McGraw Wentworth
BENEFIT Advisor

Volume Two, Issue 1 February 1999

In This Issue

We welcome you to the first issue in Volume Two of the McGraw Wentworth Benefit Advisor, the second full year of publication for our technical bulletin.

Providing retiree health care benefits is an expensive proposition for employers. This issue of the Benefit Advisor reviews:

- Alternative medical coverage for retiree's through HMO's

- The effect of new accounting standards on employers

- Recent developments in post-retirement health care

We look forward to your comments and suggestions regarding all future issues of the Benefit Advisor. You can reach us by contacting your account team or by utilizing the Feedback Forum on our interactive web site at www.mcgrawwentworth.com.

Medicare Risk HMOs

An Alternative To Medicare

In the continuing battle against the rising cost of post-retirement health care benefits, more employer sponsors are utilizing "Medicare-Risk" HMOs for their retirees. These employers hope to voluntarily attract their retiree segment to the Medicare-Risk HMOs. This is done by offering enhanced benefits to enrollees. The gain for plan sponsors is a reduction in current outlays and FASB 106 liabilities.

Medicare-Risk HMOs may save money by eliminating the need for supplemental Medigap insurance coverage. They do this by offering services that go beyond what traditional Medicare/ Medigap coverage offers. A Medicare-Risk HMO is tantamount to getting Medicare and Medicare supplements on a combined basis – with higher benefits and reduced costs.

Background

The cost of retiree health benefits is growing substantially. Not only are medical costs, most notably prescription drugs, rising at a significant rate, but our population is aging as well. Therefore, there are a growing number of retirees who require post retirement health care protection. Medicare alone often doesn't do the job.

Most employer-sponsored retiree medical plans rely on two sources to meet the needs of retirees:

- Medicare Parts A and B
- Medigap Supplemental Insurance

A 1997 survey of employers found that the average cost of providing Medigap supplemental coverage was nearly $2,000 per retiree per year (for post-65 re-

Continued on Page 2

tirees, not "early" retirees). Also, many services Medicare doesn't cover are the ones seniors care most about, including:

- Routine & preventive office visits
- Outpatient prescription drugs
- Vision care expenses

Liabilities Expanding

Not only are employer sponsors observing the direct cost of retiree medical benefits going up year after year, but they also face the problem of accounting for their costs on an accrual basis. Thanks to the Financial Accounting Standards Board, which issued Financial Accounting Standard 106 a few years ago, companies can no longer account for their costs on a pay-as-you-go basis. Instead, companies must accrue the present value of all future retiree health care liability on their financial statements. That amount can be several million dollars for a mid-sized company with generous post-retirement health care benefits.

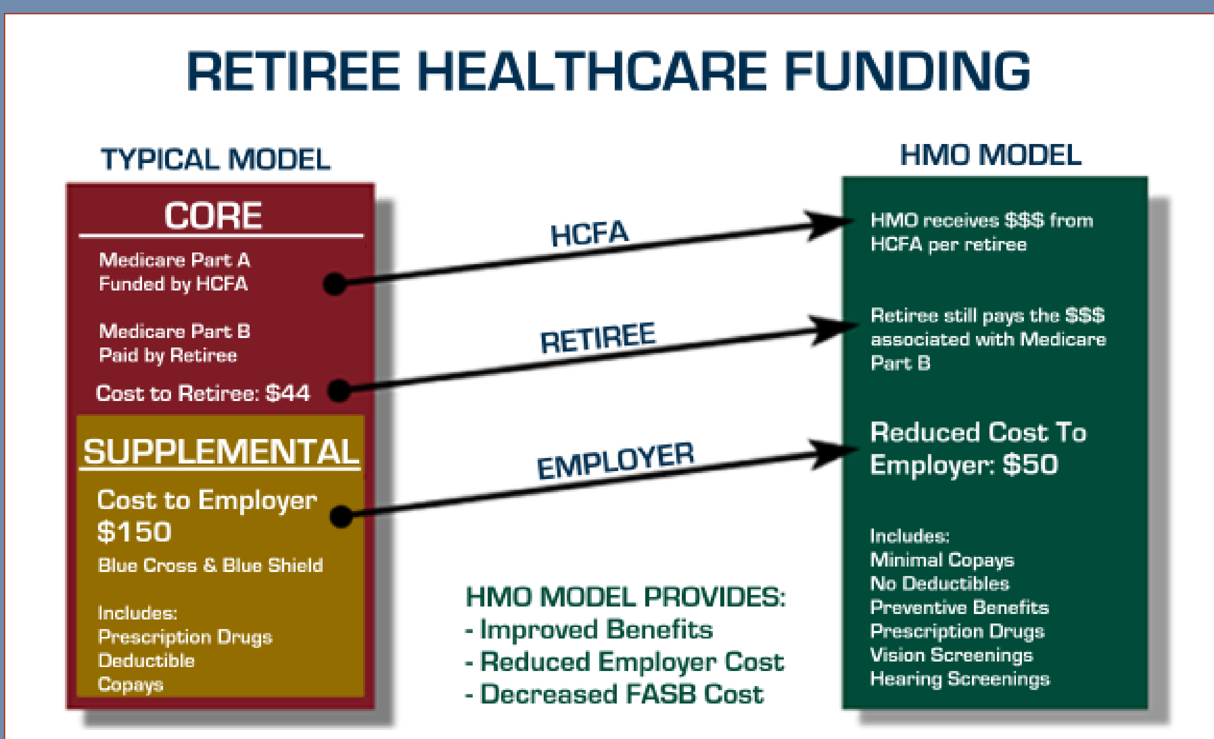
With this in mind, many companies are looking for ways to get the cost of post-retirement health care under control. One way is to reduce benefits to retirees, or eliminate the post-retirement health care plan for future retirees. There are often employee relations and/or legal problems associated with these changes depending upon the nature of the "promise" made by the company in earlier years.

An Alternative Solution

Into this gap come Medicare-Risk HMOs. While Medicare covers some of the basic necessities of health care, Medicare-Risk HMOs cover more. They usually offer preventive care, prescription drug, vision care services and other benefits associated with pre-65 HMO coverage levels.

Many Medicare-Risk HMOs offer these comprehensive benefits for little, if any, premium charge against the employer. These benefits are largely funded by the federal government, which pays the Medicare-Risk HMO to

Continued on Page 3



provide the Medicare benefits while the retiree pays the Part B premium.

Many Medicare-Risk HMOs are willing to offer unlimited prescription drug benefits for the group retirees with only a small additional premium funded by the employer. This allows the employer to offer attractive benefits to the retiree so as to persuade the retiree to try the Medicare-Risk HMO delivery system.

From an employer's point of view, Medicare-Risk HMOs offer a clear advantage. All of the additional services under the Medicare-Risk HMO come at a price substantially lower than a Medigap supplement that would provide similar coverage. The Medicare-Risk HMO generally prices its products so that the subsidy received from the federal government, plus a small employer premium, are enough to deliver a more attractive benefit level to the retirees. That means less money is going out from the employer and a reduced FASB 106 liability is obtained. As an example:

An employer pays $1,800 per retiree per year for coverage to supplement Medicare. With a Medicare-Risk HMO, that same employer may reduce the payout to $600 per year ($50 per month) while increasing benefits for the retiree.

Not only does the company save about $1,200 per retiree per year in current expenses, but the FASB 106 liability is reduced as well.

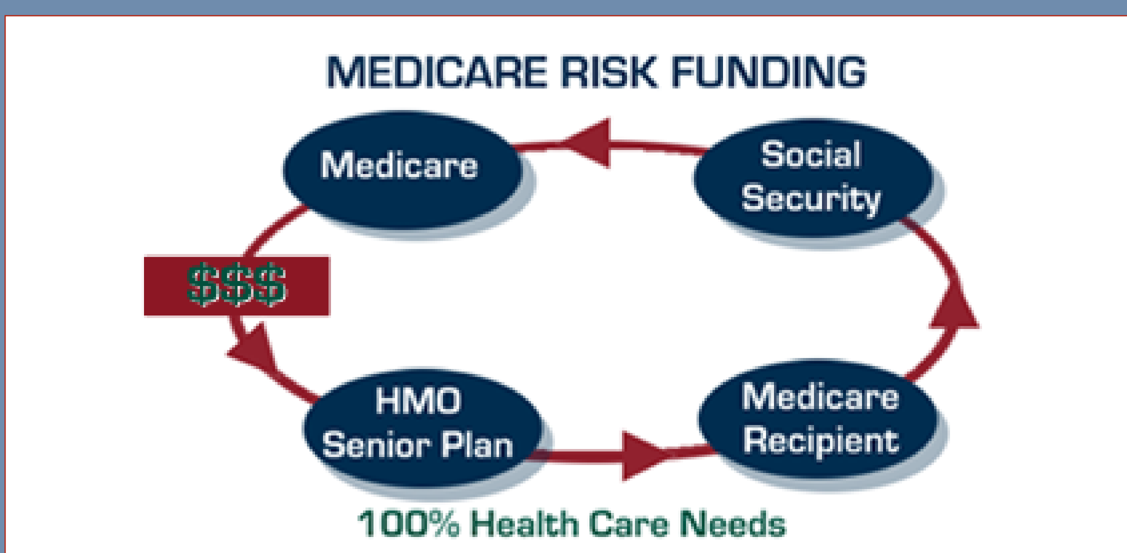
Enhanced Benefits For Retirees

In a Medicare-Risk HMO, the US Government pays the HMO to provide health care coverage rather than directly paying a portion of retirees' medical expenses. The HMO's ability to provide more services at a lower cost enables them to offer benefit enhancements that typically require Medigap supplemental insurance. This attracts enrollment by cost conscious seniors.

While details of coverage will differ from plan to plan, basically everything is paid in full except for co-payments for office visits and prescriptions. Routine preventive care is covered as are hospital stays, diagnostic tests, durable medical equipment, etc.

Beyond superior benefits, retirees enjoy reduced paperwork as well. Also, some Medicare HMOs offer special arrangements so

Continued on Page 4



that so-called "snowbirds" are covered when they head to warmer climates for the winter. Such arrangements are available from national HMOs.

Health Costs Decline

Employer sponsors observed a small cost reduction in retiree health care plans in 1997. Retirees 65 and older eligible for Medicare have followed their younger co-workers into managed care plans thereby assisting employers and reducing the cost of heath care. In 1997, 11% of Medicare eligible retirees with employer provided coverage were enrolled in Medicare-Risk HMOs. That enrollment was up substantially compared to 1995 figures.

A Win/Win Situation

Assuming that Medicare-Risk HMOs stand the test of time, both employers and retirees can win from the arrangement.

Employers win because they are getting substantial cost savings and reduced FASB 106 liabilities. Some employers may be able to continue offering retiree medical benefits by virtue of having access to Medicare-Risk HMOs when they otherwise might have had to terminate such programs.

Retirees win by gaining access to medical benefits beyond what they would get under traditional Medigap supplements. With the additional services offered by many Medicare-Risk HMOs, retirees are reducing their out-of-pocket cost for health care.

Final Notes

As employer plan sponsors evaluate Medicare-Risk HMOs as options to help control retiree health plan costs, there are several final points to consider:

Since their inception, Medicare-Risk HMOs have been subject to government-imposed price controls. Effective January 1, 1999, the price controls disappear, and Medicare-Risk HMOs will be able to charge plan beneficiaries (and retiree plan sponsors) market rates for coverage. Employers should expect rate corrections in areas with traditionally high medical plan costs.

Effective January 1, 1999, Medicare-Risk HMOs become one of a number of choices available under the new Medicare + Choice, or Medicare Part C, legislation passed in 1997. Please see our October 1998 issue of the McGraw Wentworth Benefit Advisor for a more detailed discussion of the new Medicare + Choice coverage options.

Notable Thoughts

"By three methods we may learn wisdom: First, by reflection, which is noblest; Second, by imitation, which is easiest; and third by experience, which is the bitterest."

Confucius

McGraw Wentworth
3310 West Big Beaver Road Suite 105
Troy, MI 48084
Telephone: 248-822-8000 Fax: 248-822-4131
Internet: www.mcgrawwentworth.com