October 4, 2006

Memorandum

To: Members of the Faculty and Administration
From: The Benefits Committee (Betsy Eismeier, Dan Giannini, David Kennett, Bill Lunt, Alan Marco, Sabrina Pape, Mary Carole Starke, with assistance from Marianne Begemann, Leslie Power, and Ruth Spencer)

Re: Background information concerning post-retirement health insurance

The Board of Trustees of Vassar College has requested that the Benefits Committee review and recommend changes to Vassar's post-retirement health insurance practices. Due to the complexity of issues surrounding post-retirement health insurance practices, the importance of this coverage to all of us, and the interest expressed by many faculty and administrators, the Benefits Committee is providing information about Vassar's current post-retirement health insurance program, practices at peer institutions and relevant accounting and funding issues. This memorandum is background information only and does not contain any specific recommendations. That is the work of the Benefits Committee this year, and we will be closely coordinating with the Faculty Compensation Committee, the Committee on Priorities and Planning, and the entire long-range planning process, in preparing those recommendations.

Vassar's Post-Retirement Health Insurance

1. For a number of years, Vassar has offered post-retirement health insurance to eligible employees, as a supplement to Medicare Part A (Hospital) and Part B (Major Medical). 100% of the annual premium for the Vassar retiree insurance, about $4,900 per person in 2006, is paid for by the College. In total, Vassar currently pays about $990,000 a year for post-retirement health insurance on behalf of all eligible retirees.

2. Eligibility for this insurance is limited to continuing faculty, administrators, and hourly office/technical employees who have worked for at least ten years after age 45 in full-time or part-time positions with at least 20 hours per week. Enrollment, however, can only take place when an employee reaches age 65. Tenured faculty may enter a bridge leave program prior to full retirement which provides paid health insurance after age 62. All other eligible employees retiring before age 65 must pay the full cost of health insurance until age 65. Spouses/partners of eligible retirees may also enroll for coverage, but the full cost is borne by the individual. Widows and widowers often continue in this coverage at their own expense. B&G, dining and security staff are not eligible for post-retirement health insurance, based on collective bargaining agreements and past employment arrangements.

3. Since January of 2004, the insurance has been provided through the Empire BC/BS PPO plan. Prior to that date, a BC/BS indemnity plan and other plans were also offered to

retiring faculty and administrators. However, as a result of deliberations between the Faculty Compensation Committee (FCC) and the Committee on Priorities and Planning (P&P) in 2002/03, these plans were discontinued in January of 2004 as a cost containment strategy. The terms and conditions of active and retiree benefits are subject to change, as stated in various handbooks. As a result of the change effective January of 2004, the College experienced one year in which post-retirement health costs remained essentially steady. It was hoped that reliance on the PPO plan design for post-retirement health insurance would help to control the upward pressure on costs for retiree health insurance in future years. This has not proved to be the case. In the last year, the total premium cost of post-retirement health insurance grew by 19%, and over the period from 1998 to the present, the cost of post-retiree health insurance premiums has grown at an average annual compound rate of 12.7% per year, primarily driven by health care costs and utilization of the plan, not by increased enrollment.

4. About 60 to 70% of the amount typically paid under this insurance is for prescription drug coverage. After evaluating the limitations of the new Medicare D program, the College advised retirees not to elect any of the Medicare D plans, as the Vassar insurance is much more comprehensive. Because the College sponsors a plan that relieves the Federal Government of its new obligation for limited prescription drug coverage, the College expects to receive a partial reimbursement from Medicare – estimated at about $100,000 annually – beginning with the 2006 plan year.

Accounting and Funding Issues

5. Vassar's cash cost in any year, and the amount included in the College's operating budget, is the actual premium paid for current retirees. This amounts to about $990,000 annually, as stated earlier. However, since 1995, the College has been required to record a portion of the estimated lifetime cost for each employee who might ultimately be eligible for retiree health insurance, as an unfunded expenditure. This accounting cost is much higher than the actual premium paid for current retirees – about $3 million in 2005/06 – because it is based on the notion that an individual's health care cost in retirement should be fully recorded as an expense *prior* to the retirement of that individual. In fact, the rule requires that the expected cost be fully expensed prior to the first date of eligibility. The estimate of the annual cost changes each year, following principles agreed upon by the accounting and actuarial professions. As the annual cost rises, it increases the accumulated liability in the balance sheet, which represents an actuarially-computed present value of post-retirement health insurance.

6. As a result, Vassar's audited financial statements reflect a large unfunded liability for post-retirement health insurance. As of June 30, 2006, the unfunded obligation has increased to $30.3 million. Current accounting rules permit the College to record only a portion of that total liability on the balance sheet, $19.8 million as of June 30, 2006. The accounting profession is changing those rules, and the draft that has been released for comment indicates that the full obligation will be posted in the financial statements for 2006/07 or 2007/08.

7. The College's unfunded liability for post retirement health insurance takes into account current retirees, current employment, service toward the eligibility requirements, the

health care plan offered, Medicare coverage, estimates of longevity, price escalation in health care costs, and other variables. It is an actuarial estimate of the full cost of benefits.

Comparative Data

8. Last year, the Benefits Committee reviewed comparative data on post-retirement health insurance, as shown in the exhibit attached to this memorandum. Information for this survey came directly from the Human Resources/Benefits offices of these colleges, and was updated as of June 2006. It includes all of Vassar's traditional reference group plus other similar liberal arts colleges. The comparative information indicates that other institutions are reviewing or have recently reviewed post-retirement benefits.

9. Twelve of the 29 colleges (Group 1) in this survey sponsor a group health insurance plan for retirees and provide a subsidy for the cost of participation. The subsidy ranges from 100% of the annual premium (for Vassar and two others) to as low as 25% of the annual premium. Note that many of the institutions have higher age and service requirements than Vassar. Note also that the benefits conferred under these plans are not equivalent. Vassar's plan design is much more comprehensive than some shown in this survey.

10. Four of the 29 institutions in the survey (Group 2) provide a flat dollar amount toward the cost of post-retirement health insurance, usually in a college-sponsored group plan.

11. Four of the institutions (Group 3) have joined a new program called EMERITI, initiated by the Mellon Foundation to create a defined contribution savings plan for retiree health insurance, somewhat like the 403b defined contribution retirement plans offered by most colleges and universities, but with different tax advantages related specifically to health care. EMERITI became an active program in July of 2005. The hope has been that the EMERITI plan would evolve to become something like TIAA CREF for health insurance in retirement. Two of the institutions in this comparative data – Haverford and Smith – had no post-retirement health insurance prior to their entry into the EMERITI plan.

12. Four others of the 29 (Groups 4 and 5) have frozen some aspect of their plan (for new enrollees after a certain date, at a certain subsidy level) at some point in the last few years. Five others (Group 6) offer no post-retirement health insurance.

13. It should be noted that the post-retirement health insurance benefit is *not included* in benefit data collected by AAUP with their salary survey. It is expected that the new "savings plan" approaches will be factored into the benefits package by AAUP for schools adopting that approach, since those are defined contributions like the TIAA CREF/403b pension plan contributions.

14. We also reviewed data provided by the Budget Office based on the financial statements of peer colleges. Vassar's unfunded book liability for post-retirement benefits has been about 1.5 to 2% of gross assets for some years. For those peers that offer post-retirement health insurance, the unfunded liabilities appear to fall in the range of 1-2% of gross assets. It should be noted that a number of the peer colleges do not offer post-retirement health insurance and therefore do not record an unfunded liability for this benefit.

Other Information

15. The trustees have asked that our recommendations address long-term sustainability and consider funding issues. Because no assets are earmarked and set aside for the future cost, the benefit depends upon the College's ability or willingness to continue to pay the annual premium costs in the future. This is a consideration not simply for the College as a permanent institution with many demands on its resources, but for all individuals who rely upon the benefit or wish to plan for retirement. We understand that the Board of Trustees has asked that our review be completed this year.

16. The national debate about health care costs and the unfunded liabilities of Social Security and Medicare are the backdrop for our work. Vassar's current cost is predicated on the continuation of Medicare, but there are concerns about its financial viability.

What is the Benefits Committee Doing?

The Benefits Committee is reviewing the information from last year as our first order of business. We understand that post-retirement health insurance is probably a factor in producing an average retirement age around 65 for faculty and administrators, and that this is healthy for the college as a whole. We recognize that there are retirees under the current program who have both expectations and needs to be considered. We recognize that there are individuals nearing retirement who also have expectations and needs to be considered. We see ourselves as representatives of the faculty and administration and also as advisors to the President on an issue with both significant individual consequences and long-term institutional consequences.

We share this memorandum to enable members of the faculty and administration to become informed about this important topic and to encourage discussion as we continue our work this year.

Attachment