

# CURRENT TRENDS AND FUTURE OUTLOOK FOR RETIREE HEALTH BENEFITS

Findings from the Kaiser/Hewitt 2004  
Survey on Retiree Health Benefits

## SECTION 2

### RETIREE HEALTH COSTS

# RETIREE HEALTH COSTS

Retiree health benefits are highly valued by employees, retirees, and their families but are also a substantial cost for the large private-sector firms surveyed in this study. Despite ongoing efforts to manage the cost of retiree health programs, the total cost of providing retiree health benefits has been rising rapidly in recent years and remain a significant source of tension in negotiations between labor and management. High costs have contributed to both the decline in employer sponsorship of retiree health benefits in the past decade and the shift in costs from employers to retirees. Many large employers have imposed caps on their future financial obligations for retiree health benefits.

Retiree health costs vary widely among large firms due to the demographics of the retiree group, differences in plan design and in utilization of medical services, the types of health plans offered, and geographic concentrations of retirees. Costs also vary by the overall size of the firm, industry practice, financial situation, and whether the plan is collectively bargained. Accordingly, because of all the factors that influence cost, there can be significant variations in the total cost of retiree health benefits among employers with roughly similar numbers of retirees. Total costs reported in this section include the combined employer and retiree costs of providing health coverage to all retirees (pre-65 and age 65+) and their dependents.

## Total Costs

- Among the 333 surveyed employers, the 2003 estimated total cost (employer and retiree contributions) of providing health benefits to pre-65 and age 65+ retirees and their dependents was \$15.5 billion.<sup>15</sup>
- Between 2003 and 2004, the total cost of providing retiree health benefits increased by an estimated 12.7 percent, on average, among employers in this survey (Exhibit 5).
  - This is roughly comparable to the 12.3 percent national average increase in large employer costs of providing health benefits to active workers during the same time period, according to a report previously released by Hewitt Associates based on a different sample of large employers.<sup>16</sup>
- In 2004, retiree health benefits for these employers are expected to reach \$17.4 billion, calculated based on their estimates of the average increase in total annual costs from 2003 to 2004.
- As might be expected, the larger the firm offering retiree health benefits, the larger their retiree population, and hence the greater their total costs. For example, the average total cost among all

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<sup>15</sup> The total cost of retiree health benefits for employers participating in the 2004 survey is lower than the total cost reported by employers in the *Kaiser/Hewitt 2003 Survey on Retiree Health Benefits* because there are fewer participating companies in the 2004 survey (333 vs. 408). The average cost per firm in the 2004 survey was higher than the average cost per firm in the 2003 survey. See note 17.

<sup>16</sup> Hewitt Associates, "Health Care Costs Show Signs of Moderating, but Still Outpace Inflation," press release, October 11, 2004, based on data from the Hewitt Health Value Initiative.™

surveyed employers with at least 1,000 employees was \$46.9 million per firm in 2003.<sup>17</sup> Among jumbo firms with 20,000 or more employees, the average total cost of providing retiree health benefits was \$189 million per firm in 2003. For some jumbo firms, the total costs exceeded \$1 billion or more.

- For employers with 1,000–4,999 employees, the average annual 2003 total cost per firm was \$4.1 million, compared to \$14.2 million for employers with 5,000–9,999 employees, and \$22 million for those with 10,000–19,999 employees.

## Financial Caps on Employer Retiree Health Obligations

In response to the rising cost of providing retiree health benefits and to the Financial Accounting Standards Board rules that require firms to account for retiree health obligations on an accrued, rather than pay-as-you-go basis,<sup>18</sup> many large employers have placed caps on their future financial obligations for retiree health coverage. When an employer places a cap on the firm's contributions to retiree health benefits, retirees begin to pick up more costs as medical costs rise above the level of the pre-determined amount. Financial caps take on many shapes and forms. Some employers establish caps on the total cost (e.g., the company will not spend more, in total, for retiree medical benefits than twice what was spent in a given year). Others focus the caps on individuals (e.g., the employer subsidy for 65+ costs will not exceed \$2,000 per person in the future). Some strategies combine a service-related aspect of the employer subsidy.<sup>19</sup> Sometimes the cap is indexed to rise as future costs rise.

Financial caps on employers' retiree health obligations are common among the large employers surveyed.

- 54 percent of all surveyed firms that offer retiree health coverage report having a cap on their firms' contributions toward retiree health benefits in any plan offered to retirees. Among the companies with caps, 70 percent report that there is more than one plan with a cap across the firms' retiree health plans (Exhibit 6).
- Among the plans with a cap, 84 percent have a cap for the largest pre-65 retiree health plan and 89 percent have a cap for their largest age 65+ retiree health plan (Exhibits 7 and 8).

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<sup>17</sup> By comparison, the average cost per firm in the *Kaiser/Hewitt 2003 Survey on Retiree Health Benefits* was \$42.8 million among 408 large firms. Although the surveys consist of different samples and are not strictly comparable from year to year, for reference purposes, if the 2004 average cost of \$46.9 million per firm were applied to 408 employers, total retiree costs for 408 companies would be \$19.1 billion in 2004, versus \$18.1 billion in 2003.

<sup>18</sup> Financial Accounting Statement No. 106 (FAS 106) is an accounting standard that stipulates the manner in which companies expense for post-retirement medical benefits. It requires employers to accrue the cost of retiree health and other post-employment benefits during the working careers of active employees. The accounting standard requires companies to account for their retiree health care benefits on an accrual basis (much like pensions). For companies that did not change their retiree health plan design in response, their accounting costs for retiree health care benefits were typically increased by factors of six to eight or more, depending on the company's plan design and demographics. From *Retiree Health Trends and Implications of Possible Medicare Reforms*, by Hewitt Associates for The Kaiser Family Foundation, September 1997.

<sup>19</sup> Hewitt Associates, *Retiree Health Trends and Implications of Possible Medicare Reforms*, prepared for The Kaiser Family Foundation, September 1997.

- Among firms that have a cap on their largest pre-65 retiree health plan, 53 percent of firms say they have already hit the cap. Over one-quarter of this group (28 percent) anticipate hitting the cap in the next one to three years.
- Among firms that have a cap on their largest age 65+ retiree health plan, 56 percent of firms say they have already hit the cap. Another 27 percent of this group anticipates hitting the cap in the next one to three years.
- Nine out of ten firms that have already hit the cap or anticipate hitting the cap within the next year say they have or intend to hold firm on the cap (92 percent for largest pre-65 plan; 91 percent for largest 65+ plan).
- Among employers that have held firm on the cap or intend to hold firm on the cap, 30 percent say they have taken steps to soften the impact of the cap on pre-65 and 65+ retiree contributions to premiums. Strategies to soften the impact of the cap include: (1) modifying existing coverage with lower cost options, such as prescription drug only plans or catastrophic plans; (2) modifying cost-sharing requirements to reduce retiree premium contributions; and (3) indexing the cap based on an alternative definition of inflation.

In the 2004 survey, we took the additional step of not only determining the percentage of large companies with caps but also the percentage of retirees in plans that are capped, based on the largest plan offered by the surveyed employers.

- 54 percent of retirees in the largest pre-65 plans are in plans that are capped, as are 51 percent of retirees in the largest age 65+ plan.

## **Employer Cost Worries**

The costs associated with retiree health obligations appear to be a significant concern for company CEOs. Based on reports from the human resources professionals who participated in the survey, 89 percent said their CEO is very or somewhat concerned about retiree health care costs (Exhibit 9).

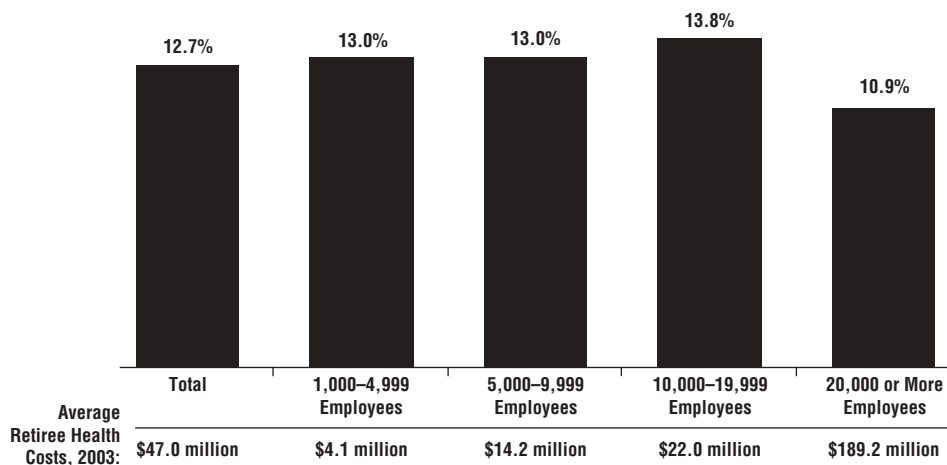
- 58 percent say their CEO is very concerned about retiree health costs and another 31 percent say their CEO is somewhat concerned about retiree health costs.

Retiree health costs account for a relatively large share of firms' total health care expenses.

- Retiree health costs among surveyed companies represent more than a quarter (29 percent) of the total health costs for active workers, retirees, and dependents.

Exhibit 5

### Average Increase in Total Retiree Health Costs, by Firm Size, 2003 to 2004

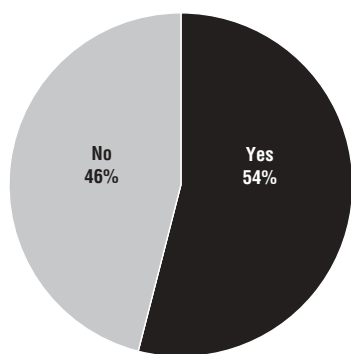


Note: Based on responses from private-sector firms with 1,000 or more employees offering retiree health benefits.  
SOURCE: Kaiser/Hewitt 2004 Survey on Retiree Health Benefits, December 2004.

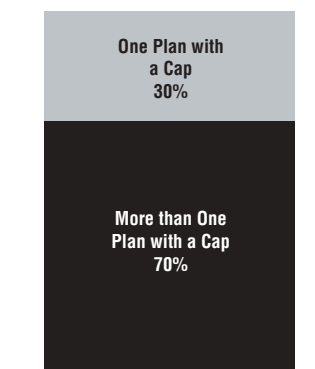
Exhibit 6

### Percentage of Large Private-Sector Employers Having a Cap on Their Firm's Contribution to Retiree Health Benefits

Percentage of large private-sector employers with a cap in any plan:



Among these firms, percentage with one or more plans with a cap:

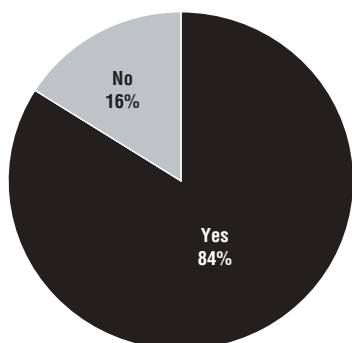


Note: Based on responses from private-sector firms with 1,000 or more employees offering retiree health benefits, describing plans with the largest number of enrolled retirees.  
SOURCE: Kaiser/Hewitt 2004 Survey on Retiree Health Benefits, December 2004.

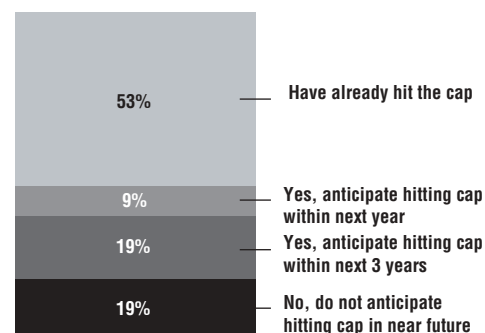
Exhibit 7

### Percentage of Large Private-Sector Employers Having a Cap on Their Firm's Contribution to Retiree Health Benefits for Pre-65 Retirees in Their Largest Plan, Among Firms with Caps

Of large private-sector employers with a cap, percentage with a cap on their largest plan:



Of large private-sector employers with a cap on their largest plan, percentage that anticipate hitting the cap:

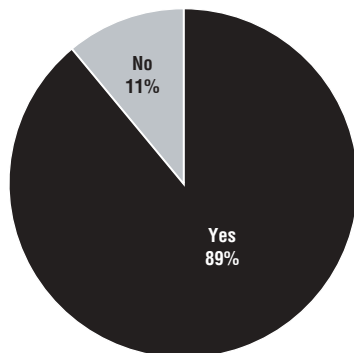


Note: Based on responses from private-sector firms with 1,000 or more employees offering retiree health benefits, describing plans with the largest number of enrolled retirees.  
SOURCE: Kaiser/Hewitt 2004 Survey on Retiree Health Benefits, December 2004.

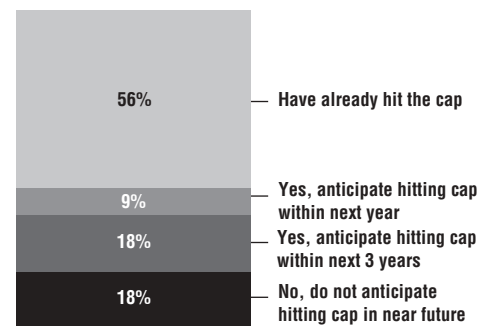
Exhibit 8

### Percentage of Large Private-Sector Employers Having a Cap on Their Firm's Contribution to Retiree Health Benefits for 65+ Retirees in Their Largest Plan, Among Firms with Caps

Of large private-sector employers with a cap, percentage with a cap on their largest plan:



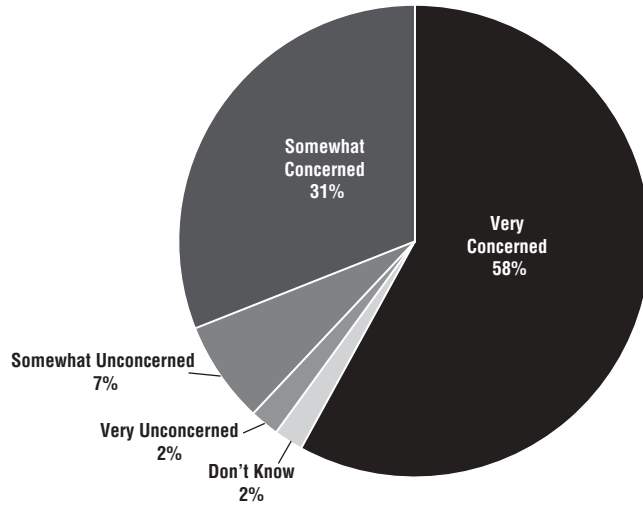
Of large private-sector employers with a cap on their largest plan, percentage that anticipate hitting the cap:



Note: Numbers may not add to 100% due to rounding. Based on responses from private-sector firms with 1,000 or more employees offering retiree health benefits, describing plans with the largest number of enrolled 65+ retirees.  
SOURCE: Kaiser/Hewitt 2004 Survey on Retiree Health Benefits, December 2004.

Exhibit 9

### CEO Concerns About Retiree Health Care Costs, as Reported in Survey of Large Private-Sector Employers



Note: Based on responses from private-sector firms with 1,000 or more employees offering retiree health benefits.  
SOURCE: Kaiser/Hewitt 2004 Survey on Retiree Health Benefits, December 2004.