# THE FUTURE OF RETIREE BENEFITS:

*Private exchanges offer a solution for both employer and retiree*

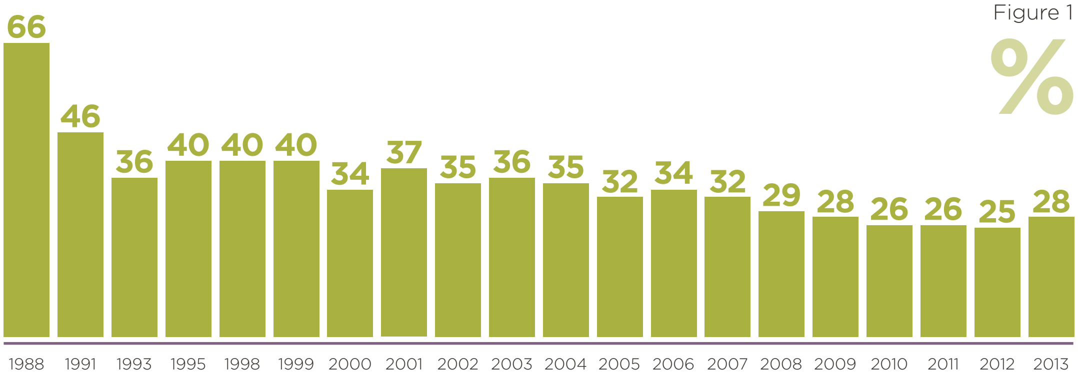
After more than 20 years of changes, the state of retiree health coverage is at a critical point. The number of employers electing to sponsor health coverage for their retirees continues to decline as a result of rising health care costs. [Figure 1]

Due to changes in accounting standards, elimination of tax advantages, and implications of the Affordable Care Act and other policies, employers who sponsor retiree health benefits have had to take a hard look at their retiree benefit programs. Many have determined that it's become too great an expense, so they've taken other approaches like capping their contribution, making eligibility requirements more stringent and in some cases, eliminating coverage altogether. Some are also looking at newer alternatives, like private exchanges, whereby the retiree can select their own personal plan among many choices available on the private exchange, often at a lower cost.

**THE SHARE OF LARGE FIRMS (200 OR MORE WORKERS) OFFERING RETIREE HEALTH BENEFITS TO ACTIVE WORKERS HAS DECLINED, 1988-2013 ▸**

Source: Kaiser/HRET Survey of Employer Sponsored Health Benefits, 1999-2013; KPMG Survey of Employer-Sponsored Health Benefits, 1991, 1993, 1995, 1998; The Health Insurance Association of America (HIAA), 1988

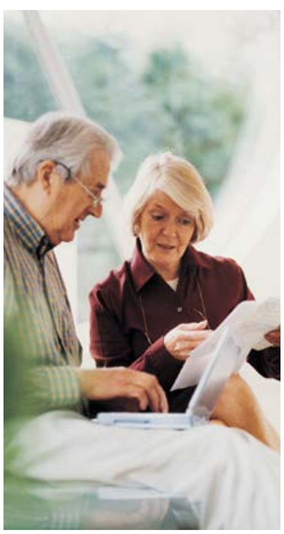
Figure 1



## MARKET TRENDS
### *Changes in Accounting Standards*

Probably the most significant milestone that subsequently triggered the decrease in available retiree health coverage was a major accounting rule change, Financial Accounting Statement No. 106 (FAS 106), issued in 1990 by the Financial Accounting Standards Board. The bottom line was FAS 106 required companies to record the liabilities of their retiree health benefits on their financial statements. Beginning with fiscal years after Dec. 15, 1992, private sector employers must accrue and expense for not only actual paid claims but future claims as well. This new accounting requirement dramatically affected companies' income statements, and as a result, employers began to overhaul their retiree health programs in order to control, reduce or eliminate these costs.[1]

A similar provision was also issued for public sector employers more than a decade later. The Governmental Accounting Standards Board (GASB) imposed Statement No. 43 (for state and local governments with over $100 million in annual revenue) and Statement No. 45 (for governments with annual revenues of $10-100 million), which required governments to accrue and report liabilities for future retiree benefit costs, as opposed to reporting actual claim costs as they were paid. Governmental employers now face the same issues as the private employers faced in the early 1990s. They discovered that this change impacted their bond rating, annual required expense recognition and political/public relations perceptions.



### *Medicare and Policy Changes*

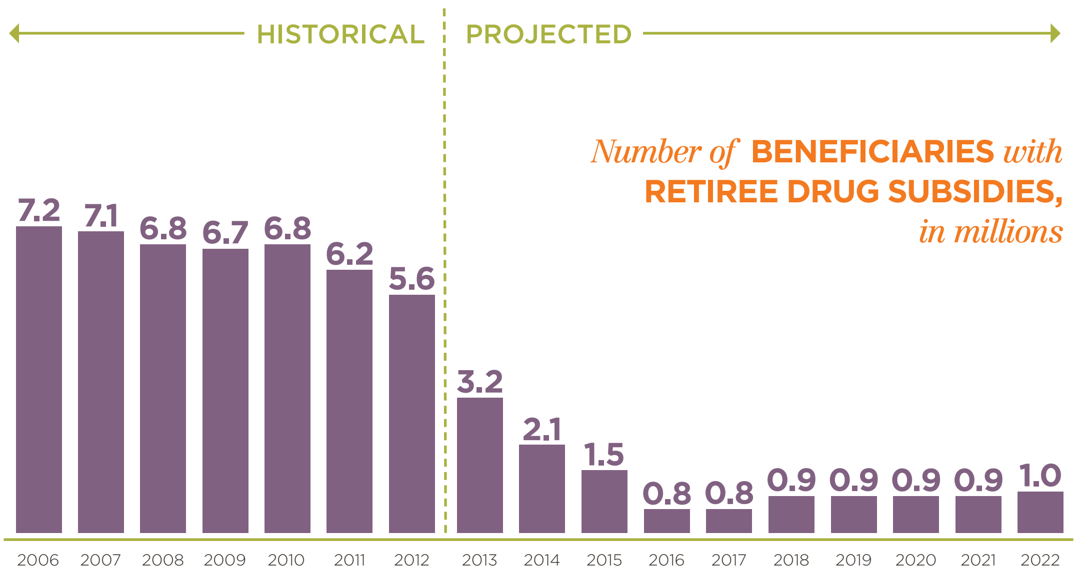
Until 2006, there was a major gap in traditional Medicare coverage in that it excluded prescription drug coverage. The Medicare Modernization Act of 2003 (MMA), however, filled that gap with the inclusion of a prescription drug benefit (called Medicare Part D), as well as additional provisions to encourage employers to maintain prescription drug coverage for their retirees.[2] So long as an employer's prescription drug plan offered drug benefits at least as good as the standard Medicare benefit, the employer qualified for a retiree drug subsidy (RDS) equal to up to 28 percent of allowable drug costs. Even more important, this subsidy could be excluded from income and employers could still deduct the full cost of retiree health benefits. (In other words, employers were allowed to take a larger tax deduction because under general tax rule, they aren't allowed to deduct costs that are reimbursed). This significant tax advantage was designed to ensure employers would maintain prescription drug coverage in their retiree health plans.

However, in 2010, the Affordable Care Act (ACA) repealed the preferential tax treatment for the RDS. Effective 2013, plan sponsors became subject to the normal tax rules whereby they can't deduct for expenses that are reimbursed, which in essence makes the RDS payment taxable.[2] This tax implication, among other challenges with the RDS, has already led to declining RDS claims, and according to CMS, the number of retirees in employer-sponsored drug plans will continue to decline. [Figure 2]

**THE NUMBER OF RETIREES IN EMPLOYER-SPONSORED RETIREE DRUG PLANS HAS DECLINED, & IS EXPECTED TO CONTINUE DECLINING, 2006-2022 ▸**

Source: Centers for Medicare and Medicaid Services, *2013 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, May 2013.

Figure 2




## *Impact*

The accounting and policy changes of the last two decades have had a dramatic financial impact on employers who offer employee health benefits. In fact, the percentage of large firms offering retiree health coverage has dropped by more than half since 1988 to only about 28 percent in 2013.[3] The financial consequences for both private and public sector employers who sponsor retiree health coverage have forced companies to make significant changes to their programs. Studies have consistently found that fewer employers are offering retiree health benefits,[4] and the prevalence of retiree health coverage is expected to decline incrementally over time.[2] While most do not appear to be dropping coverage altogether, companies are finding ways to cut costs which are impacting retirees, including:[2]

- Capping the employer's contribution (or limiting the amount of the employer share of the total cost)
- Making eligibility requirements stricter, i.e., raising minimum age and service requirements
- Raising retirees' premiums and cost sharing, including changes that essentially eliminated first-dollar coverage for retirees
- Eliminating coverage for future retirees, typically starting with new hires, but sometimes also for current employees
- Optimizing savings from Medicare prescription drug coverage

Most companies don't want to make the unpopular decision to reduce benefits or increase costs to their retirees. Another strategy that more and more companies are adopting is transitioning from an employer-based retiree group health plan to a non-group or individual market, like a private exchange.

## PRIVATE EXCHANGES

The private exchange concept has garnered a lot of attention in the media in recent years as more and more well-known companies announce they are moving in this direction. Not unlike Obamacare's state and federal-run health insurance exchanges, private exchanges use a similar "e-commerce" approach but are run by private agencies or consultancies. However, unlike public exchanges, private exchanges offer more consumer-centric support tools and personalization. For private exchanges specializing in retiree health benefits, the advantage for the retiree includes broader coverage options, more carrier plans, individualized plans, which all contributes to lower cost.

In 2014, about 2.5 million people across companies of all sizes will be enrolled in health insurance through so-called private exchanges.[5] A majority of those part icipants represent the retiree population. Employers find the private exchange market attractive because they can offer their retirees a choice of health plans while controlling their future retiree health care costs. They are able to limit reported liabilities since, in most cases, the employer contributes to a fixed contribution using a tax-effective health reimbursement arrangement (HRA) and reimburses retirees for premiums and/or out-of-pocket expenses.[2] Many times, however, the private exchange market can provide retirees with comprehensive, lower-cost options without the subsidy, whereby employers can eliminate that expense altogether. The private exchange agency also typically assumes the responsibility for all administrative duties for retirees benefits, eliminating the burden, time and expense for company human resources departments.

**PRIVATE EXCHANGE:** ***Win-Win for Employers & Retirees***

| EMPLOYER | RETIREE |
|---|---|
| Controls future retiree healthcare costs | Lower healthcare costs (20-60%) |
| Limits liabilities when shifting to defined contribution | Customized, individualized plans (retiree and spouse can have different plans) |
| Improves bottom line and credit rating | Broader choice of healthcare plans |
| Potential opportunity to eliminate subsidy for retiree medical | Licensed, college-educated Medicare specialists to guide retiree through process and questions |
| Eliminate HR retiree administration (now exchange vendor takes on administration) | Nights and weekend hours for call center |

## EVALUATING A PRIVATE EXCHANGE

The recent trend toward moving Medicare eligible retirees to an exchange-based solution is expected to continue and grow given the cost savings, defined contribution employer support and simplified administration. With this projected expansion of the marketplace, it's important to understand what to look for when shopping the private exchange market.

- **Cost-savings**

  As this is likely the key reason your company is investigating the benefits of a private exchange, you'll want to understand exactly what the comprehensive savings will look like. What is your current and future liability for carrying retiree health insurance? What are the tax implications? If these liabilities were off the balance sheet, how would that impact your annual earnings, credit rating, ability to borrow and cash flow? The private exchange agency can run models to help predict cost savings, whereby there might be opportunities where employer subsidies can be eliminated altogether.

- **Single-carrier vs. multi-carrier model**

  Private exchanges prescribe to either a multi-carrier or single-carrier model. Most employers prefer multi-carrier exchanges, whereby the retiree selects from multiple insurance carriers instead of one. This provides more choice, more options, more customization and always more competitive pricing.

- **Depth and breadth of exchange**

  Many private exchanges claim to have broad range of carriers and plans. However, you need to ask what the carrier depth and plan offering looks like for an implementation as it varies considerably.

**CASE STUDY SNAPSHOT ▸**

Manufacturing company with nationwide retail locations and 4,000 Medicare-eligible retirees

| OBJECTIVE | IMPLEMENTATION CONSIDERATIONS | OUTCOME |
|---|---|---|
| Client sought an additional choice with its current group plan. Wanted to ensure there was no disruption associated with eliminating the current plan. | Opt-In/Steerage whereby the client offered a private exchange alongside the employer group plan as a “choice” for retirees to consider. | By partnering with a highly consultative exchange, 56% of retirees converted to an individual policy |

- **Customer Center**

  In this market, there’s nothing more important than the quality, training and experience of the agents facilitating the retiree on-boarding process. They should be licensed, college-educated and highly-trained in all Medicare benefit plans. Agents must be commission agnostic, and retirees must have a dedicated concierge team assigned for their needs for the life of their plan. The customer center culture should reward for longer call times, not shorter, as is often the case, as that ensures retirees are receiving the best service. Employers evaluating private exchanges need to ensure customer center access 365 days per year, as well as night and weekend hours when it’s most convenient for their retirees.

  An employer will want to understand more about the center’s conversion rate – what percentage of the time are their retirees getting what they need and activating their policy? You should expect no less than 40% policy activation rate after the retiree calls to evaluate options.

  Lastly, some employers choose to adopt a multi-year strategy where the exchange offering would be voluntary for one to two years before moving all retirees to an exchange. In this case, the quality of the service center staff may even be more important.

- **Technology**

  Operationally, the exchange is only as good as its agents in the customer center and its technology platform. What platform is the exchange using? Is it proprietary? Is the platform electronically integrated with the carriers' systems, so the agent can take the retiree all the way through to policy activation on one call? Is it all seamless and paperless or are there additional steps that their platform doesn't handle?

- **Compliance**

  In this market, it's critical that the private exchange customer center provides excellent service to retirees also because their participating insurance carriers rate that performance. Carriers evaluate their business partners via evaluations like United Health Care's rating for eAlliance partners, so employers should know the carriers ratings/rankings of the private exchanges. It's good to see that they employ a compliance director or similar role to ensure compliance.

**CASE STUDY SNAPSHOT ▸**

National management services company with 2,300 Medicare eligible retirees

| OBJECTIVE | IMPLEMENTATION CONSIDERATIONS | OUTCOME |
|---|---|---|
| Provide valuable replacement coverage with cost savings due to employer plans to reduce subsidy for their retirees. | Replace group benefits with a private exchange offering choice in both carrier and plan offerings.<br><br>Limit retiree exposure of paying an increased portion of premium costs. | 100% of retirees converted to the private exchange with guaranteed issue status. Employer saved 40% or $3 million annually<br><br>Retirees obtained better benefits at lower costs. |

- **Experience**

  Some agencies have been offering exchanges for decades, and more experience in the space and more vertical integration with other markets (other than retiree healthcare) often contributes to more competitive rates for retirees.

- **Communication Resources**

  Oftentimes, private exchanges will provide communication tools to help make the transition seamless for your retirees. You want these to be comprehensive and customizable.

In the dynamic healthcare market, the days of employer-funded retiree benefits are dwindling. As the baby boomer generation enters retirement, healthcare costs increase and tax benefits decrease, employers simply can't afford the current costs and future liabilities of retiree healthcare benefits.

The good news is there are new and emerging solutions, like private exchanges, that can be a cost-effective solution for employers looking to decrease costs, and still support their retirees with much broader plan options that fit their needs, at a lower cost. It can truly be a win-win.

### *About SelectQuote Benefit Solutions*

SelectQuote was founded in 1985 and has been an innovative and established leader in building and operating insurance exchanges for auto & home, term life and Medicare insurance products. Through its insurance exchanges, SelectQuote offers voluntary benefit programs that provide substantial cost savings to corporations, public sector employers, unions, associations and their employees, members or retirees. SelectQuote has delivered business solutions to companies and organizations such as Hallmark, VFW (Veterans of Foreign War) and Transamerica, resulting in more than 140,000 policies annually and over 900,000 active customers. For more information visit SelectQuote Benefit Solutions online or connect via LinkedIn, Facebook or Twitter.

## *References*

[1] Fronstin, Paul and Nevin Adams. "Employment-Based Retiree Health Benefits: Trends in Access and Coverage, 1997-2010." Employee Benefit Research Institute (EBRI) Issue Brief,No. 377, October 2012.

[2] The Henry J. Kaiser Family Foundation, *Retiree Health Benefits at the Crossroads*, April 2014.

[3] The Henry J. Kaiser Family Foundation/HRET, *Survey of Employer-Sponsored Health Benefits*, MONTH 2013.

[4] Fronstin, Paul."The Impact of the Erosion of Retiree Health Benefits on Workers and Retirees." EBRI Issue Brief, No. 279, March 2005.

[5] Feyman, Yevgeniy. Are Private Exchanges the Future of Health Insurance? Forbes, October 15, 2014. http://www.forbes.com/sites/theapothecary/2014/10/15/are-private-exchanges-the-future-of-health-insurance/