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.[1] 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,[2] 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,[3] 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.[4] 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.[5]

***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.[6]**

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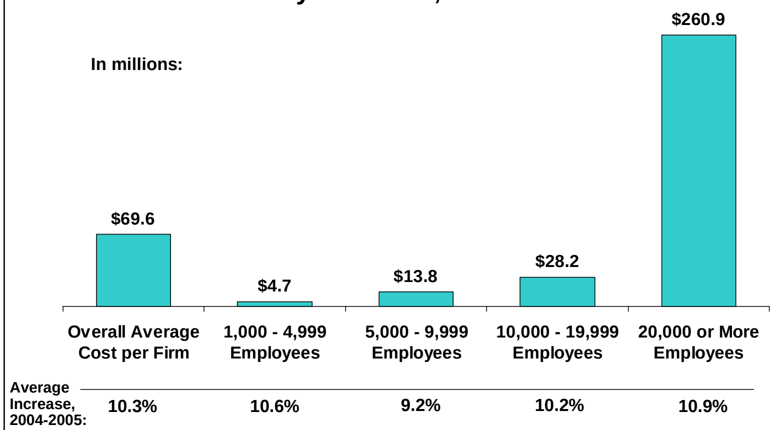
4 According to the *Kaiser/HRET Annual Employer Health Benefits Survey, 2005,* retiree health benefits are offered by 55 percent of firms with 5,000 or more employees, 43 percent of firms with 1,000-4,999 employees, 28 percent of firms with 200-999 employees, 18 percent of firms with 50-199 employees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

Exhibit E1

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.

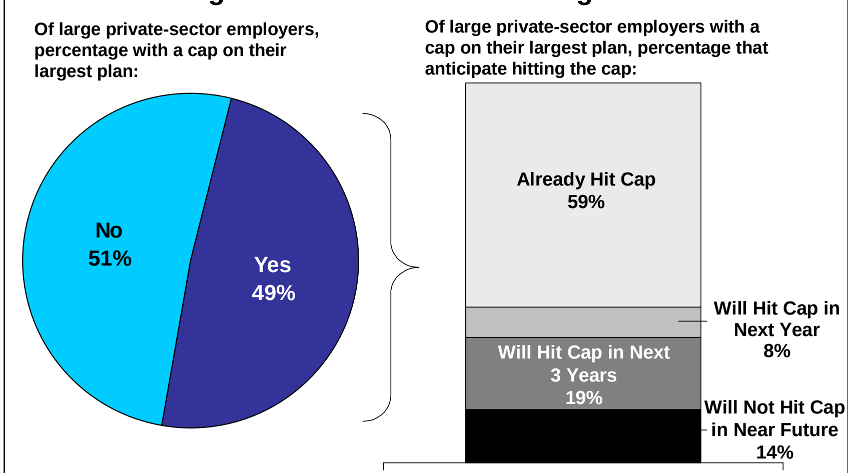
***Caps on Employer Obligations*. Many large employers have caps on their future financial obligations for retiree health coverage in response to rising costs.**

- 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).

Exhibit E2

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.

– 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).[7]

- 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.

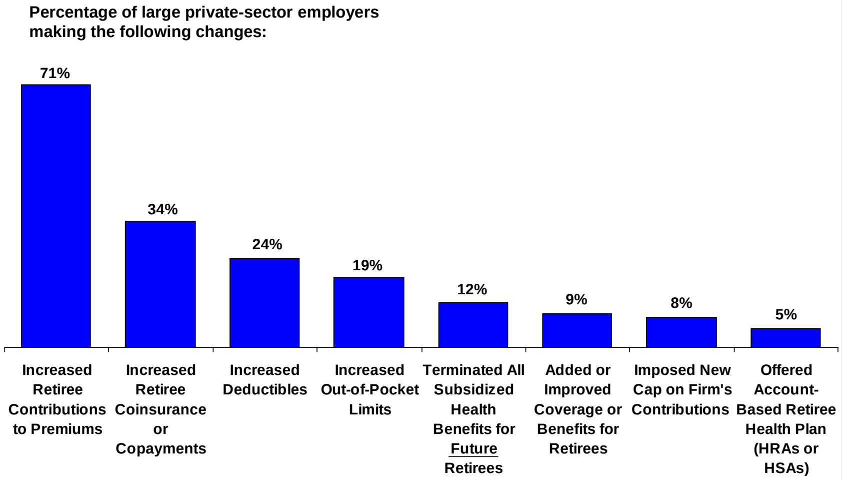
  – Among firms that terminated subsidized retiree health coverage, most provide affected retirees access to health benefits for which retirees would pay 100 percent of the premium.

7 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).

Exhibit E3

Percentage of Large Private-Sector Employers that Made Changes to Retiree Health Benefits between 2004 and 2005



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.

***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;

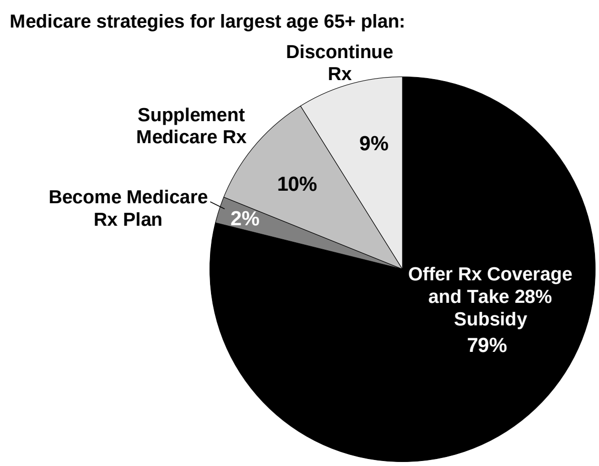
- 10 percent of surveyed employers – representing 7 percent of age 65+ retirees in the largest plans – expect to offer prescription drugs as a supplement to the Medicare drug benefit for the plan with the largest group of age 65+ retirees;

- 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.

Exhibit E4

Strategies Employers Are Likely to Choose for 2006 in Response to the Medicare Drug Benefit



Note: Rx = prescription drug. Applies to plan with the largest number of Medicare-eligible retirees. 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.

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.[8] 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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8 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.