
- **Employee VEBA**: Voluntary contributions are after-tax, with tax-free earnings and tax-free payout.
- **Employee VEBA**: Mandated contributions are optional and tax-free with tax-free earnings.
- **Employer Grantor Trust**: Optional contributions are pre-tax and have tax-free earnings and payout.

**NOTE:** By comparison to Emeriti’s 501 (c) 9 welfare plan, distributions from 403(b) retirement plans are taxable and do not confer guaranteed access to health care benefits.
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Eligibility for Participation

Once an individual satisfies one of the following they are eligible for retiree medical coverage:

- Attained age 62 with at least 15 years of service; or
- Attained age 65 with at least 10 years of service

Maintain Current Plan For Current Retirees?

Establish Groupings for change in the active populations:

- Faculty and staff within 10 years of eligibility
- Actives over 40, not eligible w/in 10 years
- All other actives

Alternatives Considered

Consider institutional goals for work force planning:

- Consider raising service requirements

Only count years of service after age 40

Eliminate subsidized coverage for employees hired after 1/1/2012. Eventually liabilities will level off and ultimately be eliminated

Eliminate coverage for current actives under age 40 and replace with same coverage for new hires
Plan Design Considerations
Possibilities Discussed

**Employee Contributions**

- Eliminate inherent pre-65 subsidy by charging retirees based on a true retiree rate
- Limit future claim increases to 2x the 2011 Colgate subsidy or a fixed dollar amount (e.g., $7,500)

**Changes for Medicare Eligible Retirees**

- Change post-65 plan design to better capture savings from carve-out Medicare coordination method

- Review Prescription Drugs:
  - Eliminate Rx plan
  - Offer plan with a doughnut hole
  - Subsidize retirees Part D plan up to a fixed monthly amount
## Retiree Medical Redesign Cost Implications

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Participants</th>
<th>Baseline</th>
<th>Scenario 1</th>
<th>Scenario 2</th>
<th>Scenario 3</th>
<th>Scenario 4</th>
<th>Scenario 5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Present Value of Benefits</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Actives</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group 1: Eligible on December 31, 2011</td>
<td>74</td>
<td>$3,491,811</td>
<td>$3,240,990</td>
<td>$3,169,696</td>
<td>$2,477,430</td>
<td>$2,624,224</td>
<td>$2,985,323</td>
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<tr>
<td>Group 2: Within 5 years of eligibility</td>
<td>98</td>
<td>$4,810,252</td>
<td>$4,225,577</td>
<td>$4,389,542</td>
<td>$2,977,587</td>
<td>$3,675,408</td>
<td>$3,710,596</td>
</tr>
<tr>
<td>Group 3: Within 10</td>
<td>138</td>
<td>$5,980,833</td>
<td>$5,284,930</td>
<td>$5,373,307</td>
<td>$3,162,557</td>
<td>$4,491,110</td>
<td>$3,869,110</td>
</tr>
<tr>
<td>Group 4: All other Actives over age 47</td>
<td>148</td>
<td>$5,337,571</td>
<td>$4,631,860</td>
<td>$4,876,853</td>
<td>$2,803,517</td>
<td>$4,087,317</td>
<td>$2,827,267</td>
</tr>
<tr>
<td>Group 5: All other Actives over age 40 but have not attained age 47</td>
<td>154</td>
<td>$4,056,749</td>
<td>$3,485,760</td>
<td>$3,714,259</td>
<td>$2,136,277</td>
<td>$3,116,195</td>
<td>$1,632,984</td>
</tr>
<tr>
<td>Group 6: All actives who have not attained age 40</td>
<td>225</td>
<td>$2,835,776</td>
<td>$2,426,458</td>
<td>$2,597,757</td>
<td>$1,485,534</td>
<td>$2,178,072</td>
<td>$757,857</td>
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<tr>
<td><strong>Total Actives</strong></td>
<td>837</td>
<td>$26,424,992</td>
<td>$23,295,575</td>
<td>$24,121,454</td>
<td>$15,042,902</td>
<td>$20,172,328</td>
<td>$15,783,138</td>
</tr>
</tbody>
</table>

- **Scenario 1**: Change Pre-65 Plan to eliminate inherent subsidy by charging off a true cost basis
- **Scenario 2**: Change Post-65 plan design to better capture savings from carve-out Medicare coordination method
- **Scenario 3**: Eliminate Rx from Post-65 coverage in 2020 (Medicare plan will be improved by then)
- **Scenario 4**: Lower subsidy percentage to 75%
- **Scenario 5**: Limit future cost increases to 2x the 2011 level
Recommendation

Retirees as of 1/1/2012 no changes with this process.

**Active Employees:**

- Maintain DB retiree health benefits for all employees with start date prior to 7/1/2012
- Change eligibility service to begin at age 40
- Eliminate Rx coverage effective 2020 for all future Medicare eligible participants, who are active 1/1/2012
- Replace DB retiree health coverage with a DC alternative for all new hires with start date after 6/30/2012
Present Value of Future Benefits

- $0
- $10,000,000
- $20,000,000
- $30,000,000
- $40,000,000
- $50,000,000
- $60,000,000

Baseline
Remove Rx - Keep Under 40
Remove Rx - Remove Under 40
Defined Contribution Option

➢ For actives that are currently not close to retirement, explored a defined contribution approach. Based on campus feedback, it was decided to offer to new hires after 6/30/2012 only

➢ The benefits of this approach are as follows:
  • Would limit the future FAS 106 liability for Colgate
  • Allows both employer and employee to contribute to their retirement over the course of their employment
  • Gives employees control over the value of their benefits

➢ Accounts similar to the current retirement plan would be established:
  • Medical plan coverage can be linked to the accounts depending on the vendor/model selected

➢ Two companies/models were explored as potential options for administering the defined contribution option for Colgate:
  1. Emeriti
  2. TIAA-CREF
Replace DB For New Entrants  
Eliminate Rx in 2020

<table>
<thead>
<tr>
<th>Age</th>
<th>Current Year Contribution 2012</th>
<th>Last Contribution Prior to Retirement</th>
<th>Accumulated Fund Balance at Retirement</th>
<th>Discounted Value of Current Colgate Plan at Retirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>40</td>
<td>$722</td>
<td>$1,467</td>
<td>$62,232</td>
<td>$62,232</td>
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<tr>
<td>45</td>
<td>$722</td>
<td>$1,266</td>
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<td>50</td>
<td>$722</td>
<td>$1,092</td>
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<tr>
<td>55</td>
<td>$722</td>
<td>$942</td>
<td>$11,635</td>
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Key Assumptions Program

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Target Retirement Age</td>
<td>65</td>
</tr>
<tr>
<td>Assumed Retirement Age</td>
<td>65</td>
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<tr>
<td>Funding Start Age</td>
<td>40</td>
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<tr>
<td>Investment Return</td>
<td>7%</td>
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<tr>
<td>Annual Increase %</td>
<td>3%</td>
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<tr>
<td>Funding Years</td>
<td>25</td>
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<tr>
<td>Turnover</td>
<td>None after age 40</td>
</tr>
</tbody>
</table>

Projected Cash Flow for Colgate

<table>
<thead>
<tr>
<th>Year</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>Total</th>
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<tr>
<td>1</td>
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<td>$9,877</td>
<td>$10,634</td>
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<td>$20,511</td>
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<td>5</td>
<td>$10,479</td>
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<td>$45,630</td>
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<td>6</td>
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<td>$12,497</td>
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<td>7</td>
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<td>$12,872</td>
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<td>$76,965</td>
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<td>8</td>
<td>$11,451</td>
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<td>9</td>
<td>$11,794</td>
<td>$12,698</td>
<td>$13,209</td>
<td>$13,656</td>
<td>$14,430</td>
<td>$16,509</td>
<td>$18,366</td>
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<tr>
<td>10</td>
<td>$12,148</td>
<td>$13,078</td>
<td>$13,605</td>
<td>$14,066</td>
<td>$15,308</td>
<td>$15,896</td>
<td>$17,005</td>
<td>$18,917</td>
<td>$19,081</td>
<td>$139,104</td>
</tr>
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</table>
## Emeriti vs. TIAA

<table>
<thead>
<tr>
<th><strong>EMERITI</strong></th>
<th><strong>TIAA</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pros</strong></td>
<td><strong>Pros</strong></td>
</tr>
<tr>
<td>● More established</td>
<td>● Greater flexibility on investment menu</td>
</tr>
<tr>
<td>● Has a number of liberal arts schools on client list</td>
<td>● Lower administrative expenses</td>
</tr>
<tr>
<td>● Has flexible Medical/Rx/Dental program offerings for Medicare eligible participants</td>
<td>● Not tied to an one insurance vendor</td>
</tr>
<tr>
<td>● Outsourcing of administration, enrollment, billing, etc.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>● Relatively new program, not many institutions of the competitive group on a small client list</td>
</tr>
<tr>
<td><strong>Cons</strong></td>
<td></td>
</tr>
<tr>
<td>● Investment options limited to those chosen by Emeriti</td>
<td></td>
</tr>
<tr>
<td>● Higher start-up and administrative fees</td>
<td></td>
</tr>
<tr>
<td>● Programs are tied to the experience of the participants in the Emeriti program. If the groups experience goes south, then plan offerings may become unaffordable</td>
<td></td>
</tr>
</tbody>
</table>
Elements of the DC Design

- **Number of years Colgate Contribution:** Earlier of retirement or 25 years
- **Age when contributions begin:** 40
- **Contribution amount for Fiscal 2013:** $750 ($62.50/month), annual increase 3%
- **Eligibility for vesting:** Keep same rules as DB retiree health plan
- **Forfeiture prior to retirement**
  - **Employer Balance:** Would offset future University contributions
  - **Employee Balance:** Is 100% vested and can be used after age 55 with Emeriti. Balance would go to tax qualified dependents and upon the death of all tax qualified dependents, it will be shared with plan participants
- **Forfeiture after retirement upon death**
  - **Employer and Employee Balance:** Would go to tax qualified dependents and upon the death of all tax qualified dependents, it will be shared with plan participants
- **Allow for post-tax retiree contributions**
- **VEBA can be used for a qualified expense for any tax qualified dependent**
- **Emeriti Health Solutions will be the program administrator**
Questions