

# **PROSPECTS FOR RETIREE HEALTH BENEFITS AS MEDICARE PRESCRIPTION DRUG COVERAGE BEGINS**

**Findings from the Kaiser/Hewitt 2005  
Survey on Retiree Health Benefits**

**December 2005**



- AND -

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# EXECUTIVE SUMMARY

## Introduction

Interest in employer-sponsored retiree health plans remains very high as coverage under the new Medicare prescription drug benefit begins. Employers, retirees and their families, and policymakers all have a major stake in the implementation of the prescription drug coverage program that was established under the Medicare Modernization Act of 2003. This 2005 survey by the Kaiser Family Foundation and Hewitt Associates, conducted between June and October 2005, is the fourth in a series of such surveys that provides detailed information on the state of retiree health benefits. This survey captures the most current and comprehensive set of survey results on how large private-sector employers are responding to the changes in Medicare. Unlike the three prior Kaiser/Hewitt surveys, it focuses on coverage for age 65+ retirees who are most likely to be immediately affected by the changes in Medicare.

Employer-sponsored health benefits are a critical source of relatively generous health insurance for retirees. Today, an estimated 3.6 million early retirees and their dependents between the ages of 55 and 64 receive health coverage from a former employer or union.<sup>1</sup> For early retirees who are not yet eligible for Medicare, it is often difficult if not impossible to find comparable, affordable coverage in the individual market. For more than 12 million retirees on Medicare,<sup>2</sup> employer-sponsored plans help by filling gaps in the Medicare benefit package and by providing additional cost-sharing protections, such as limits on retiree out-of-pocket expenses, which traditional Medicare fee-for-service does not provide. Employer plans have also been the primary source of prescription drug coverage for seniors prior to the availability of Medicare drug coverage, and typically, this coverage is more generous than the standard prescription drug benefit offered by Medicare plans in 2006.

However, there is significant concern about the erosion of retiree coverage driven in part by annual double-digit increases in health costs. A key issue throughout the debate leading up to the passage of the Medicare drug benefit was whether the expansion of Medicare would hasten the erosion of retiree coverage – and this issue remains a critical concern today. Between 1988 and 2005, the share of employers with 200 or more employees offering retiree health benefits declined from 66 percent to 33 percent,<sup>3</sup> which is likely to increase the number of future retirees without such coverage.

This report provides a detailed description of retiree health benefits offered by large, private-sector employers to age 65+ retirees in 2005, with information on total costs, retiree contributions to premiums, and actions taken by employers between 2004 and 2005 to help control spending. The survey also documents employers' expected responses to the Medicare drug benefit in 2006, including expected savings related to the Medicare benefit, and the extent to which employers are likely to continue those same Medicare strategies in future years.

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1 Kaiser Commission on Medicaid and the Uninsured and Urban Institute Analysis of the March 2005 Current Population Survey, 2005.

2 Kaiser Family Foundation analysis of 2002 Medicare Current Beneficiary Survey Cost and Use File. Of the 14.7 million Medicare beneficiaries with employer sponsored coverage, 12.6 million were not working.

3 *Kaiser/HRET Annual Employer Health Benefits Survey, 2005.*

## Survey Methods

The data in this report reflect the responses of 300 large private-sector firms with 1,000 or more employees that currently offer health benefits to retirees, based on an online survey conducted between June 21 and October 7, 2005. The study focuses on large employers because these firms are far more likely than mid- and small-sized firms to offer retiree health benefits.<sup>4</sup> The firms that participated in this survey represent 32 percent of all Fortune 100 companies and 33 percent of all Fortune 500 companies. They account for more than one quarter (27 percent) of the Fortune 500 companies with the largest retiree health liability in 2004.

The survey includes responses from 109 firms (36 percent) with 1,000 to 4,999 employees, 66 firms (22 percent) with 5,000 to 9,999 employees, 57 firms (19 percent) with 10,000 to 19,999 employees, and 68 “jumbo” firms (23 percent) with 20,000 or more employees. Together, these employers have 6.3 million employees and nearly 3.5 million retirees. They provide health benefits that impact the lives of approximately 5.7 million retirees and dependent family members, and 15.8 million employees and dependent family members. The employers in this sample provide health benefits to an estimated 3.9 million Medicare-eligible retirees and their spouses, representing nearly a third (32 percent) of the roughly 12 million retirees with employer-sponsored health coverage.

## Retiree Health Benefits Today

**Coverage. More than nine in 10 (93 percent) surveyed firms that offer retiree health benefits provide coverage for both pre-65 retirees and age 65+ retirees.** Surveyed employers typically offer health benefits to spouses and other dependents. Part-time employees, however, are far less likely to be offered retiree health benefits. The majority of surveyed firms say they offer retiree health benefits to employees newly hired as of January 1, 2005.<sup>5</sup>

**Costs. The total cost (employer and retiree contributions) of providing health benefits for both pre-65 and age 65+ retirees and their dependents was an estimated \$20.8 billion in 2004 for the large private-sector firms in this study.<sup>6</sup>**

- The total cost of providing retiree health benefits increased by an estimated 10.3 percent, on average, for surveyed employers between 2004 and 2005.

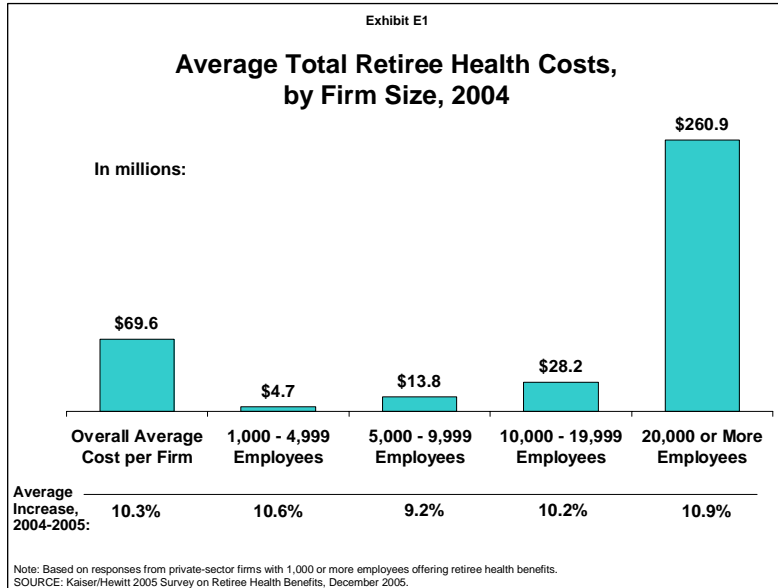
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4 According to the *Kaiser/HRET Annual Employer Health Benefits Survey, 2005*, retiree health benefits are offered by 55 percent of firms with 5,000 or more employees, 43 percent of firms with 1,000-4,999 employees, 28 percent of firms with 200-999 employees, 18 percent of firms with 50-199 employees and 6 percent of firms with fewer than 50 employees.

5 New hires, as with other employees, typically have to meet age and/or service requirements to qualify for retiree health benefits.

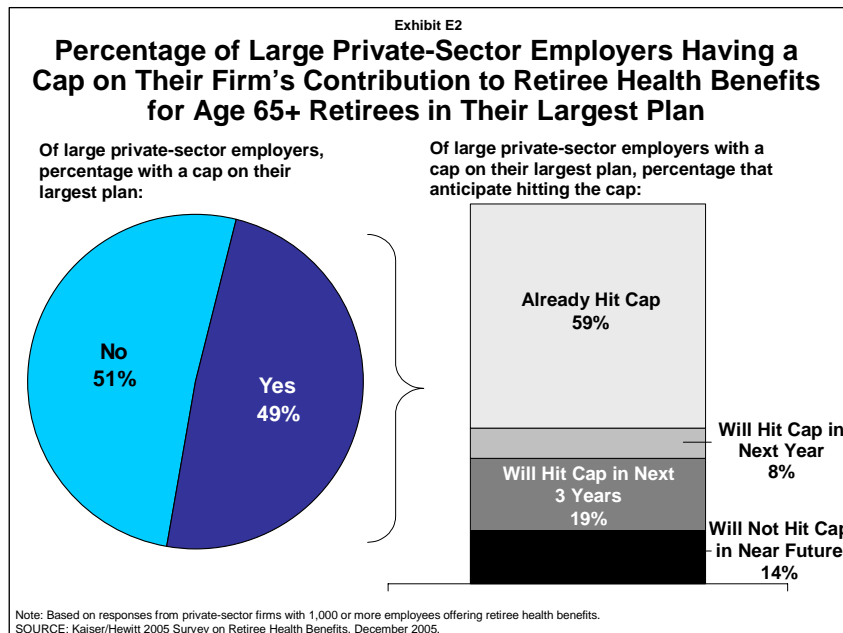
6 By 2005, total retiree health costs are estimated to be \$22.9 billion for surveyed employers, based on 2004 total costs, increased by employers' estimates of total cost increases between 2004 and 2005.

- The average 2004 cost of retiree health among surveyed firms is \$69.6 million, with significant variation by firm size, ranging from \$4.7 million on average for firms with 1,000 – 4,999 employees to \$260.9 million for jumbo firms with 20,000 or more employees (Exhibit E1).



***Caps on Employer Obligations.* Many large employers have caps on their future financial obligations for retiree health coverage in response to rising costs.**

- Nearly two-thirds of all surveyed firms (63 percent) report having a cap on their firm’s contribution to retiree health benefits in any plan offered to retirees in 2005.
- Half (49 percent) have a cap on their firm’s contribution to retiree health benefits in the largest age 65+ plan offered in 2005 (Exhibit E2).



- Among those employers with a cap on the largest age 65+ plan, 59 percent said they have already hit the cap and another 27 percent say they expect to hit the cap within the next 1-3 years.

***Premiums. The majority of surveyed employers require retirees to contribute to the cost of their health coverage, and on average new retirees contribute 38 percent of the total premium.***

- The weighted average total premium (employer and retiree) for newly retiring age 65+ retirees in the largest plan is \$340 per month, and the weighted average retiree contribution for new age 65+ retirees is \$128 per month (including firms that do not require retiree contributions to the premium).<sup>7</sup>
- 19 percent of surveyed firms require newly retiring age 65+ retirees in the largest plan to pay 100 percent of the total premium for their health insurance coverage; 11 percent do not require retiree contributions to the total premium.
- Between 2004 and 2005, the weighted average increase in the age 65+ retiree contribution was 9.9 percent for new age 65+ retirees in plans with the largest number of retirees.

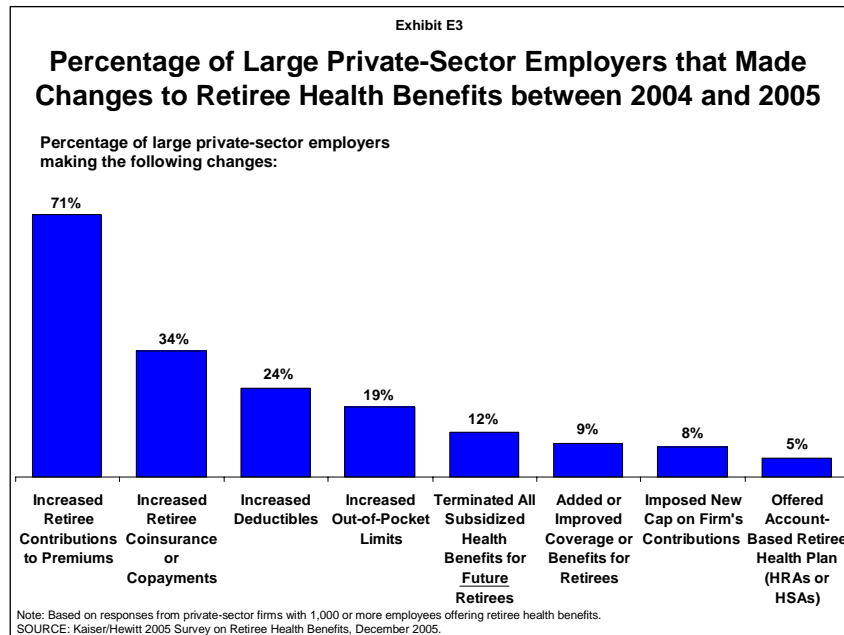
***Changes between 2004 and 2005. Surveyed employers report making a number of changes in their retiree health plans in an effort to control rising costs between 2004 and 2005 (Exhibit E3).***

- Nearly three in four employers (71 percent) increased retiree contributions to premiums between 2004 and 2005.
- Employers also reported that they increased retiree cost sharing (34 percent), raised deductibles (24 percent) and increased retiree out-of-pocket limits (19 percent).
- 12 percent eliminated subsidized health benefits for future retirees between 2004 and 2005, primarily affecting employees *hired* after a specific date.
  - Among firms that terminated subsidized retiree health coverage, most provide affected retirees access to health benefits for which retirees would pay 100 percent of the premium.

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<sup>7</sup> This survey asks about total premiums and retiree contributions for retiree-only coverage for new age 65+ retirees (those retiring on or after January 1, 2005) in the plan with the largest number of enrolled retirees. Total premiums and retiree contributions to premiums are weighted by firm size and by the number of retirees in the largest employer health plan in order to give greater weight to the responses of larger firms that have a greater number of retirees (for additional information, see Appendix: Methods).

- 8 percent said they imposed a new cap on their firms' contributions and 5 percent put in an account-based plan such as an HRA (health reimbursement arrangement) or HSA (health savings account).



**Prescription Drugs.** Virtually all surveyed employers (99 percent) provide prescription drug coverage to age 65+ retirees.

- The majority of employers (94 percent) say their 2005 prescription drug benefit is of equal or greater value than the standard Medicare drug benefit in 2006.
- To help curtail the increase in drug costs in the last year, 39 percent raised copayments or coinsurance for prescription drugs between 2004 and 2005.

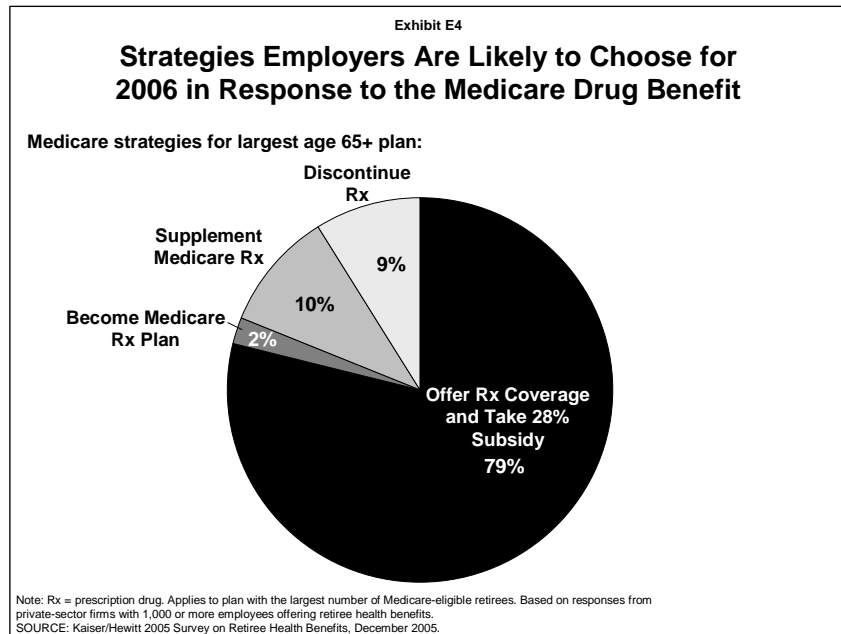
## Employers' Responses to Medicare Drug Coverage

Looking toward the start of the new Medicare drug benefit, a key concern is whether employers will continue to offer drug coverage to their Medicare-eligible retirees. The law includes a new financial incentive in the form of a 28 percent tax-free subsidy to encourage employers to maintain drug benefits for their retirees.

**Medicare Strategy for 2006.** The majority of surveyed employers say they intend to continue to offer prescription drug benefits for their Medicare-eligible retirees in the largest plan in 2006 (Exhibit E4).

- 79 percent of surveyed employers – representing 89 percent of age 65+ retirees in the largest plans – expect to continue to offer prescription drug coverage and accept the tax-free subsidy for their largest group of age 65+ retirees;

- 10 percent of surveyed employers – representing 7 percent of age 65+ retirees in the largest plans – expect to offer prescription drugs as a supplement to the Medicare drug benefit for the plan with the largest group of age 65+ retirees;
- 9 percent of surveyed employers – representing 2 percent of age 65+ retirees in the largest plans – report that they are likely to discontinue drug and/or medical coverage for the plan with the largest group of age 65+ retirees;
- 2 percent of surveyed employers – representing 2 percent of age 65+ retirees in the largest plans – report that they are likely to become a Medicare prescription drug plan.



***Expected Savings in 2006.*** The Medicare drug benefit is expected to provide some savings to employers who would otherwise bear greater financial responsibility for the cost of prescription drug coverage.

- Across all surveyed employers – including employers that maintain drug benefits, supplement drug benefits, or even terminate drug coverage – the weighted average savings is estimated to be \$644 per individual retiree in 2006.
  - Among employers who intend to maintain prescription drug benefits and accept the 28 percent subsidy, the weighted average savings per individual retiree is \$626 for 2006.
  - Among employers who intend to supplement the Medicare drug benefit, expected savings are higher at \$826 per individual retiree for 2006.

- The total employer savings attributable to their responses to the Medicare drug benefit represents a median 7 percent of the total cost of retiree health benefits for pre-65 and age 65+ retirees.<sup>8</sup> Employers incur medical and drug costs for pre-65 retirees and for medical benefits and any supplemental drug coverage for their age 65+ retirees.

***Other Rx Changes in 2006. Employers planning to maintain drug coverage and take the retiree drug subsidy for their Medicare-eligible retirees in 2006 are also considering a number of other strategies for controlling drug costs.***

- 36 percent say they are very (20 percent) or somewhat (16 percent) likely to increase retiree copayments or coinsurance for prescription drugs.
- 21 percent say they are very (11 percent) or somewhat likely (10 percent) to require use of mail-order for prescription refills or maintenance drugs.
- 14 percent say they are very (8 percent) or somewhat (6 percent) likely to replace fixed dollar copayments for prescription drugs with a coinsurance approach.

***Medicare Strategies Beyond 2006. Employers taking the subsidy in 2006 are less certain about their strategies in future years.***

- Eight out of 10 surveyed employers reporting that they will take the subsidy in 2006 say they are very or somewhat likely to do so in 2007, but only half say they are likely to do so in 2010.
- The share of employers reporting they “don’t know” what their firm will do increases from 11 percent for 2007 to 28 percent for 2010.

***Other Policies Affecting Retirees. Employers have established a number of policies that would affect retirees who sign up for a Medicare drug plan in 2006.***

- Among employers who say they will take the subsidy in 2006 and continue to offer drug coverage, 41 percent say retirees who sign up for a Medicare plan would maintain all employer-sponsored coverage, 31 percent say retirees would lose prescription drug coverage only (and retain other benefits), and 29 percent say that retirees would lose both employer-sponsored medical and drug coverage if they enroll in a Medicare prescription drug plan.
- More than half of employers taking the subsidy for retirees in their largest age 65+ plan in 2006 (56 percent) say retirees would be allowed to enroll or re-enroll in the employer plan at a future date if they sign up for a Medicare drug plan; however, 44 percent of employers say retirees would not be able to do so in the future.

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<sup>8</sup> This percentage was calculated by taking the total savings for each employer (i.e., savings per individual retiree multiplied by the total number of the company’s age 65+ retirees) and dividing that sum by the employer’s estimated 2005 total cost (employer and retiree share) of providing retiree health benefits to pre-65 and age 65+ retirees. We then calculated the median percentage savings among these companies.

- Employers will be a key source of information for their age 65+ retirees as the Medicare prescription drug benefit is rolled out: 89 percent say they plan to distribute general education materials, 62 percent say they will maintain a benefits center or call center, and 57 percent say they will provide personalized retiree communications in addition to required notices.

## Discussion

As the Medicare drug benefit approaches, the cost and future of employer-sponsored retiree health benefits remain key concerns among policymakers, employers and retirees. In the first year of the Medicare drug benefit, most surveyed employers say they intend to continue their current retiree benefit plans and accept the 28 percent retiree drug subsidy from Medicare. Whether employers pursue this same strategy in the future remains to be seen, with considerable continuity expected in 2007 but potentially more change and uncertainty in the surveyed employers' strategies in 2010. Some of the issues employers will be addressing are the cost/benefit ratio of taking the subsidy, the relative savings that may result from wrapping around or supplementing Medicare prescription drug plans, the strategies taken by major competitors, and the financial strength of the company.

On average, surveyed employers are estimated to receive savings of about \$644 per individual retiree in 2006, with the level of savings varying according to the type of strategy pursued and the degree to which employers subsidize the current drug benefit. Those savings are significant, but when placed in the context of spending for all retiree health benefits, both medical and prescription drugs, and for pre-65 and age 65+ retirees, the savings represent a relatively modest share of the total cost.

From the retiree perspective, employer-sponsored benefits are relatively generous when compared with the standard Medicare drug benefit, suggesting it may often be in retirees' best interests to remain in employer plans. More than four in 10 employers taking the subsidy say they will not permit retirees to re-enroll in employer plans if retirees sign up for Medicare prescription drug plans. This finding underscores the importance of safeguards to deter retirees from making an irrevocable decision with potentially adverse long-term financial implications. Employers report making major efforts to educate retirees about the changes in Medicare and the impact on their employer coverage.

It is frequently noted that the Medicare prescription drug benefit is the biggest change in Medicare since the program was first enacted. It may similarly represent the single biggest external change affecting employer-sponsored retiree health plans since the accounting rule changes in the early 1990s.

# **PROSPECTS FOR RETIREE HEALTH BENEFITS AS MEDICARE PRESCRIPTION DRUG COVERAGE BEGINS**

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## **SECTION 1**

### **RETIREE HEALTH COVERAGE**

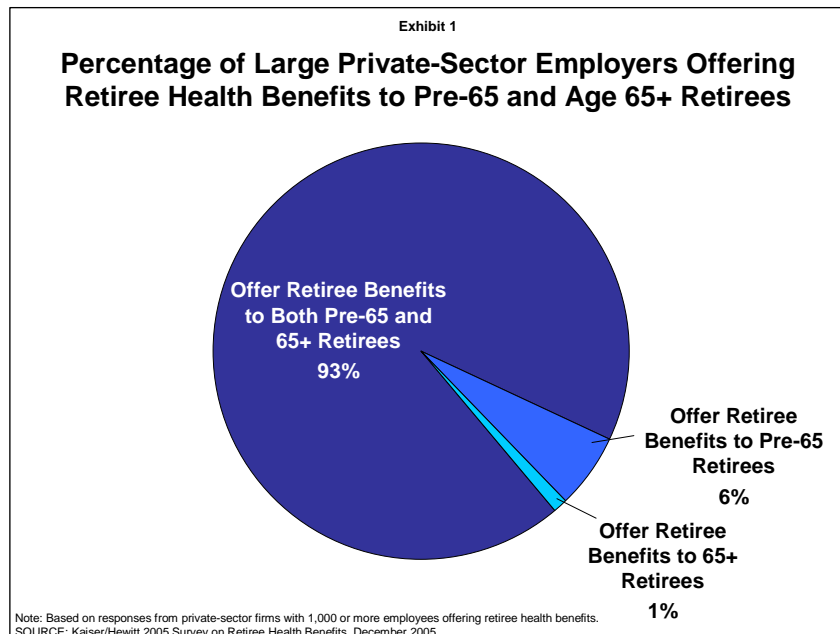
## Retiree Health Coverage

The vast majority of large private-sector firms that offer retiree health benefits provide coverage to both their pre-65 and age 65+ retirees. Today, an estimated 3.6 million early retirees between the ages of 55 to 64 and their spouses receive health coverage from a former employer or union.<sup>9</sup> For early retirees, employer-sponsored plans are typically the primary and only source of health insurance coverage. For more than 12 million retirees on Medicare,<sup>10</sup> employer-sponsored plans supplement benefits covered under Medicare and provide additional cost-sharing protections, such as limiting retiree out-of-pocket expenses, which traditional Medicare fee-for-service does not provide. Employer plans have been the primary source of outpatient prescription drug coverage for people on Medicare prior to the availability of Medicare drug coverage in 2006.

Among firms that have both non-union and union employees, the majority offer retiree health coverage to salaried, hourly, and grandfathered employees. Part-time employees, however, are far less likely to be offered retiree health benefits. The majority of firms in this survey say they offer retiree health benefits to employees newly hired as of January 1, 2005. Typically, employees must meet specific age and service criteria to qualify for retiree health benefits. In addition to retired workers, surveyed employers generally offer health benefits to spouses and other dependents.

### Retiree Health Coverage for Pre-65 and Age 65+ Retirees

- 93 percent of surveyed employers providing retiree health benefits offer this coverage to both pre-65 and age 65+ retirees, 6 percent of employers offer retiree health benefits only to pre-65 retirees, and 1 percent offers such benefits only to age 65+ retirees (Exhibit 1).

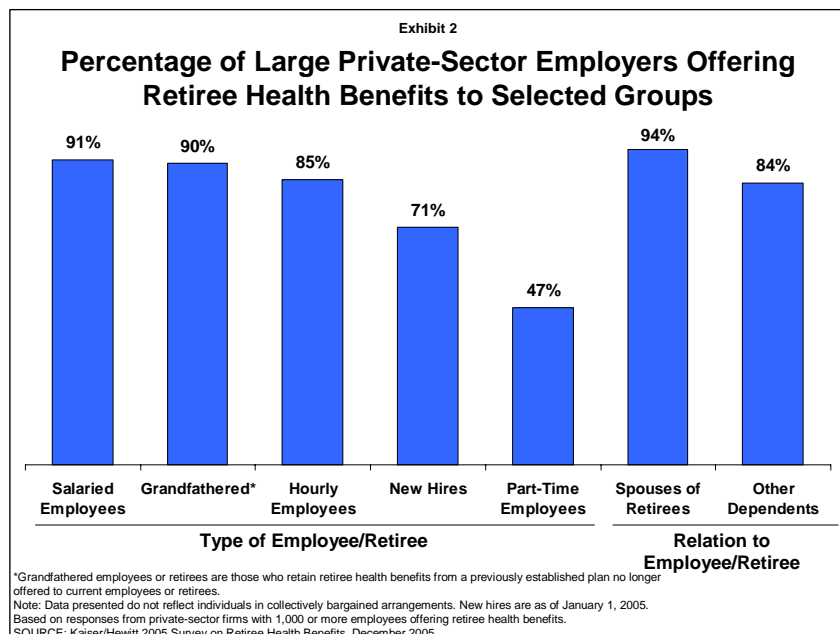


9 Kaiser Commission on Medicaid and the Uninsured and Urban Institute Analysis of the March 2005 Current Population Survey, 2005.

10 Kaiser Family Foundation analysis of 2002 Medicare Current Beneficiary Survey Cost and Use File. Of the 14.7 million Medicare beneficiaries with employer sponsored coverage, 12.6 million were not working.

## Who Is Offered Retiree Health Coverage?

- The vast majority of surveyed firms offer retiree health benefits to the following non-union employees and dependents (Exhibit 2):



- Salaried employees (91 percent of employers);
  - Hourly employees (85 percent);
  - Spouses (94 percent) and other dependents (84 percent); and
  - Grandfathered employees or retirees (90 percent). Grandfathered employees or retirees are those who retain retiree health coverage under the terms of a previously established employer-sponsored health plan that is no longer offered to current employees or retirees.
- Seven in 10 employers (71 percent) offer retiree health benefits to employees that are newly hired as of January 1, 2005.
  - About half of surveyed firms (47 percent) offer retiree health benefits to their non-union part-time workers.

With respect to surveyed firms with collectively bargained agreements (union employees):

- Employers generally provide retiree health benefits to their hourly employees, grandfathered employees or retirees, spouses and other dependents, and union employees newly hired as of January 1, 2005.
- A smaller share of surveyed employers offer retiree health benefits to union employees who work part-time.



# **PROSPECTS FOR RETIREE HEALTH BENEFITS AS MEDICARE PRESCRIPTION DRUG COVERAGE BEGINS**

**Findings from the Kaiser/Hewitt 2005  
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## **SECTION 2**

### **RETIREE HEALTH BENEFIT DESIGN AND PRESCRIPTION DRUG BENEFITS**

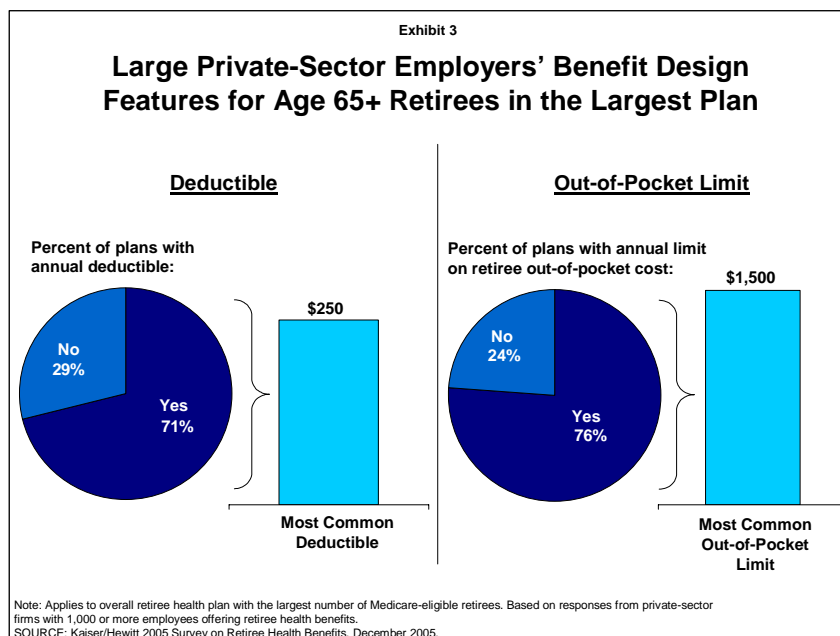


## Retiree Health Benefit Design and Prescription Drug Benefits

Employers typically require retirees to contribute to the cost of their medical coverage through cost sharing for incurred medical services, in addition to retiree contributions to premiums. Employer-sponsored plans often include a deductible and generally require a copayment or coinsurance for many covered health care services, while simultaneously limiting the retiree's financial exposure through annual limits on retirees' out-of-pocket costs. To understand common benefit design features of retiree plans, the survey asked employers about cost-sharing requirements for their retiree health plans with the largest age 65+ retiree enrollment. The survey also asked detailed questions about prescription drug benefit design to facilitate a comparison between employer plans and new Medicare drug plans.

### Deductibles

- 71 percent of surveyed employers say their largest age 65+ retiree health plan has an annual deductible that must be satisfied before the plan begins to pay benefits (Exhibit 3).
  - The annual in-network deductible ranges from \$50 to \$2,000, and the most commonly reported deductible is \$250.



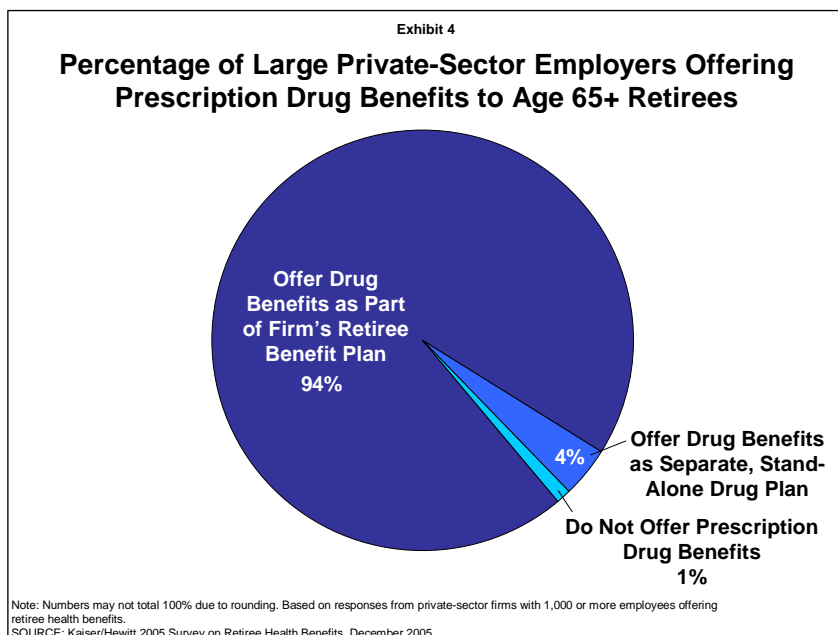
### Out-of-Pocket Limits

- 76 percent of surveyed employers report that the largest age 65+ plan has an annual limit on retiree out-of-pocket costs (Exhibit 3).
  - The most commonly reported annual out-of-pocket limit is \$1,500.

## Prescription Drug Benefits

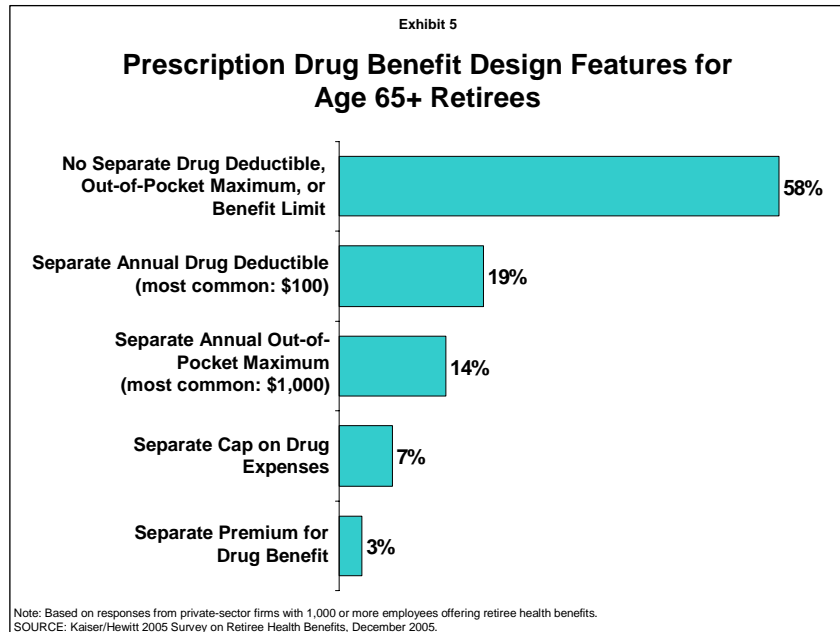
Prescription drug coverage is a critical component of retiree health benefits. For a baseline of the scope and structure of prescription drug benefits prior to the implementation of the Medicare drug benefit, the survey asked employers to describe features of prescription drug coverage for the benefit plan with the largest number of age 65+ retirees in 2005.

- The vast majority of employers that offer retiree health benefits provide coverage for prescription drugs. Most (94 percent) offer drug benefits as part of the firm's retiree health benefit plan, while a small share (4 percent) do so as a separate, employer-subsidized stand-alone drug plan. One percent of surveyed employers does not offer prescription drug benefits to age 65+ retirees (Exhibit 4).



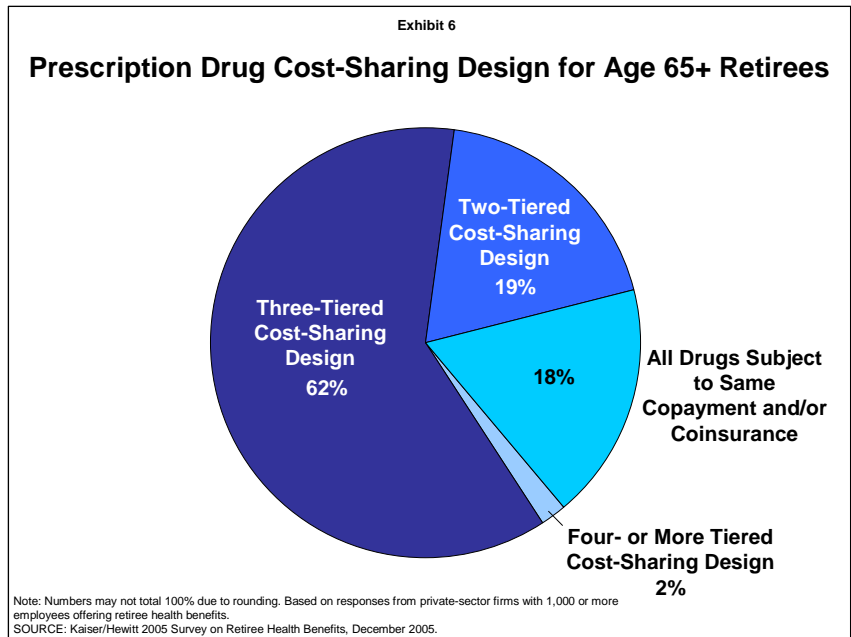
- Among plans with the largest number of age 65+ retirees, 58 percent of surveyed employers report that drug benefits are subject to the overall plan design, meaning the plan does not impose deductibles and out-of-pocket limits for drug benefits separate from other covered benefits (Exhibit 5).
- 19 percent have a separate annual drug deductible. For retail and mail order pharmacy claims combined, prescription drug deductibles range from \$25 to \$250, and the most common deductible is \$100.
- 14 percent have a separate annual out-of-pocket maximum (or stop-loss coverage) for pharmacy claims. Out-of-pocket-maximum amounts range from \$200 to \$3,350, and the most common out-of-pocket limit is \$1,000.

- Benefit limits for drugs are fairly uncommon with 7 percent of the largest plans reporting a separate cap on total covered drug expenses. Under these arrangements, the plan would cover costs up to the benefit limit but not beyond that point.
- Only 3 percent have separate premiums for prescription drug benefits.



Employers use a variety of cost-sharing strategies for prescription drug benefits, with three-tiered arrangements being the most common in the largest age 65+ plan (Exhibit 6).

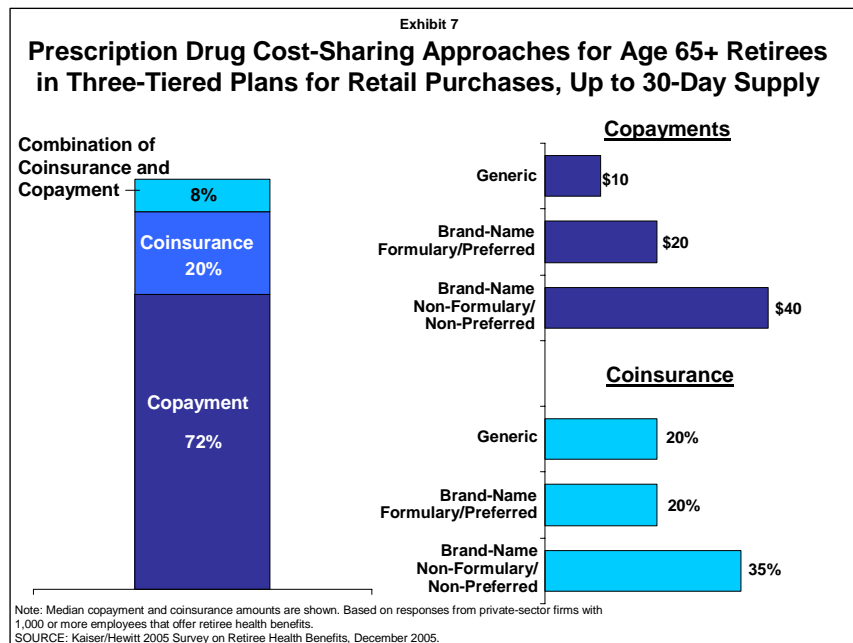
- 62 percent have a three-tiered plan design in which generic drugs, formulary/preferred drugs, and non-formulary/non-preferred drugs are each subject to different copayments/coinsurance rates.
- 19 percent have two tiers for prescriptions with generic drugs subject to a different copayment and/or coinsurance rate than all other drugs.
- Only 2 percent have a drug cost-sharing design with four or more tiers.
- 18 percent apply the same copayment and/or coinsurance rate for all prescription drugs.



## Three-Tiered Drug Cost-Sharing Design

### *Prescriptions Filled at Retail Pharmacies*

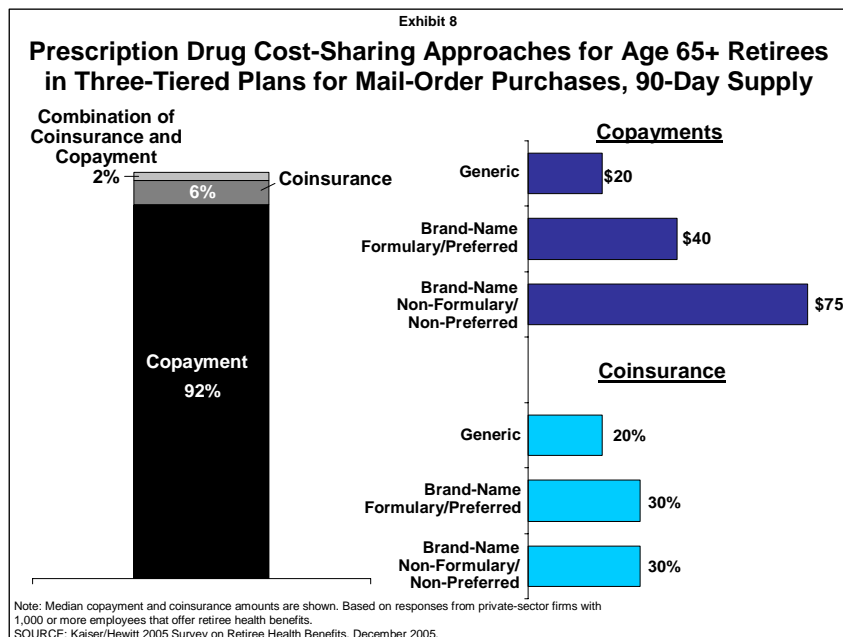
- Among the majority of employer plans with a three-tiered drug design for their largest age 65+ plan, more than two-thirds (72 percent) require flat-dollar copayments for pharmaceuticals purchased at retail pharmacies; one-fifth (20 percent) require coinsurance payments (retiree pays a specified percent of the cost of each prescription); and only 8 percent use a combination approach of copayments plus coinsurance (Exhibit 7).



- For drugs purchased at retail pharmacies, median copayment amounts are \$10 for generics, \$20 for brand-name drugs on the formulary/preferred list, and \$40 for brand-name drugs on the non-formulary/non-preferred list. Typically, retiree cost sharing at retail pharmacies covers a 30-day supply or a lesser quantity, as prescribed.
- Among the minority of plans that use a coinsurance approach for prescriptions filled at retail pharmacies, the median coinsurance rates are 20 percent for generics and brand-name formulary/preferred drugs, and 35 percent for non-formulary/non-preferred drugs.

*Prescriptions Filled at Mail-Order Pharmacies*

- Among employers whose largest age 65+ plan offers a mail-order option with a three-tiered drug design, 92 percent require retirees to pay fixed-dollar copayments, 6 percent impose coinsurance payments, and 2 percent use a combination of copayments and coinsurance (Exhibit 8).



- For drugs purchased through mail-order pharmacies, median copayment amounts are \$20 for generics, \$40 for brand-name drugs on the formulary/preferred list, and \$75 for brand-name drugs on the non-formulary/non-preferred list. Typically, the mail-order copayment covers a 90-day supply of medication.
- For the relatively few employer plans in this survey where coinsurance is used for mail-order claims, median coinsurance is 20 percent for generics, and 30 percent for brand-name formulary/preferred drugs and for non-formulary/non-preferred drugs.

## Comparison with Standard Medicare Drug Benefit

The majority of employers (94 percent) say their 2005 prescription drug benefit is of equal or greater value than the standard Medicare drug benefit in 2006. The typical prescription drug coverage offered by large employers in 2005 is unlike the standard Medicare Part D benefit in several ways.

- Most employer plans do not charge a separate premium or deductible for prescription drugs.
- The typical large employer plan does not suspend coverage at a given level of prescription drug spending until the retiree's drug spending reaches a specified out-of-pocket threshold.
- As it stands today, most plans require retirees to make flat-dollar copayments rather than pay a coinsurance percentage.<sup>11</sup>

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<sup>11</sup> Some experts expect there to be more movement toward coinsurance in coming years, perhaps following Medicare's example.

# **PROSPECTS FOR RETIREE HEALTH BENEFITS AS MEDICARE PRESCRIPTION DRUG COVERAGE BEGINS**

**Findings from the Kaiser/Hewitt 2005  
Survey on Retiree Health Benefits**

**SECTION 3**

**RETIREE HEALTH COSTS**



## Retiree Health Costs

Retiree health benefit costs continue to be a significant concern for employers and for retirees and their families. Despite ongoing efforts to curtail the growth in retiree health program costs, the total cost of providing retiree health benefits has been rising rapidly in recent years and has been cited as a major issue in negotiations between labor and management. Retiree health costs represent more than a quarter (29 percent) of the total costs of health coverage for active workers, pre-65 and age 65+ retirees, and dependents.

Double-digit increases in retiree health costs have contributed to the trend of a declining share of employers offering retiree health benefits and to the requirement that retirees pay more in terms of higher premium contributions and cost sharing.

For some time, to help alleviate cost pressures, many large employers have imposed caps on their future financial obligations for retiree health benefits, triggering increases in retiree contributions to premiums after employers' medical plan costs rise above these caps.

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. Because of the numerous factors at work, 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/retiree costs of providing health coverage to all retirees (pre-65 and age 65+) and their dependents.

### Total Retiree Health Costs

The total cost (employer and retiree contributions) of providing health benefits for both pre-65 and age 65+ retirees and their dependents was an estimated \$20.8 billion in 2004 for the large private-sector firms in this study.

According to these employers, the total cost of providing retiree health benefits increased by an estimated 10.3 percent, on average, between 2004 and 2005. This overall growth rate is slightly higher than the national average increase in large employer costs of providing health benefits to active workers during the same time period, reported in other studies.<sup>12</sup> The overall growth rate for retiree costs varied only minimally by firm size, by industry (manufacturing vs. all other), and whether the firm is publicly traded.

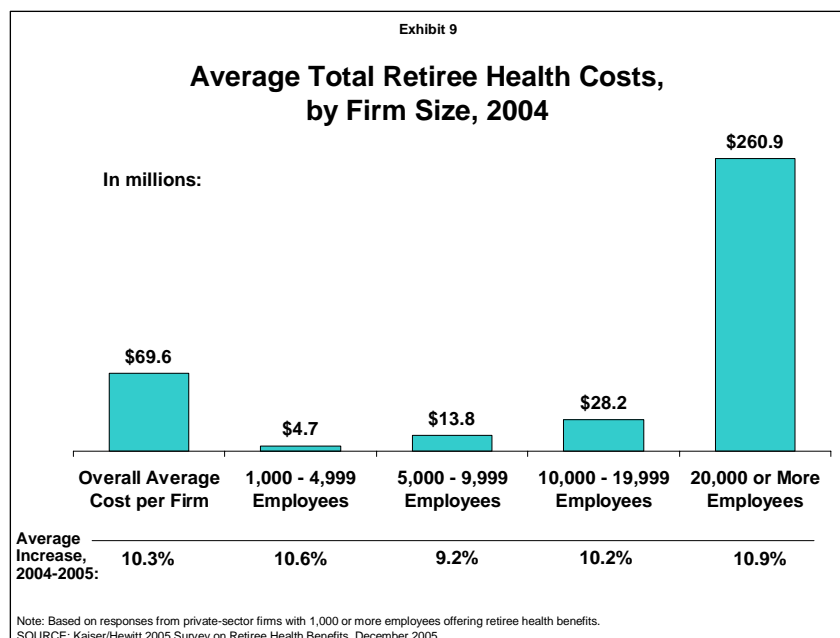
In 2005, the total retiree health cost among surveyed firms is estimated to be \$22.9 billion, calculated based on employers' reported 2004 costs, adjusted for employers' estimates of total cost increases between 2004 and 2005.

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<sup>12</sup> *Kaiser/HRET Annual Employer Health Benefits Survey*, 2005; Hewitt Associates, "U.S. Companies Face Lowest Health Care Cost Increases since 1999," Hewitt News and Information, October 10, 2005, [www.Hewitt.com](http://www.Hewitt.com).

The average total cost of retiree health benefits across surveyed firms was \$69.6 million in 2004, but as might be expected, average costs vary substantially by firm size. Larger firms tend to offer health benefits to larger numbers of retirees and thus have greater costs than do firms with fewer retirees.

- Among firms with 20,000 or more employees, the total average cost per firm of providing retiree health benefits was \$260.9 million in 2004, but within this group, some companies report total costs in excess of \$1 billion. This compares to an average of \$28.2 million for firms with 10,000-19,999 employees, \$13.8 million for firms with 5,000-9,999 employees, and \$4.7 million for firms with 1,000-4,999 employees (Exhibit 9).



## Financial Caps on 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 basis, rather than a pay-as-you-go basis,<sup>13</sup> many large employers have placed caps on their future financial obligation for retiree health coverage. When an employer places a cap on their contributions to retiree health benefits, retirees begin to pick up more costs as medical expenditures rise above a pre-determined amount.

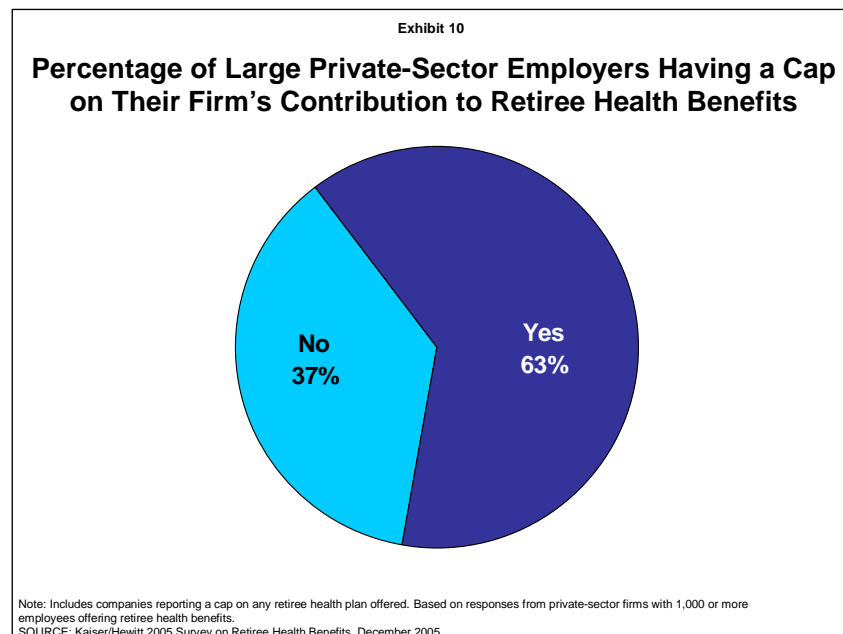
Financial caps take on many shapes and forms. Some employers establish caps on the total cost (e.g., the company will not spend more, in total, for retiree medical benefits than twice what was

<sup>13</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, prepared for the Kaiser Family Foundation, September 1997.

spent in a given year). Others focus the caps on individuals (e.g., the employer subsidy for age 65+ costs will not exceed \$2,000 per person in the future). Some strategies combine a service-related aspect of the employer subsidy.<sup>14</sup> Sometimes the cap is indexed to rise as future costs rise.

Among surveyed employers:

- Nearly two-thirds (63 percent) have a cap on their firm's contribution to retiree health benefits in at least one of the plans offered to retirees (Exhibit 10). Large employers often offer multiple plans.



- Half (49 percent) have a cap on their firm's contribution to retiree health benefits in the largest age 65+ plan offered in 2005 (Exhibit 11).<sup>15</sup>
  - A larger share of publicly-traded firms has a cap on their largest plan (52 percent) than do other surveyed firms (39 percent).
- Among employers with a cap on the largest age 65+ plan, 59 percent said they have already hit the cap, and another 27 percent say they expect to hit the cap within the next one to three years (Exhibit 11).

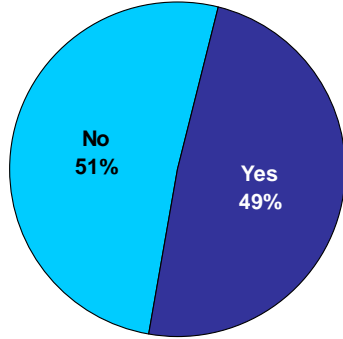
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14 Hewitt Associates, *Retiree Health Trends and Implications of Possible Medicare Reforms*, prepared for the Kaiser Family Foundation, September 1997.

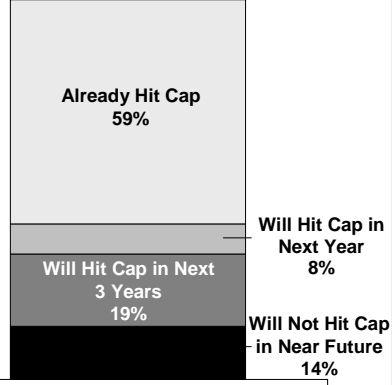
15 The largest plan offered by employers in this survey covers, on average, 79 percent of age 65+ retirees.

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

Of large private-sector employers, 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.  
SOURCE: Kaiser/Hewitt 2005 Survey on Retiree Health Benefits, December 2005.

# **PROSPECTS FOR RETIREE HEALTH BENEFITS AS MEDICARE PRESCRIPTION DRUG COVERAGE BEGINS**

**Findings from the Kaiser/Hewitt 2005  
Survey on Retiree Health Benefits**

**SECTION 4  
PREMIUMS**



## Premiums

Total premiums for retiree health benefits – the sum of both employer and retiree contributions – vary widely.<sup>16</sup> As noted in previous Kaiser/Hewitt retiree health surveys, premiums are typically higher for pre-65 retirees, where the employer plan is generally the sole source of coverage, than for those age 65+, where the employer plan is typically secondary to Medicare. This 2005 survey gathers premium data solely for employees retiring at age 65 or older in 2005.

Retiree contributions to premiums can and often do vary widely depending on the type of health plan selected, the date of retirement, the size of the firm, whether the individual retired before or after turning age 65, and whether the plan is collectively bargained. Demographics, plan type (e.g., a PPO or HMO), plan design, and scope of coverage are also key factors affecting the utilization of health benefits and the overall cost of the plan (and hence the premiums) for retirees.

Within the same firm, retiree contributions often differ based on the retiree's years of service with the company. In firms with service-related contributions, retirees with fewer years of employment typically pay a larger share of the total premium than others in the same firm with more years of service. Thus, employees retiring in the same year who are the same age and have the same health plan options could be subject to different retiree contributions.

All premium information collected in this survey refers solely to age 65+ retirees retiring in 2005 (referred to throughout as “new retirees”), and therefore does not represent the premium information for *all* retirees with employer-sponsored coverage. It does not include retiree contribution information, for example, for earlier generations of retirees who typically pay a lower percentage of the total premium than newer retirees, as the earlier generations may have had their contribution level grandfathered or protected under a previous collective bargaining agreement between the employer and the labor union, where applicable.

Because there can be wide variations in premiums for retiree health coverage within the same firm, large employers were asked to provide an average total premium and average retiree contribution for those retiring on or after January 1, 2005 (new retirees) in the plan with the largest enrollment of age 65+ retirees. To facilitate employer responses, the survey questions asked employers to indicate where the total premiums and retiree contributions fell within a fairly narrow range of premium amounts, and the analysis is conducted based on the midpoint of the ranges.<sup>17</sup>

In this section, we use two approaches to examine total premiums and retiree contributions to premiums. We present weighted average premiums to describe the experiences of retirees, and thus weight premiums and retiree contributions to premiums by firm size and number of retirees in each firm's largest health plan. We use the weighted average when presenting the average total

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<sup>16</sup> For convenience, we use the term “premium” to include “premium equivalents,” which is the term for the employer and retiree contributions in plans that are self-insured. Since the vast majority of firms in our survey are multi-state employers (87 percent), one would expect a large percentage of these retiree health plans to be self-insured, rather than insured plans.

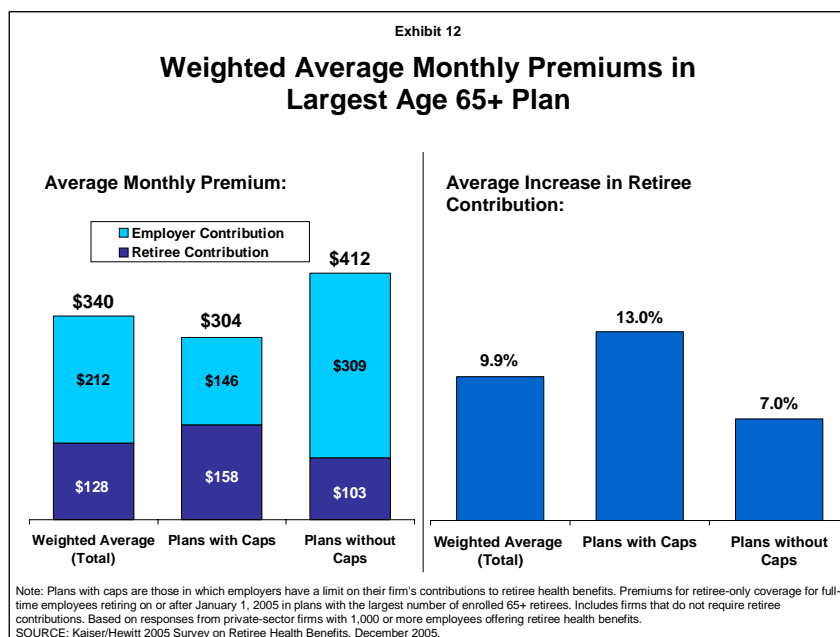
<sup>17</sup> For example, an employer might indicate that their monthly total premium ranged between \$301 and \$350, and that the percentage that the retiree contributes toward the premium ranged between 41 percent and 50 percent.

premium, the average retiree contribution to premium, the average share of total premiums paid by retirees, and the average annual increase in retiree contributions to premiums from 2004 to 2005.

We also present unweighted averages for some purposes. We use the unweighted average to show the distribution of employers by the share of premium paid by new retirees in the largest plan; the distribution of employers by the average annual increase in retiree contributions to premiums, 2004 to 2005; and the average annual increase in retiree contributions to premiums, by firm size, 2004 to 2005.

## Total Premiums

- The average weighted total premium (employer and retiree contributions combined) in 2005 is \$340 per month for new age 65+ retirees in the firms' largest plan (Exhibit 12).
  - The average weighted total monthly premium for new age 65+ retirees in the largest plan is lowest for firms with 5,000-9,999 employees (\$321 per month) and highest for smaller firms with 1,000-4,999 employees (\$412 per month).

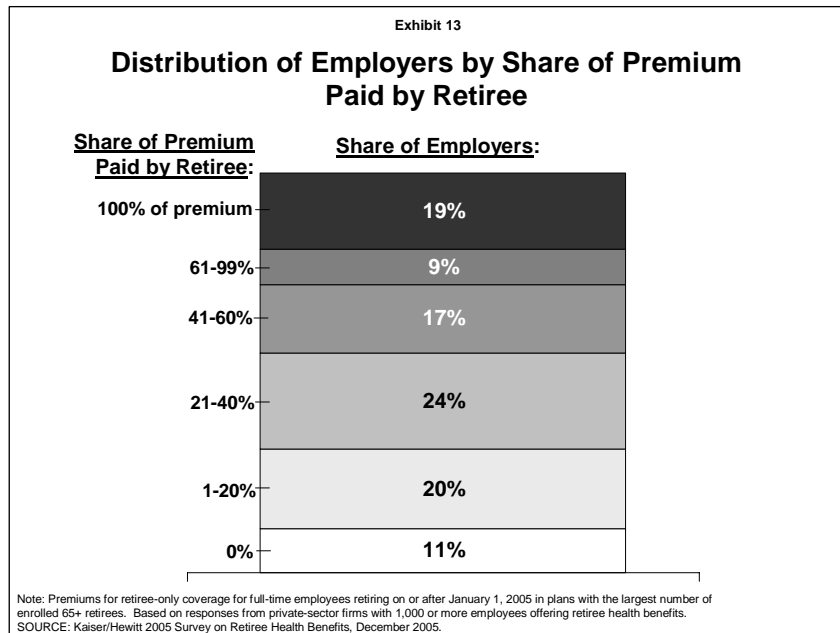


## Retiree Contributions

Nearly all employers require new age 65+ retirees to share in the cost of retiree health coverage by contributing to the total monthly premium; however, the share of the total premium and the actual contribution varies considerably across firms.

- 89 percent of surveyed firms report that new age 65+ retirees enrolled in the firms' largest plan make a contribution to the total monthly premium; 11 percent do not require retirees to contribute to the total premium (Exhibit 13).

- 19 percent of surveyed firms report that new age 65+ retirees in the largest plan pay 100 percent of the total premium for their health insurance coverage.



- The weighted average retiree contribution for new age 65+ retirees in 2005 is \$128 per month for retiree-only coverage in health plans with the largest number of age 65+ retirees (Exhibit 12). When firms that do not require retirees to pay any portion of the premium are excluded, the weighted average contribution for new age 65+ retirees increases to \$156 per month.
  - On average, retiree contributions for age 65+ retirees vary by firm size, with higher retiree contributions in firms with 1,000-4,999 employees (\$188) than in firms with 20,000 or more employees (\$123).<sup>18</sup>
  - Weighted average retiree contributions to premiums are higher in plans that are capped (\$158/month) than in plans that are not capped (\$103/month) (Exhibit 12).
- New age 65+ retirees in the largest plan pay an average of 38 percent of the total premium, when weighted by the number of retirees across all surveyed firm.
  - As expected, retiree contributions as a share of total premium are higher among plans that have a financial cap on the employer obligation. The weighted average retiree contribution is 52 percent of the total premium in the largest plans with caps, versus 25 percent in the largest plans not subject to caps.

<sup>18</sup> Except as otherwise noted average 65+ retiree contribution amounts and retiree contributions as a share of total premiums include firms that do not require retirees to pay any portion of the total premium.

## **Increase in Retiree Contributions**

- The weighted average increase in retiree contributions between 2004 and 2005 was 9.9 percent for new age 65+ retirees in plans with the largest number of retirees (Exhibit 12).<sup>19,20</sup>
  - The average increase in retiree contributions was slightly higher for firms with fewer than 10,000 employees (12 percent) than it was for larger firms.
  - The average increase in retiree contributions was also greater in firms with a financial cap on the employer's obligation: 13 percent versus 7 percent for retirees in plans without a cap (Exhibit 12).

## **Distribution of Employers by Change in Retiree Contributions, 2004 to 2005**

- Nearly one-third (31 percent) of employers report no change in age 65+ retiree contributions in the largest health plan between 2004 and 2005 (Exhibit 14). However:
  - 27 percent report an increase of 10 percent or less;
  - 26 percent report an increase of between 11 and 20 percent for new retirees;
  - 9 percent report an increase of between 21 and 30 percent, and
  - 6 percent report an increase in retiree contributions of 30 percent or more.
- More than half of surveyed employers (58 percent) increased retiree contributions to premiums at the same rate or at a lower rate than total costs increased between 2004 and 2005.
- Among the remaining 42 percent of employers, retiree contributions increased at a faster rate than did total premiums between 2004 and 2005. In these firms, however, retirees tended to pay a lower share of the total premium (34 percent on average, in 2004) than did retirees whose contributions to premiums grew at a slower rate than total premiums (50 percent on average).

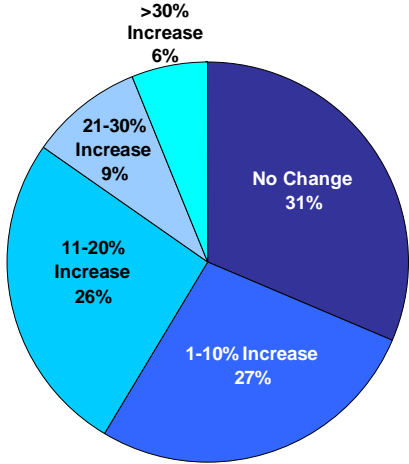
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19 The 65+ weighted average increases reported in this section include those firms that reported no change, i.e., a zero percent increase, in retiree contributions from 2004 to 2005.

20 In general, the average increase in retiree contributions is lower than in previous years most likely because the underlying trend in 2004 was better than many had projected, allowing for something of a correction in 2005. Other participating companies may have been reluctant to increase premiums sharply in 2005 on top of significant retiree contribution increases in prior years, especially given the reduction in the overall cost trend between 2004 and 2005.

Exhibit 14

### Distribution of Employers by Reported Change in Retiree Contributions to Premiums, 2004 to 2005



Note: Numbers do not total 100% due to rounding. Retiree contributions to premiums for retiree-only coverage for full-time employees retiring on or after January 1, 2004 and January 1, 2005, respectively, in plans with the largest number of enrolled 65+ retirees. Based on responses from private-sector firms with 1,000 or more employees that offer retiree health benefits.  
SOURCE: Kaiser/Hewitt 2005 Survey on Retiree Health Benefits, December 2005.



# **PROSPECTS FOR RETIREE HEALTH BENEFITS AS MEDICARE PRESCRIPTION DRUG COVERAGE BEGINS**

**Findings from the Kaiser/Hewitt 2005  
Survey on Retiree Health Benefits**

## **SECTION 5**

### **CHANGES MADE BY LARGE EMPLOYERS BETWEEN 2004 AND 2005**



## Changes Made by Large Employers Between 2004 and 2005

Under increasing pressure from cumulative rising costs, large employers as a group have, for years, been making annual changes to slow the growth in retiree health obligations. Not surprisingly, employers offering retiree health benefits made substantial changes to their retiree health benefit plans between 2004 and 2005. As observed in previous years, the majority of surveyed firms have increased retiree contributions to premiums, and over a third have increased general cost-sharing requirements for health care services in the past year. A much smaller share of employers in this survey – about one in eight – say they have terminated subsidized health benefits for future retirees entirely. While most reported changes suggest a reduction in benefits for retirees, 9 percent of surveyed employers report having added benefits or improved coverage for retirees between 2004 and 2005.

With nearly all large firms (99 percent) offering prescription drug benefits to age 65+ retirees, prescription drug costs have become a major focus of cost containment for large employers. As in prior years, large employers report having implemented a number of specific strategies to control rising drug costs. Nearly four in 10 surveyed employers report increasing copayments or coinsurance for retirees' prescription drugs between 2004 and 2005.

### Coverage Changes Between 2004 and 2005

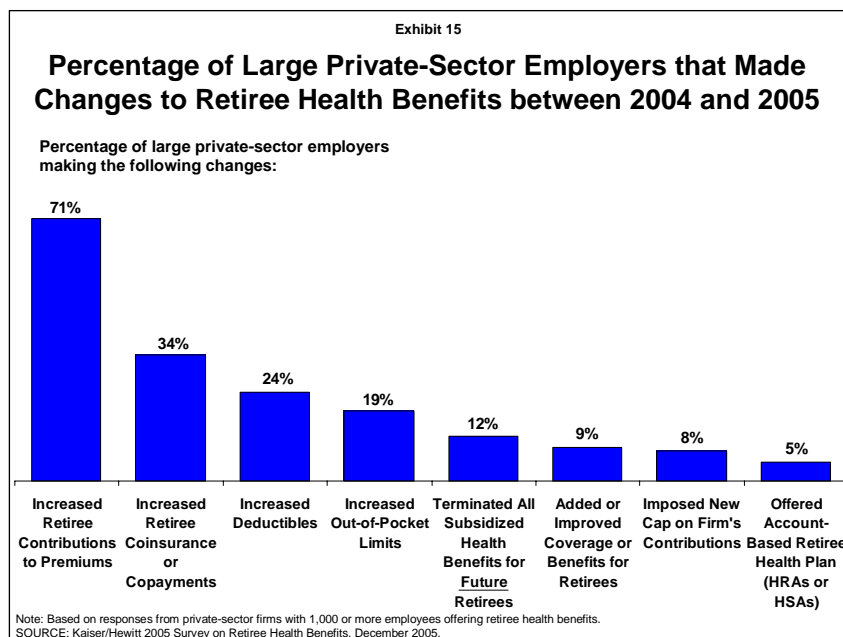
- Among large, private-sector firms currently offering retiree health benefits, 12 percent terminated all subsidized health benefits for future retirees between 2004 and 2005 (Exhibit 15).<sup>21</sup>
  - Three out of four employers that report they terminated coverage indicate that it was for non-union employees; one out of four employers terminating coverage report it was for union employees.
  - Most of the terminations reported by these employers primarily affect employees *hired* after a specific date rather than employees who will *retire* after a specific date.
  - Two out of three employers that say they terminated benefits for future retirees also indicate that they will provide access to health benefits, with these retirees paying 100 percent of the cost.
- 1 percent of surveyed employers say they terminated all subsidized retiree health benefits for current retirees in one or more plans offered. Eliminating dependent coverage is not a strategy used by surveyed firms.
- 5 percent say they offered an account-based retiree health plan, such as an HRA (health reimbursement arrangement) or HSA (health savings account).

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<sup>21</sup> Between 2000 and 2005, a total of 127 companies in the annual Kaiser/Hewitt retiree health surveys have terminated subsidized health benefits for *future* retirees.

## Cap on Firm Contributions Imposed Between 2004 and 2005

- In response to the rising cost of providing retiree health benefits, employers have imposed financial caps on their retiree health obligations. Eight percent of large employers say they imposed a new cap on their firm's contribution for a group of retirees for which there previously was no cap.



## Retiree Contributions to Premiums

- 71 percent of surveyed employers report having increased retiree contributions to premiums in one or more plans between 2004 and 2005.

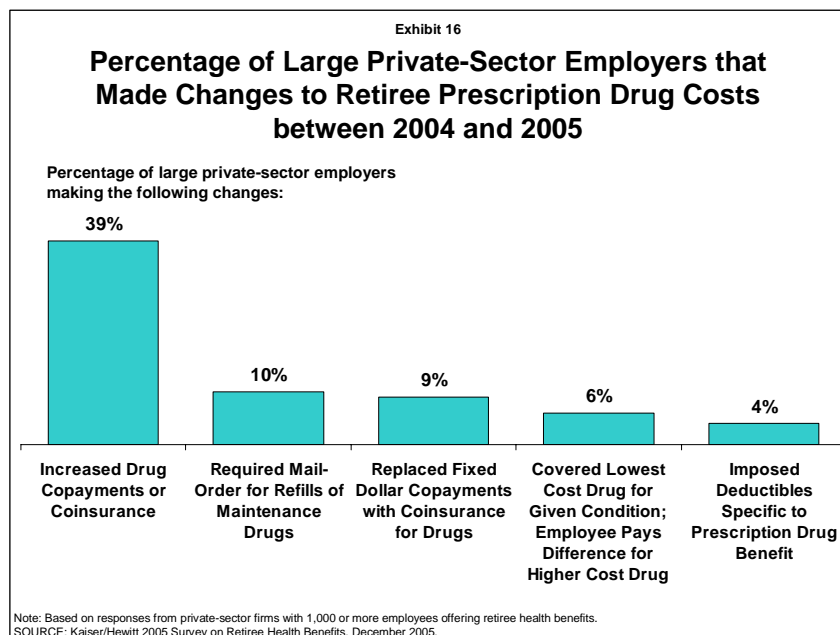
## Cost Sharing

- Between 2004 and 2005, over one-third (34 percent) of surveyed employers report increases in retiree cost sharing in the form of copayments and coinsurance for a range of health care services.
- Surveyed employers made the following additional cost-sharing changes between 2004 and 2005:
  - 24 percent raised deductibles.
  - 19 percent raised retiree out-of-pocket limits.

## Prescription Drug Benefit Changes Between 2004 and 2005

Large employers implemented a variety of measures to control rising drug costs, including plan design changes that increase cost sharing for retirees, as well as strategies to manage utilization of prescription drugs (Exhibit 16).

- 39 percent of surveyed employers increased prescription drug copayments or coinsurance.
- 10 percent required mandatory use of mail-order for prescription refills or maintenance drugs.
- 9 percent replaced fixed dollar copayments with coinsurance for drugs, a potentially significant shift for retiree out-of-pocket spending and a potential incentive for retirees to use generic or lower-cost brand-name drugs.
- 6 percent covered the lowest-cost drug for a given condition and made the retiree pay the difference for a higher-cost drug.
- Imposing deductibles specific to the prescription drug benefit was far less common, with 4 percent of employers reporting this strategy.
- Firms did not move toward capping their annual drug benefit or covering only generic drugs, with less than one half of one percent of surveyed employers reporting that they made such changes.





# **PROSPECTS FOR RETIREE HEALTH BENEFITS AS MEDICARE PRESCRIPTION DRUG COVERAGE BEGINS**

**Findings from the Kaiser/Hewitt 2005  
Survey on Retiree Health Benefits**

## **SECTION 6**

### **MEDICARE PRESCRIPTION DRUG BENEFIT AND RETIREE HEALTH**



## Medicare Prescription Drug Benefit and Retiree Health

More than 12 million people on Medicare rely on employer-sponsored and/or union plans for their retiree health benefits.<sup>22</sup> Retiree health plans are the largest single source of prescription drug coverage for Medicare beneficiaries prior to the implementation of the Medicare drug benefit.

The interaction between employer-sponsored retiree health benefits and the new Medicare prescription drug benefit received considerable attention during the long debate leading up to the enactment of the new drug benefit, and the future of retiree benefits continues to be a key issue for employers, retirees, and policymakers.

A central issue for retirees and their families is whether the new Medicare Part D prescription drug benefit will hasten the erosion of relatively generous and highly-valued employer-sponsored retiree health coverage. From the employer perspective, rising retiree health costs remain a pressing concern. Many are hopeful that the new Medicare drug benefit could help offset cumulative double-digit increases in retiree health costs.

### Background

Looking toward 2006 for their age 65+ retirees, employers have four major options with respect to the new Medicare drug benefit:

- Maintain prescription drug benefits that are at least actuarially equivalent to the standard Medicare drug benefit defined in law. Medicare offers financial incentives for employers that choose this approach, in the form of tax-free payments equal to 28 percent of allowable drug costs between \$250 and \$5,000 for each covered retiree not enrolled in Part D in 2006. Taking the retiree drug subsidy is the least disruptive approach for employers and retirees. This strategy is a viable option because 94 percent of surveyed employers say their 2005 benefits have an actuarial value that is equal to or greater than the standard Medicare prescription drug benefit for 2006.
  - The Centers for Medicare and Medicaid Services (CMS) estimates an average tax-free retiree drug subsidy payment of \$668 per participant in 2006, equivalent to \$891 for plan sponsors with a 25 percent marginal tax rate and \$1,028 for plan sponsors with a 35 percent marginal tax rate.<sup>23</sup> Corporations owing no taxes obviously do not reap the additional tax benefits, just as not-for-profit employers and governmental plans do not.
- Supplement (or “wrap around”) Medicare Part D coverage or achieve a similar result by contracting directly with a Medicare prescription drug plan (PDP) or Medicare Advantage prescription drug (MA-PD) plan to provide more generous coverage to retirees for an additional premium. Payments for prescription drugs made by employers

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<sup>22</sup> Kaiser Family Foundation analysis of 2002 Medicare Current Beneficiary Survey Cost and Use File.

<sup>23</sup> Centers for Medicare and Medicaid Services, *The Retiree Drug Subsidy: Why Employers and Union Plan Sponsors Should Consider It*, April 2005, <http://www.cms.hhs.gov/medicarereform/pdbma/RetireeDrugSubsidy4Emp04-06-05.pdf>.

on behalf of their Medicare-eligible retirees would not count toward the retirees' true out-of-pocket (TrOOP) limit. Supplementing the Medicare prescription drug benefit is considered administratively challenging in the first year, with the availability and the design of Medicare PDPs and MA-PD plans relatively unknown during the employers' benefits planning cycle for 2006.

- CMS estimates that these approaches toward supplementing Medicare drug coverage will achieve cost savings to employers of at least \$900 on average due to the federal government subsidizing a significant portion of the cost of standard Part D coverage.<sup>24</sup>
- Become a Medicare PDP or MA-PD plan, receiving a CMS-estimated average payment of close to \$900 per participant in an employer-sponsored PDP or MA-PD plan.<sup>25</sup>
- Terminate prescription drug coverage (and possibly make a contribution to Medicare prescription drug plan premiums).

A key concern remains which path(s) employers choose for 2006, and whether they contemplate changing their approach in subsequent years. This survey was conducted between June 21 and October 7, 2005, during the period that private-sector employers were making final decisions as to whether they would choose to take the retiree drug subsidy or pursue some other employer option for coordinating with Medicare drug coverage in 2006.

### **Strategies for 2006**

The Kaiser/Hewitt 2005 survey asked employers to identify which strategies their firm would most likely pursue in response to the Medicare drug benefit. Overall, the majority of surveyed employers (82 percent) say they intend to maintain prescription drug coverage for their Medicare-eligible retirees in 2006 and take the 28 percent subsidy; 15 percent say they are likely to supplement the Medicare prescription drug benefit; and 2 percent say they intend to become a prescription drug plan. Eleven percent said they are likely to discontinue prescription drug coverage, of which 3 percent report they are likely to discontinue both drug and other medical coverage.<sup>26</sup>

Employers were then asked which strategy they were most likely to pursue for their largest group of age 65+ retirees (Exhibit 17).

- 79 percent of surveyed employers – representing 89 percent of age 65+ retirees in the largest plans – expect to continue to offer prescription drug coverage and accept the tax-free subsidy for their largest group of age 65+ retirees.

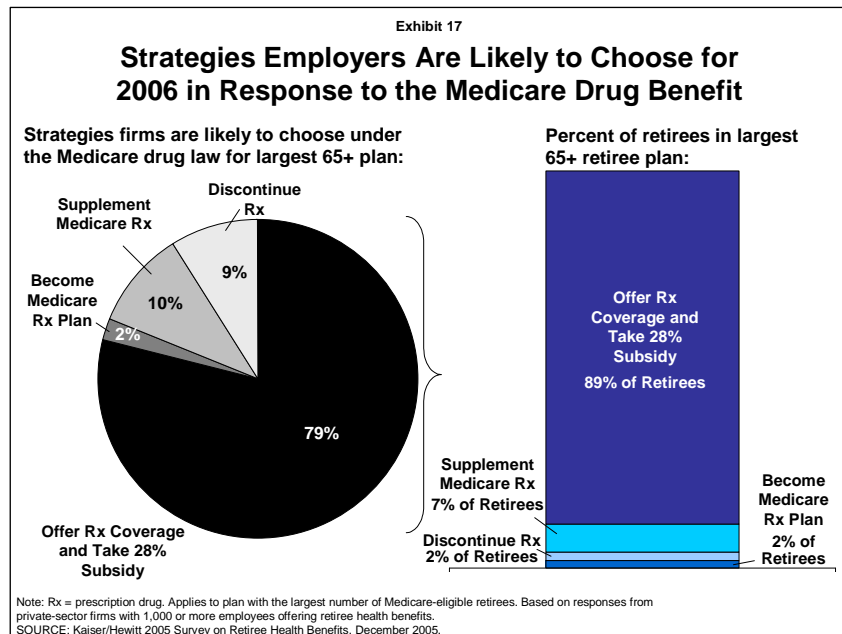
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<sup>24</sup> Centers for Medicare and Medicaid Services, *Overview of Plan Sponsor Supplemental Coverage Options and TrOOP*, <http://www.cms.hhs.gov/medicarereform/pdbma/OverviewofPlanSponsorSupplementalCoverageOptionsandTrOOP.pdf>.

<sup>25</sup> Centers for Medicare and Medicaid Services, *The Retiree Drug Subsidy: Why Employers and Union Plan Sponsors Should Consider It*, April 2005, <http://www.cms.hhs.gov/medicarereform/pdbma/RetireeDrugSubsidy4Emp04-06-05.pdf>.

<sup>26</sup> Some employers with multiple plans provided multiple responses to this question because they chose different strategies for their various plans. As a result, the total exceeds 100 percent.

- 10 percent of surveyed employers – representing 7 percent of age 65+ retirees in the largest plans – expect to offer prescription drugs as a supplement to the Medicare drug benefit for the plan with the largest group of age 65+ retirees.
- 9 percent of surveyed employers – representing 2 percent of age 65+ retirees in the largest plans – report that they are likely to discontinue drug and/or medical coverage for the plan with the largest group of age 65+ retirees.
- 2 percent of surveyed employers – representing 2 percent of age 65+ retirees in the largest plans – report that they are likely to become a Medicare prescription drug plan.



## Expected Savings for Employers

*Per Retiree Savings Due to Medicare Drug Benefit.* As firms look toward 2006 and assess their preferred strategy, a key consideration is how much they expect to save as a result of the new Medicare prescription drug benefit.<sup>27</sup>

- Across all surveyed employers – including employers that maintain drug benefits, supplement drug benefits, or even terminate drug coverage – the weighted average savings is estimated to be \$644 per individual retiree in 2006.<sup>28</sup>

<sup>27</sup> The survey asked employers to indicate the average dollar savings per individual retiree that would result from the Medicare drug benefit in 2006. Employers reported their savings per individual retiree within pre-defined ranges (e.g., \$600 to \$649/year). Using the midpoint of these ranges, we calculated average savings across employers, weighted by firm size and the average number of age 65+ retirees. By doing so, the average savings per individual retiree of larger firms with a greater number of retirees are weighted more heavily than the relatively smaller firms that have fewer retirees. Employers that reported no savings attributable to their Medicare strategy were excluded from the analysis.

<sup>28</sup> In some instances, there are no savings to the employer because the retiree pays 100 percent of the premium. In other cases, employer savings may be lower because the employer contribution is capped and/or the employer pays a smaller percentage of the overall cost than other employers. Savings will also be lower if the employer intends to share a portion of the savings with retirees (a question not asked in the survey).

Estimated average savings per retiree varies by strategy. Looking at the two most common strategies identified by employers:

- The weighted average savings per individual retiree is \$626 among employers who intend to continue prescription drug benefits and accept the 28 percent subsidy.
- The weighted average savings per individual retiree is \$826 among employers who intend to supplement the Medicare drug benefit.

*Savings as a Share of Total Retiree Health Costs.* When the Medicare drug law was being debated, the hope was that the subsidy would provide employers with sufficient financial relief so they would maintain rather than terminate coverage for their Medicare-eligible retirees. While the subsidy provides a direct payment for drug costs associated with each eligible age 65+ retiree and Medicare-eligible dependent, employers incur costs associated with both their pre-65 retirees (for whom the employer is the primary payer) and for other medical and supplemental drug benefits provided to age 65+ retirees.

- The total employer savings attributable to their Medicare drug benefit responses represents a median 7 percent of the total cost of retiree health benefits for pre-65 and age 65+ retirees.<sup>29</sup>

### **Other Strategies for Controlling Prescription Drug Costs in 2006**

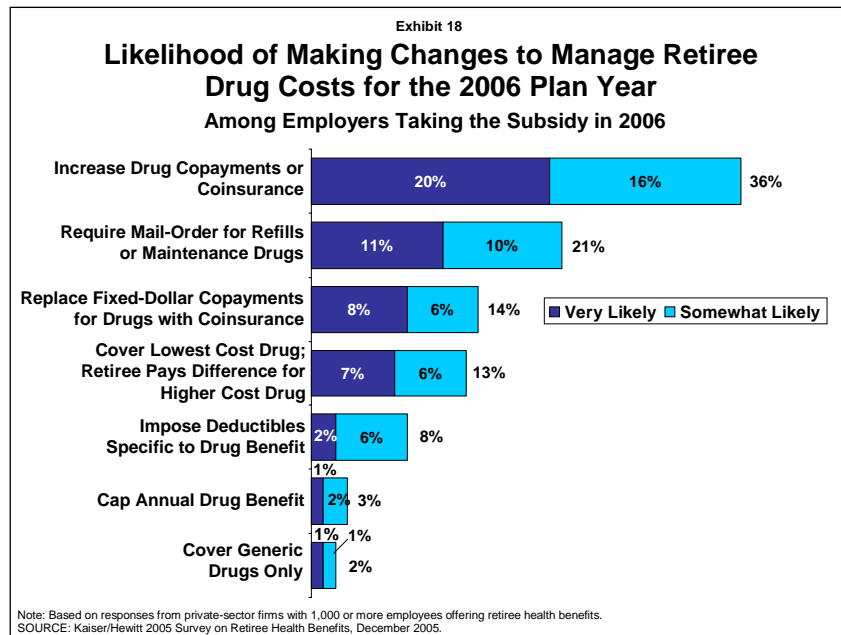
Among employers planning to continue drug coverage and take the retiree drug subsidy in 2006 (Exhibit 18):

- 36 percent say they are very (20 percent) or somewhat (16 percent) likely to increase retiree copayments or coinsurance for prescription drugs.
- 21 percent say they are very (11 percent) or somewhat likely (10 percent) to require use of mail-order for prescription refills or maintenance drugs.
- 14 percent of surveyed employers say they are very (8 percent) or somewhat (6 percent) likely to replace fixed dollar copayments with a coinsurance approach for prescription drugs.
- 13 percent of surveyed employers say they are very (7 percent) or somewhat (6 percent) likely to cover the lowest-cost drug for a given condition and make the retiree pay the difference for a higher-cost drug.

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<sup>29</sup> This percentage savings was calculated by taking the total savings for each employer (i.e., savings per individual retiree multiplied by the total number of the company's age 65+ retirees) and dividing that sum by the employer's estimated 2005 total cost (employer and retiree share) of providing retiree health benefits to pre-65 and age 65+ retirees. We then calculated the median percentage savings among these companies.

- 8 percent of surveyed employers say they are very (2 percent) or somewhat (6 percent) likely to impose deductibles specific to the prescription drug benefit in 2006.
- 3 percent say they are very (1 percent) or somewhat (2 percent) likely to impose a cap on the annual drug benefit.
- 2 percent say they are very (1 percent) or somewhat (1 percent) likely to cover generic drugs only.



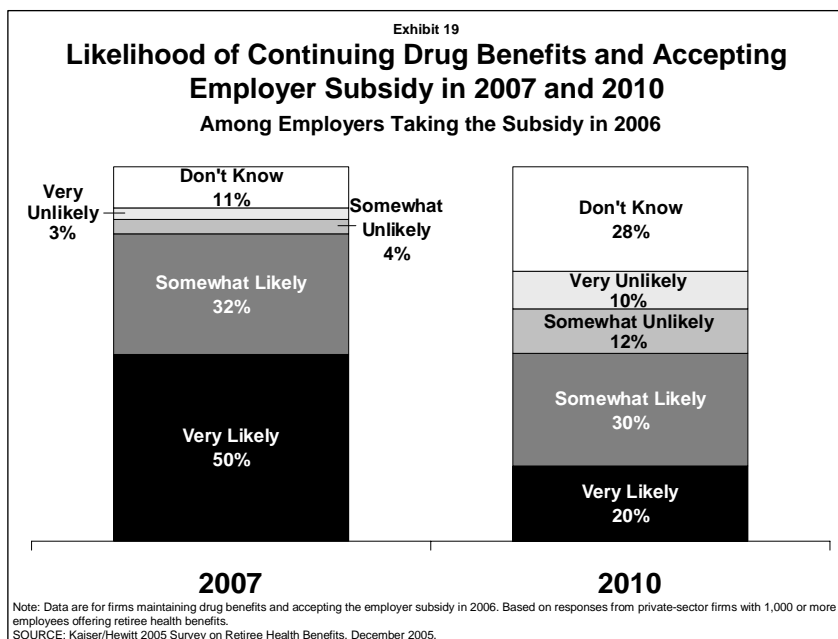
## Likelihood of Continuing Medicare Strategy in Years Beyond 2006

The survey asked employers that intend to continue prescription drug coverage and accept the subsidy in 2006, how likely they are to continue the same strategy in later years (Exhibit 19).

Among the employers taking the retiree drug subsidy in 2006 for their largest group of age 65+ retirees in 2006 (79 percent):

- Looking to 2007, 82 percent say they are very (50 percent) or somewhat (32 percent) likely to continue offering these benefits and accept the 28 percent subsidy; 7 percent say they are very (3 percent) or somewhat (4 percent) unlikely to do so; and 11 percent report that they do not know what they will do.
- Looking to 2010, 50 percent say they are very (20 percent) or somewhat (30 percent) likely to continue offering these drug benefits and accept the 28 percent subsidy; 22 percent report that they are very (10 percent) or somewhat (12 percent) unlikely to do so, and 28 percent report that they do not know.

In other words, eight out of 10 employers that report they will take the subsidy in 2006 say they are likely to continue doing so in 2007, but that proportion drops to 5 out of 10 employers in 2010, and the uncertainty among these employers as to whether they will continue taking the 28 percent subsidy grows between 2006 and 2010. Employers may find other options to be more attractive in later years, such as supplementing Medicare drug plans as a secondary payer.



Whether employers maintain drug coverage for their age 65+ retirees over the long term will depend on a number of factors. A key consideration will likely be the financial burden of providing retiree health coverage over time, but other factors could include the administrative costs and challenges associated with any of the options, and the ease with which employers will be able to wrap around Medicare drug plans.

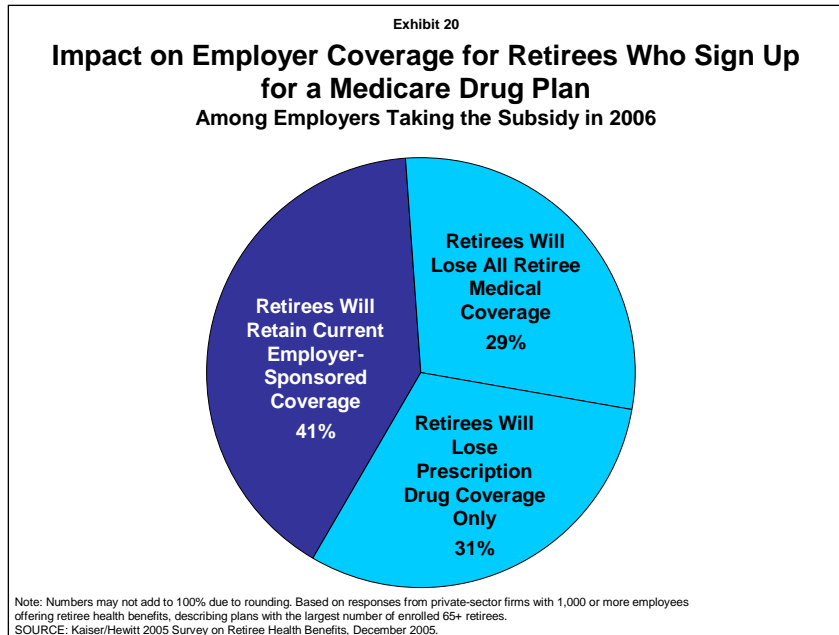
### Other Employer Policies Affecting Retirees

Medicare beneficiaries with retiree health benefits from their former employer or union health plan generally have the option of retaining their employer/union benefits (assuming such coverage is offered and is at least as generous as the standard Medicare benefit) or enrolling in a Medicare prescription drug plan.

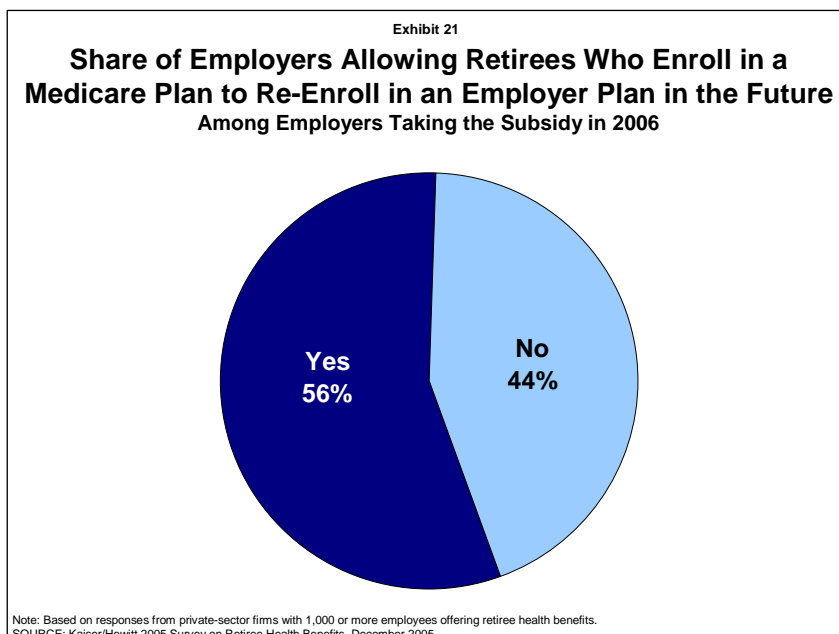
The 2005 survey asked employers taking the subsidy in 2006 for their largest age 65+ plan whether a retiree would have the option to maintain employer coverage if he or she enrolls in a Medicare prescription drug plan (Exhibit 20).

- 41 percent of employers said their retirees would be able to retain employer-sponsored coverage, which generally means both medical and prescription drug coverage, as a supplement to a Medicare drug plan.
- 31 percent said their retirees would lose prescription drug coverage only.

- 29 percent said their retirees would lose both employer-sponsored medical and prescription drug coverage if they elected to sign up for a Medicare prescription drug plan.



For retirees with employer coverage, informed decision-making is especially important. Many are concerned that some retirees – faced with a fairly significant change in their Medicare options – may sign up for a Medicare prescription drug plan without realizing the potential consequences in terms of forfeiting their employer-sponsored benefits. CMS and employers are taking steps to make retirees aware of the implications of dropping their employer coverage for a Medicare drug plan. They also have procedures in place to flag and address situations where retirees in employer plans taking the subsidy attempt to enroll in Medicare drug plans.



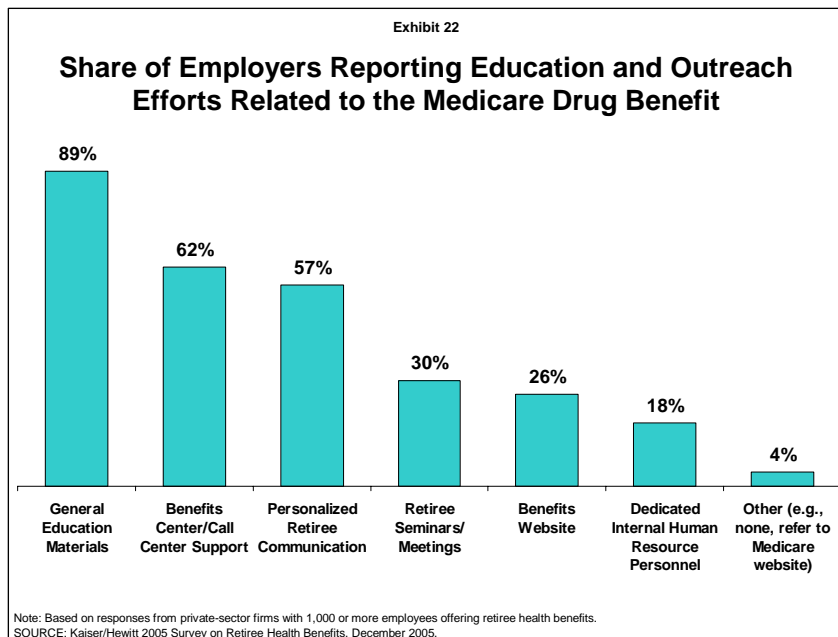
If Medicare-eligible retirees choose to enroll in Part D plans as they are entitled to do:

- More than half of employers taking the subsidy for their largest age 65+ plan in 2006 (56 percent) say retirees would be allowed to enroll or re-enroll in the employer plan at a future date if they sign up for a Medicare drug plan; however, 44 percent of employers say retirees would not be able to do so in the future (Exhibit 21).

This finding underscores the importance of safeguards to deter retirees from making an irrevocable decision with potentially adverse long-term financial implications.

## Education Challenges

Employers are expected to be a key source of information for their age 65+ retirees as the Medicare prescription drug benefit is rolled out (Exhibit 22). Employers are required to provide their Medicare-eligible retirees with a notice indicating whether their employer coverage is “creditable” (i.e., at least as good as the Medicare prescription drug benefit) or “non-creditable” (i.e., less than the actuarial value of the Medicare drug benefit).



Many large employers report that they plan to provide additional support to their age 65+ retirees using multiple strategies, including:

- 89 percent will distribute general educational materials.
- 62 percent will maintain a benefits center or call center.
- 57 percent will provide personalized retiree communications (in addition to required notices).

- 30 percent are planning on hosting retiree seminars or meetings.
- 26 percent will have a benefits website.
- 18 percent have dedicated human resources personnel.



# **PROSPECTS FOR RETIREE HEALTH BENEFITS AS MEDICARE PRESCRIPTION DRUG COVERAGE BEGINS**

**Findings from the Kaiser/Hewitt 2005  
Survey on Retiree Health Benefits**

**APPENDIX  
METHODS**



## **Appendix: Methods**

### **Survey Approach**

This survey, conducted by Kaiser Family Foundation and Hewitt Associates, was designed to capture information on retiree health programs offered to Medicare-eligible retirees by large private-sector employers having at least 1,000 employees. The survey focuses on large employers because they are significantly more likely than small and mid-sized employers to offer retiree health benefits.

By design, the Kaiser/Hewitt survey focused exclusively on large private employers that currently provide retiree health coverage, rather than surveying employers who do not offer coverage. This survey is based on a non-probability sample of large employers because there is no database that identifies all private-sector firms offering retiree health benefits from which a random sample could be drawn. A list of approximately 1,800 employers identified as potentially offering retiree health coverage was compiled based on data from respondents to Hewitt's previous employer surveys and data from Hewitt's proprietary client databases, supplemented by other employers drawn from a public database called Standard & Poor's Research Insight.<sup>SM</sup>

Despite interest in examining trends in this area, comparisons between the new 2005 findings and results from the 2004 Kaiser/Hewitt survey are somewhat limited. Given the nonrandom nature of this sample and the fact that the samples each year include different companies offering different plans, study findings may not be strictly comparable from year to year.

The survey was conducted between June 21 and October 7, 2005 and completed by human resources professionals at each of the firms. Most employers were e-mailed a note inviting them to participate in the survey; the remaining employers were invited via a letter. Both the e-mail note and the letter provided employers with a link to a website through which they could complete the survey online. Employers were also given the option of completing and returning a printed questionnaire. Invitees were sent multiple reminder notices by mail and e-mail. Overwhelmingly, employers chose the online survey, with 97 percent completing the survey in that manner, versus 3 percent that completed and returned the printed questionnaire.

### **Characteristics of Participating Employers**

Overall, 335 employers responded to the survey. Employers not providing coverage, those with fewer than 1,000 employees, and government employers were excluded, leaving a total of 300 large private employers whose responses are included in the survey analysis. These employers represent 32 percent of Fortune 100 companies and 33 percent of Fortune 500 companies. The surveyed employers include one-quarter (27 percent) of the Fortune 500 companies with the largest retiree health liabilities in 2004.

Most (279) of the surveyed employers provide retiree health coverage to both pre-65 and age 65+ retirees, but some only provide coverage to either pre-65 or age 65+ retirees, but not both. There are 297 employers that provide pre-65 coverage and 282 that provide coverage to age 65+

retirees. The overwhelming majority (87 percent) of surveyed employers are multi-state companies that represent a broad range of manufacturing (44 percent) and non-manufacturing (56 percent) industries. Sixteen percent of surveyed employers are large subsidiaries of a parent organization.

The 300 surveyed employers reported having 6,322,442 employees, with an average of 21,075 employees per employer and a median of 7,550 employees. Using a typical ratio of family members to employees (2.5) identified by Hewitt actuaries, the surveyed employers provide benefits that impact the lives of about 15.8 million employees and family members.

The surveyed employers reported a total of 3,446,024 pre-65 and age 65+ retirees, with an average of 11,487 retirees and a median of 1,800 retirees. Using a typical ratio of family members to retirees (1.65) identified by Hewitt actuaries, the surveyed employers provide retiree health benefits that impact the lives of approximately 5.7 million retirees and family members. The employers in this sample provide health benefits to an estimated 3.9 million Medicare-eligible retirees and their spouses, representing more than a quarter of the roughly 12 million retirees on Medicare with employer-sponsored health coverage.

In terms of the overall distribution of firms, 36 percent have 1,000 to 4,999 employees, 22 percent have 5,000 to 9,999 employees, 19 percent have 10,000 to 19,999 employees, and 23 percent are “jumbo” firms with 20,000 or more employees (Table A1).

### **Total Cost of Retiree Health Benefits in 2004**

Among surveyed employers, the total cost (employer and retiree share) of providing retiree health benefits to pre-65 retirees, age 65+ retirees, and dependents was \$20.8 billion in 2004. The total was derived by taking the average total cost by firm size for the 253 surveyed employers who responded to the total cost question, and applying that average cost per size of firm to the 47 employers who did not respond to the question. This resulted in a total cost of \$3.2 billion for the 47 non-responding employers added to the \$17.6 billion for the 253 responding employers.

The total cost of retiree health coverage of firms in this study represents more than a quarter (29 percent) of the total estimated cost of health coverage for active workers, retirees, and dependents. To calculate this estimate, the total dollar expenditures for the respondents were estimated assuming that the premium for the largest retiree plan is a fair representation of the cost for the other retiree plans offered. The total retiree premium was therefore set equal to the total retiree count times the premium for the largest plan. Given that, for most respondents, the largest retiree plan represents a significant portion of retirees (79 percent, on average), this should provide a reasonable proxy of total cost. The cost for active employees was estimated assuming that the active participating employer had costs equal to the average active employee cost in Hewitt Associates' 2005 Hewitt Health Value Initiative (HHVI) survey that collects detailed active employee plan costs for over 400 major employers. Using this active employee cost (\$6,707 per employee) multiplied by the total employee count provided by respondents yields the expected medical plan premiums for workers.

## Premiums

In this report, the term “total premium” includes both the employer and retiree contributions. “Premium equivalent” refers to the employer and retiree contributions for plans that are self-insured. Since the vast majority of firms in the survey are multi-state employers (84 percent), one would expect a large percentage of these retiree health plans to be self-insured, versus insured plans where the appropriate term is “premium.” For convenience, however, the term “premium” includes “premium equivalents.”

The total premium and retiree contribution information is gathered with respect to the surveyed employer’s retiree health plan with the largest enrollment of age 65+ retirees. Large employers typically offer more than one health plan for a given group and different plans may be offered across the firm’s various locations and business lines. Requesting premium information for the largest plan is, therefore, the most administratively feasible request to which large employers would respond. In addition, the retirees in the largest plan represent the majority of all retirees with health coverage among the surveyed employers (Table A2).

The premium and retiree contribution information is gathered with respect to employees newly retiring on or after January 1, 2005, to minimize survey burden on respondents and maximize the number of responses. For example, an employer may have previous retirees with multiple generations of retiree contributions, depending on the period during which the retiree contributions were bargained between the employer and the labor union. Additional feedback suggested that the average premium for new retirees is of greater interest to employers. In addition, the retirees of the largest plan represent the majority of all retirees with health coverage among the surveyed employers. Table A3 presents additional information, comparing mean and median premiums by firm size. To facilitate employer responses, the survey questions asked employers to indicate where the total premiums and retiree contributions fell within a fairly narrow range of premium amounts, and the analysis is conducted based on the midpoint of the ranges. For example, an employer might indicate that their monthly total premium ranged between \$301 and \$350 and that the percentage that the retiree contributes toward the premium ranged between 41 percent and 50 percent.

To address the variation in retiree and employee populations among firms in the survey sample, the average total premium per retiree and the average per retiree contribution toward the total premium were weighted by employer size and number of retirees in the employer’s largest plan. By doing so, the premiums of larger firms with the greater number of retirees are weighted more heavily than the relatively smaller firms that have fewer retirees. The average percentage increase in retiree contributions in 2005 over 2004 is weighted similarly.

In this year’s report, the weighted average retiree contribution toward the total premium is calculated and reported in two ways. First, the study reports an average that includes the contribution amount reported by every firm, including contributions of \$0 (some firms do not require their retirees to pay any portion of the monthly premium). In addition, the survey reports a second average retiree contribution, which excludes from the calculation those firms whose retirees pay nothing (or \$0) towards the premium. This second reported average sheds some additional light on the issue of retiree costs, particularly among the vast majority of firms that

require retirees to pay part of the monthly premium. Finally, the retirees' share of the total premium was computed by dividing the 2005 retiree contribution reported for new retirees by the 2005 total premium reported for new retirees.

### **Medicare Cost Savings**

The survey asked employers to indicate the average dollar savings per individual retiree that would result from the Medicare drug benefit in 2006. Employers reported their savings per individual retiree within pre-defined ranges (e.g., \$600 to \$649/year). Using the midpoint of these ranges, we calculated average savings across employers, weighted by firm size and the average number of age 65+ retirees. By doing so, the average savings per individual retiree of larger firms with a greater number of retirees is weighted more heavily than the relatively smaller firms that have fewer retirees. Employers that reported no savings attributable to their Medicare strategy were excluded from the analysis.

For companies that report using multiple strategies in response to the Medicare drug benefit (9 percent of surveyed employers), their savings were allocated to the 28 percent retiree drug subsidy and supplement calculations, respectively, based on the percentage of retirees included in each strategy, as reported by the surveyed companies. For example, if a company had 10,000 age 65+ retirees and said that 80 percent of retirees would be under the subsidy strategy and 20 percent under the supplement, we included 8,000 retirees and their savings under the subsidy analysis and 2,000 under the supplement analysis.

Medicare savings as a percentage of total retiree health costs was calculated by taking the total savings for each employer (i.e., savings per individual retiree multiplied by the total number of the employer's age 65+ retirees) and dividing that sum by that employer's estimated 2005 total cost (employer and retiree share) of providing retiree health benefits to pre-65 and age 65+ retirees. We then calculated the median percentage savings among these companies.

**Table A1**

<b>2005 Sample Characteristics, by Firm Size</b>					
	<b>Total</b>	<b>1,000-4,999 Employees</b>	<b>5,000-9,999 Employees</b>	<b>10,000-19,999 Employees</b>	<b>20,000 or More Employees</b>
<b>Number of Firms</b>	300	109	66	57	68
<b>Firms as a Percent of Total</b>	100%	36%	22%	19%	23%
<b>Number of Retirees</b>	3,446,024	129,805	200,657	324,834	2,790,728
<b>Number of Workers</b>	6,322,442	272,749	468,617	789,519	4,791,557

Note: Based on responses from private-sector firms with 1,000 or more employees that offer retiree health benefits.

SOURCE: Kaiser/Hewitt 2005 Survey on Retiree Health Benefits, December 2005

**Table A2**

<b>Age 65+ Retiree Enrollment in Plan with Largest Participation, by Firm Size, 2005</b>					
	<b>All Retirees Largest Plan</b>	<b>1,000-4,999 Employees</b>	<b>5,000-9,999 Employees</b>	<b>10,000-19,999 Employees</b>	<b>20,000 or More Employees</b>
<b>Average Number of Retirees in Largest Plan</b>	5,189	456	1,407	2,224	18,730
<b>Average Percent of Retirees Covered in Largest Plan</b>	79%	84%	81%	72%	75%

Note: Based on responses from private-sector firms with 1,000 or more employees that offer retiree health benefits.

SOURCE: Kaiser/Hewitt 2005 Survey on Retiree Health Benefits, December 2005.

**Table A3**

<b>Total Premiums and Age 65+ Retiree Contributions, by Firm Size, 2005 (Median and Mean)</b>				
	<b>1,000-4,999 Employees</b>	<b>5,000-9,999 Employees</b>	<b>10,000-19,999 Employees</b>	<b>20,000 or more Employees</b>
<b>Total Premium</b>				
<b>Median</b>	\$325	\$275	\$325	\$275
<b>Mean</b>	\$412	\$321	\$380	\$355
<b>Average Retiree Contribution</b>				
<b>Median</b>	\$124	\$99	\$124	\$99
<b>Mean</b>	\$188	\$129	\$157	\$123

Note: Premiums for retiree-only coverage for full-time employees retiring on or after January 1, 2005, in plans with the largest number of enrolled retirees. Retiree contribution amounts include firms that do not require retirees to pay any portion of the premium. Based on responses from private-sector firms with 1,000 or more employees that offer retiree health benefits.  
SOURCE: Kaiser/Hewitt 2005 Survey on Retiree Health Benefits, December 2005.

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