

do not. In fact, in 2001, only about “one-third of large employers and less than 10% of small employers offer[ed] retiree health benefits.”<sup>1</sup> Employers who choose to provide retiree health benefits are not required to provide such benefits indefinitely, absent some contractual agreement to the contrary. Employers that do offer retiree health benefits, however, often do so to maintain a competitive advantage in the marketplace—using these and other benefits to attract and retain the best talent available to work for their organizations.

Likewise, employer-sponsored retiree health benefits clearly benefit employees. In many cases, employers offer retiree health benefits as a bridge to Medicare so that younger retirees have access to affordable health care benefits when they leave the workforce before reaching the age of Medicare eligibility. Often those benefits are more generous than Medicare benefits because, for example, the employer simply includes younger retirees in its group plan for existing employees. In other cases, employers wish to offer their retirees age 65 and older health benefit plans that supplement the coverage provided under Medicare so that these retirees have access to comprehensive health care benefits at a time when their health care needs may be greatest. The Commission believes that it is in the best interest of both employers and employees for the Commission to pursue a policy that permits employers to offer these benefits to the greatest extent possible.

### *The Rising Cost of Health Care*

The cost of employee health care has increased consistently for several years, making it difficult for employers to continue to provide retiree health benefits. One report estimates that employers will experience a double-digit increase in their health care costs in 2003 for the third consecutive year.<sup>2</sup> Two widely-cited surveys of employer-sponsored health plans—(1) the Health Research and Educational Trust survey sponsored by The Henry J. Kaiser Family Foundation (Kaiser/HRET) and (2) the William M. Mercer, Incorporated survey (formerly produced by Foster Higgins) (Mercer/Foster Higgins)—estimate that premiums for employer-sponsored health insurance increased

an average of about 11% in 2001.<sup>3</sup> The 2002 Kaiser/HRET study found monthly premium costs for employer-sponsored health insurance rose 12.7% between the Spring of 2001 and 2002, while early results from the 2002 Mercer/Foster Higgins study estimate that health care costs increased almost 15% in 2002.<sup>4</sup> The 2001 Kaiser/HRET survey found that these large changes in premiums would affect small employers, defined as those employing between 3–199 workers, at a greater rate than larger employers.<sup>5</sup> Indeed, the 2002 Kaiser/HRET survey suggests that there may be evidence of erosion in the number of small employers offering health benefits; the study reports that the number of small employers offering such benefits dropped 6% between 2000 and 2002.<sup>6</sup> Many employers and benefit experts believe that the rising cost of prescription drug coverage, in particular, has heavily contributed to the rising cost of health care, with 64% of employers responding to the 2001 Kaiser/HRET study citing “higher spending for drugs” as a significant factor in health insurance premium increases.<sup>7</sup>

In addition to the rising cost of health care generally, increased longevity and, thus, increased numbers of retirees, will continue to mean larger and more

frequent payments for health care services on behalf of retired workers. The United States General Accounting Office (GAO) projects that, by 2030, the number of people age 65 or older will be double what it is today, while the number of individuals between the ages of 55 and 64 will increase 75 percent by 2020.<sup>8</sup> It is well-established that utilization of health care services generally rises with age.<sup>9</sup> Thus, the demand for and cost of retiree health coverage is likely to grow significantly in the next few years, while there will be comparatively fewer active workers to subsidize such benefits.<sup>10</sup> The 2000 Mercer/Foster Higgins National Survey of Employer-Sponsored Health Plans showed substantial cost increases for retiree health care coverage between 1999 and 2000, with a 10.6 percent increase for retirees under age 65 and a 17 percent increase for those over 65.<sup>11</sup> A 2002 study by The Henry J. Kaiser Family Foundation and Hewitt Associates (Kaiser/Hewitt) found that retiree health care costs increased an average of 16% between 2001 and 2002 for employers with at least 1000 employees.<sup>12</sup>

Changes in accounting rules also have dramatically impacted the way employers account for the long-term costs of providing retiree health benefits.<sup>13</sup> In 1990, the Financial Accounting Standards Board, which is charged with establishing U.S. standards of financial accounting and

<sup>3</sup> The Henry J. Kaiser Family Foundation & Health Research and Educational Trust, “Employer Health Benefits, 2001 Annual Survey” (Menlo Park, CA: The Henry J. Kaiser Family Foundation and Health Research and Educational Trust 2001); William M. Mercer, “Mercer/Foster Higgins National Survey of Employer-Sponsored Health Plans 2001” (New York, N.Y.: William M. Mercer Inc. 2002). The 2001 Kaiser/HRET study, conducted between January and May 2001, surveyed more than 2,500 randomly selected public and private companies in the United States. The 2001 Mercer/Foster Higgins study used a national probability sampling of public and private employers and the results represent about 600,000 employers.

<sup>4</sup> The Henry J. Kaiser Family Foundation & Health Research and Educational Trust, “Employer Health Benefits, 2002 Annual Survey” (Menlo Park, CA: The Henry J. Kaiser Family Foundation and Health Research and Educational Trust 2002); Mercer Human Resource Consulting LLC, “Rate Hikes pushed employers to drop health plans, cut benefits in 2002—but average cost still rose,” (New York, N.Y.: Mercer Human Resource Consulting LLC December 9, 2002). The 2002 Kaiser/HRET study surveyed 3,262 randomly selected public and private employers.

<sup>5</sup> The Henry J. Kaiser Family Foundation & Health Research and Educational Trust, “Employer Health Benefits, 2001 Annual Survey” (Menlo Park, CA: The Henry J. Kaiser Family Foundation and Health Research and Educational Trust 2001).

<sup>6</sup> The Henry J. Kaiser Family Foundation & Health Research and Educational Trust, “Employer Health Benefits, 2002 Annual Survey” (Menlo Park, CA: The Henry J. Kaiser Family Foundation and Health Research and Educational Trust 2002).

<sup>7</sup> The Henry J. Kaiser Family Foundation & Health Research and Educational Trust, “Employer Health Benefits, 2001 Annual Survey” (Menlo Park, CA: The Henry J. Kaiser Family Foundation and Health Research and Educational Trust 2001).

<sup>8</sup> U.S. General Accounting Office, “Retiree Health Benefits: Employer-Sponsored Benefits May Be Vulnerable to Further Erosion,” GAO Doc. No. GAO-01-374, at 17 (May 2001).

<sup>9</sup> Anna M. Rappaport, “Planning for Health Care Needs in Retirement,” in *Forecasting Retirement Needs and Retirement Wealth*, 288, 288–294 (Olivia S. Mitchell et al. eds., University of Pennsylvania Press 2000).

<sup>10</sup> U.S. General Accounting Office, “Retiree Health Benefits: Employer-Sponsored Benefits May Be Vulnerable to Further Erosion,” GAO Doc. No. GAO-01-374, at 17–18 (May 2001).

<sup>11</sup> Anna M. Rappaport, “Postemployment Benefits: Retiree Health Challenges and Trends—2001 and Beyond,” in *Compensation and Benefits Management*, 52, 56 (Autumn 2001) (citing William M. Mercer, “Mercer/Foster Higgins National Survey of Employer-Sponsored Health Plans 2000” (New York, N.Y.: William M. Mercer Inc. 2001)).

<sup>12</sup> The Henry J. Kaiser Family Foundation & Hewitt Associates LLC, “Kaiser/Hewitt 2002 Retiree Health Survey” (Menlo Park, CA: The Henry J. Kaiser Family Foundation and Hewitt Associates LLC 2002). This online survey, conducted between July and September 2002, represents information from 435 private employers (with at least 1000 employees) that currently offer retiree health benefits.

<sup>13</sup> Anna M. Rappaport, “FAS 106 and Strategies for Managing Retiree Health Benefits,” in *Compensation and Benefits Management*, 37 (Spring 2001); Paul Fronstin, “Retiree Health Benefits: Trends and Outlook,” EBRI Issue Brief No. 236 (Employee Benefit Research Institute Aug. 2001).

<sup>1</sup> Hearing Before the House Comm. on Education and the Workforce, 107th Cong. (2001) (statement of William J. Scanlon, Director of Health Care Services, GAO).

<sup>2</sup> Hewitt Associates LLC, “Health Care Cost Increases Expected to Continue Double-Digit Pace in 2003,” (Lincolnshire, IL: Hewitt Associates LLC Oct. 14, 2002).