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.[12] 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.

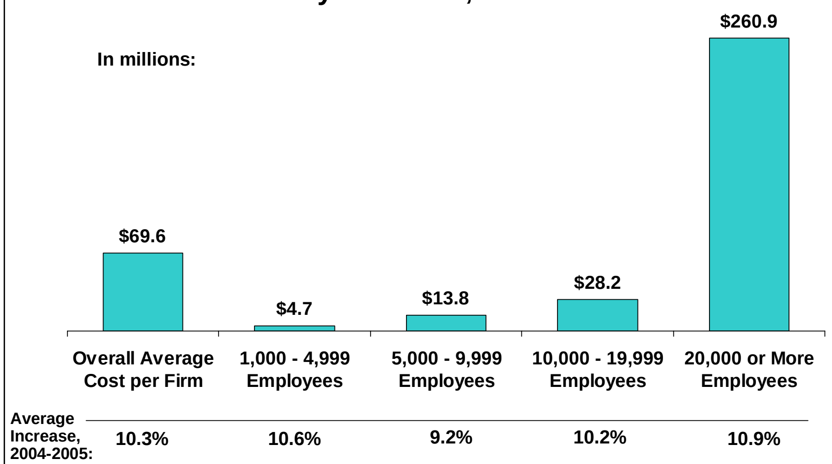
12 *Kaiser/HRET Annual Employer Health Benefits Survey*, 2005; Hewitt Associates, "U.S. Companies Face Lowest Health Care Cost Increases since 1999," Hewitt News and Information, October 10, 2005, www.Hewitt.com.

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).

Exhibit 9

Average Total Retiree Health Costs, by Firm Size, 2004



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.

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,[13] 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

13 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.

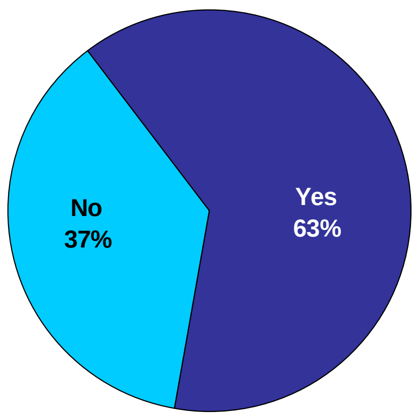
spent in a given year). Others focus the caps on individuals (e.g., the employer subsidy for age 65+ costs will not exceed $2,000 per person in the future). Some strategies combine a service-related aspect of the employer subsidy.[14] Sometimes the cap is indexed to rise as future costs rise.

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.

Exhibit 10

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



Note: Includes companies reporting a cap on any retiree health plan offered. 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.

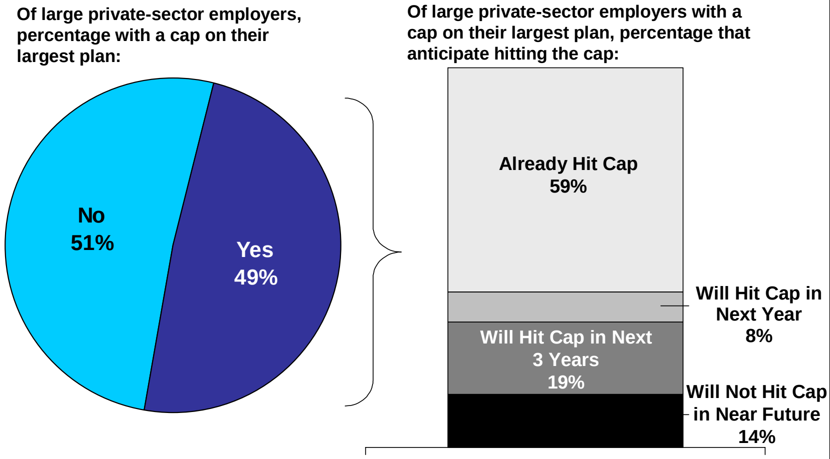
- Half (49 percent) have a cap on their firm's contribution to retiree health benefits in the largest age 65+ plan offered in 2005 (Exhibit 11).[15]
  - A larger share of publicly-traded firms has a cap on their largest plan (52 percent) than do other surveyed firms (39 percent).

- 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).

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.

Exhibit 11

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



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.