December 13, 2006

Vassar College
Retiree Medical Discussion for Faculty & Administration
Retiree Medical Discussion
Agenda

- The Situation Today
- Profile of Current Costs
- What If We Do Nothing
- What Can We Do to Address Costs
- Which Groups Could Be Affected -- Grandfathering Strategies
- Developments in Retiree Health Care Products
The Situation Today

- Vassar today:
  - Extends the active employee medical plan to eligible retirees
  - Offers coverage to retirees who are at least 55 with 10 years of service at retirement
  - Provides free retiree health benefits for roughly 200 retirees age 65 and older
    - And covers roughly 60 retiree spouses and pre-65 retirees who pay the full cost of coverage
  - Will spend roughly $1 million in 2006 on retiree health insurance
    - Average cost per retiree is about $5,000
  - Has a liability of $30 million for future retiree health benefit payments
  - Sees both cash costs and liability costs growing each year
The Situation Today

- Nationally, employers continue to drop retiree medical benefit programs
  - In 2006, only 19% of employers offer programs covering current and future Medicare-eligible retirees
- Most of Vassar’s peer academic institutions do have retiree medical plans
- Retiree—and employee—health care costs continue to rise at near double-digit rates of no plan changes are made
- Employers are increasingly looking to modify retiree programs with new approaches available today
- Vassar faces concern over the size and increase in cash cost and accounting cost for this program
The Situation Today
Costs for Fiscal Year Ending June 30, 2006

I. The Accounting Cost of Future Benefit Payments: $30.3 million unfunded liability

<table>
<thead>
<tr>
<th>Future Retirees</th>
<th>Current Retirees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Future Retirees</td>
<td>$ 19.9 million</td>
</tr>
<tr>
<td>Current Retirees</td>
<td>$ 10.4 million</td>
</tr>
</tbody>
</table>

- Eligible for Benefits $ 13 million
- Not Yet Eligible for Benefits $ 6.9 million

II. Annual Expense

<table>
<thead>
<tr>
<th></th>
<th>Future Retirees</th>
<th>Current Retirees</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Cash</td>
<td>$ 0</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>B. Annual growth in unfunded liability</td>
<td>$2,400,000</td>
<td>$ 700,000</td>
</tr>
</tbody>
</table>

- with no changes, the $30.3 million unfunded liability will grow each year as employees accrue more benefits and interest is credited to the liability

Note: Figures are rounded based on fiscal year 2006 retiree medical valuation figures
What If We Do Nothing?
Projected Cash Costs Rise Each Year

FY 2006
FY 2007
FY 2008
FY 2009
FY 2009
FY 2010
FY 2011

$1.0
$0.9
$1.0
$1.1
$1.2
$1.3
$6,400

Total Premium
Cost Per Retiree

*FY 2007 is the first time plan will get a full year of federal credits under Medicare Part D
What If We Do Nothing?
Unfunded Liability Grows Each Year with Interest and Newly “Earned” Benefits

Projected Expense Components

<table>
<thead>
<tr>
<th>Year</th>
<th>Interest</th>
<th>Service Cost</th>
<th>Amortization</th>
<th>Special Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2006</td>
<td>$1.2</td>
<td>$1.4</td>
<td>$0.3</td>
<td>$0.2</td>
</tr>
<tr>
<td>FY 2007</td>
<td>$1.9</td>
<td>$1.5</td>
<td>$0.3</td>
<td>$0.3</td>
</tr>
<tr>
<td>FY 2008</td>
<td>$2.0</td>
<td>$1.6</td>
<td>$0.3</td>
<td>$0.3</td>
</tr>
<tr>
<td>FY 2009</td>
<td>$2.2</td>
<td>$1.6</td>
<td>$0.3</td>
<td>$0.3</td>
</tr>
<tr>
<td>FY 2010</td>
<td>$2.4</td>
<td>$1.7</td>
<td>$0.3</td>
<td>$0.3</td>
</tr>
<tr>
<td>FY 2011</td>
<td>$2.5</td>
<td>$1.8</td>
<td>$0.3</td>
<td>$0.3</td>
</tr>
</tbody>
</table>

Note: Interest, Service Cost, Amortization, and Special Benefit components are shown in the respective colors in the chart.
What If We Do Nothing?
The Result is an Increasing Liability for Vassar

The liability grows each year with the annual expense and is reduced by cash (premium) payments.
What Can We Do to Address Costs?

- Eligibility
  - older age, longer service needed to be eligible

- Retiree Contributions

- Subsidy Approach
  - percentage-of-cost vs. fixed dollar amount

- Subsidy Formula
  - function of age and/or service at retirement

- Plan design
  - increase cost sharing features; limit covered services

- Plan sponsorship
  - maintain a plan or open to market choice
Which Groups Could Be Affected -- Grandfathering Strategies

- Current retirees: changes would affect one-third of the liability and all current cash costs
- Need to balance cost savings against disruption to those in or near retirement
- Could apply changes only to those
  - not yet retired
  - not yet hired
  - hired after a set date
  - retiring after a set future date
  - with age and/or service at or above a set level
Developments in Retiree Health Care Products

- Defined Dollar Benefit programs
- Defined Contribution programs
  - Funded accounts
  - Notional (unfunded) accounts
  - Employee pre-funding
- Medigap Plans
- Medicare Advantage Plans
Potential Approaches: Defined Dollar Benefit Programs (DDB)

- Vassar’s cost would be a dollar amount instead of a benefit (percent)
  - Annual cost would be known
  - Not subject to medical inflation
  - Often targeted to a certain cost level
  - DDB could be set to rise slowly

- Option: Continue to sponsor a medical plan
  - Retiree cost = Vassar premium cost - DDB

- Option: Do not sponsor a plan
  - Retiree would buy an individual policy
  - Retiree cost = Policy premium cost - DDB
  - Market choices may help retirees keep cost increases down
Potential Approaches: Defined Contribution Programs (DC)

- Vassar could make a defined contribution toward an individual account
  - Annual contribution would be known
  - Not subject to medical inflation
  - No accounting liability for future benefits
  - Funded or notional (unfunded)

- Ideally, funds would be used only for medical care after a certain age
  - Pay for choice of coverage available in the market
    - e.g. Medigap, Medicare Advantage, and traditional Medicare
  - Pay directly for out-of-pocket medical expenses
    - Requires some added administration
Potential Approaches: Defined Contribution Programs (continued)

- Funded DC Accounts
  - Health Reimbursement Accounts (HRAs)
  - Health Savings Accounts (HSAs)
    - employee must be covered by a high deductible health plan
    - federal rules govern funding limits and design
    - funding is immediately vested
  - VEBA
    - dedicated accounts in trust, maintained by the employer
    - funds belong to the employees
  - Additional contributions to retirement programs, e.g. 403(b)

- Notional (unfunded) DC Accounts
  - Book entries, no cash committed
  - Could use HRAs
Comparing the Approaches: Defined Benefit v. Defined Contribution

**Defined Benefit Plan**
- Retiree coverage is known
- Employer provides a specific medical plan or plans
- Typically no funding while an active employee
- Not portable
- No vesting
- Creates accounting liability for future payments (FAS106 et al)
- Employee shares in cost only after retirement

**Defined Contribution Plan**
- Health care benefit is not defined
- Employer may or may not offer a benefit plan for purchase in retirement
- Employer funds or credits an individual account while employee is active
- Account balance may be portable
- No accounting liability for future benefits; liability is fund built to-date
- Employee may be able to contribute to account while active
## Employee Account Pre-funding
### Available Vehicles

<table>
<thead>
<tr>
<th>Savings Vehicle</th>
<th>Contribution</th>
<th>Investment Earnings</th>
<th>Disbursements for Health Care</th>
<th>Limitations on Contributions</th>
</tr>
</thead>
<tbody>
<tr>
<td>HRA</td>
<td>Tax-Free</td>
<td>NA</td>
<td>Not Taxable</td>
<td>Non-discriminatory</td>
</tr>
<tr>
<td>HSA</td>
<td>Tax-Free</td>
<td>Tax-Free</td>
<td>Not Taxable</td>
<td>HDHP; maximum contribution</td>
</tr>
<tr>
<td>403(b)</td>
<td>Tax-Free</td>
<td>Tax-Deferred</td>
<td>Taxable</td>
<td>Employer must have Plan; pre-tax and total contribution limits; min. required distributions after specified age</td>
</tr>
<tr>
<td>Traditional IRA</td>
<td>Tax-Free</td>
<td>Tax-Deferred</td>
<td>Taxable</td>
<td>Maximum contribution; tax-deduction limit for active retirement plan participant based on income; minimum required distributions after specified age</td>
</tr>
<tr>
<td>Roth IRA</td>
<td>Post-Tax</td>
<td>Tax-Free</td>
<td>Not Taxable</td>
<td>Contribution limits based on income</td>
</tr>
<tr>
<td>VEBA</td>
<td>Post-Tax</td>
<td>Tax-Free</td>
<td>Not Taxable</td>
<td>Employer must have plan</td>
</tr>
</tbody>
</table>
**Medigap Plans**

- Individual medical coverage, filling in Medicare coverage “gaps”
- Designs are federally set; up to 12 designs available
- Plans are insured; insurer may offer any or all designs
- Part B and Prescription Plan premium are additional

**Medicare Advantage Programs**

- Alternative to traditional Medicare; widely available
- Medicare pays an insurer to offer complete “Medicare” benefits
- Various plan types (HMO, PPO, etc.) & benefits available
- Part B premium is additional
- Plan sponsors believe Medicare Advantage will be successful, with more stable costs than earlier versions of these kinds of plans