AMERICAN ACADEMY of ACTUARIES

October 16, 2002

Mr. David Frank
Legal Counsel
U.S. Equal Employment Opportunity Commission
1801 L Street, N.W.
Washington, D.C. 20507

Dear Mr. Frank:

The American Academy of Actuaries'[1] EEOC-ADEA and Retiree Health Work Group initially met with you and your colleagues at the Equal Employment Opportunity Commission on November 6, 2001. During the meeting we discussed a variety of issues related to the *Erie County*[2] court decision, and we offered our assistance in providing information as the EEOC formulates its position on the case.

At a subsequent meeting on April 10, 2002, the work group distributed a document that listed possible methods for addressing the *Erie County* ruling. During this meeting, you expressed an interest in learning more about possible issues that might complicate implementation of a safe harbor method. A conference call was held on May 3, 2002, to further discuss these issues, and the work group offered to develop a document summarizing such complexities. The following list of potential issues that could complicate implementation of retiree medical safe harbors are placed into three categories—rating and measurement, plan interpretation, and other.

RATING AND MEASUREMENT

Per Capita Costs

Many issues could arise regarding the use of per capita costs in safe harbor calculations. Often, costs specific to all benefit plans being offered may not be evident without considerable analysis. For example, while estimated per capita costs are used for FAS 106 financial reporting requirements, it is not unusual for composite per capita costs to be used for similar plans for ease of computation, because accounting materiality allows such combinations. From a small business perspective, smaller employers may not be following GAAP accounting, and therefore, plan costs may not have been developed. This could place a heavier burden on smaller plans to comply with safe harbors.

[1] The Academy is the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification and practice standards, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is nonpartisan and assists the public policy process through the presentation of objective analysis. The Academy regularly prepares comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualification and practice, and the Code of Professional Conduct for all actuaries practicing in the United States.

[2] *Erie County Retirees Association v. Erie County*, 3d Cir., No. 99-3877, 8/1/00.

Credibility of Claims Data
For plans with few retirees, such as plans for smaller employers, or for organizations that do not yet have many retirees, actuarial credibility in establishing plan costs is often an issue. In these cases, actuaries may rely on rate manuals and, possibly, on insurance premiums rather than on actual plan claims experience. Any safe harbor will need to allow the use of these measurement tools.

Capped Plans
Plans in which the company has limited or "capped" its liability at a certain level are also common. Depending on how the cap is defined, measurement issues could be easier or more difficult.

Retiree Cost-Sharing
A very common plan feature is retiree cost-sharing based on service. For example, a plan could pay 5 percent of plan costs for every year that a retiree worked for the organization, with the retiree paying the balance. The potential for variance in cost-sharing could make some testing difficult.

Managed Care
Some managed care features, such as access, may be very difficult to measure. For example, it may be difficult to assess whether an HMO that restricts retiree choice but provides more generous benefits compared to other offerings would pass discrimination testing. This was central to the *Erie County* ruling.

Consistency of Assumptions Used
There is a wide range of acceptable assumptions that can be used in measuring the present value of retiree medical benefits. For example, it would be reasonable to use a different medical trend assumption for Medicare-eligible retirees than for non-Medicare eligible retirees because of the balanced billing limitations of Medicare. In addition, how would anticipated future plan changes be recognized? What about expected and unexpected future Medicare changes (e.g., a prescription drug benefit)?

PLAN INTERPRETATION

Grandfathered Plans
It is very common for organizations to make changes to the benefits for future retirees while existing retirees are "grandfathered" in the prior benefit plans, which usually are more generous. Often, these groups are grandfathered to avoid potential litigation or costly changes. Any safe harbor methodology should address whether plans that are no longer available (closed to new entrants) are subject to discrimination testing.

Choice of Multiple Plans
Many employers offer several plans from which the retiree can choose. Will all combinations of plan offerings need to be tested, or will an employer pass if one combination of offerings passes? The thought here is that if retirees want to pick a plan that may not be in compliance, they are free to do so as long as they are offered a plan that does pass the test. Otherwise, employers will most likely reduce offerings, which will be detrimental to retirees.

Collectively Bargained Plans
These plans are not exempt. Legal action against the company and the union is possible. Renegotiation of existing labor agreements would add considerable complexity and cost to

compliance. Typically, collectively bargained plans are excluded from discrimination testing.

30-and-out Plans
A "30 and out" provision (30 years of service qualifies for retiree medical benefits) is somewhat common. This provision could make compliance very difficult, because an organization could have employees who retire prior to age 50.

Frequency of Testing
Frequency of testing may need to be addressed. Once they pass, will plans be exempt from further testing until the benefits are changed? It is possible that a company could be initially in compliance under several of the methodologies, but would no longer be in compliance after a number of young retirees had accepted an early retirement window, even though the benefits offered had not changed.

Dependent Coverage
Often dependent coverage receives a different company subsidy from that provided to retirees. Should dependents and surviving spouse coverage be included in the testing?

OTHER
Retiree Life Insurance
Will testing also apply to retiree life insurance? Many plans reduce benefits as the retiree ages. For example, the retiree life benefit is equal to the retiree's final average salary, but at age 70 the amount of life insurance is reduced by one-half. In addition, there are a number of plans that reduce the coverage each year and/or limit the amount in force. Benefit reductions are typically allowed under the ADEA as long as they are actuarially justified based on cost. Life insurance reductions typically fall in this category.

Simplified Approach for Small Employers
If possible, a more simplified safe harbor should be considered for small employers that offer retiree H&W benefits since these organizations are more sensitive to increased costs.

We hope you find this information useful in determining the best course of action to address the *Erie County* ruling. We would be glad to continue to work with you as a resource on this and other issues. If you have further questions, please feel free to contact me or the Academy's senior federal health policy analyst, Holly Kwiatkowski at (202) 223-8196 or Kwiatkowski@actuary.org.

Sincerely,

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American Academy of Actuaries

[3] Other work group members who contributed to this letter are: Pete Ford, A.S.A., M.A.A.A.; Karl Madrecki, A.S.A., M.A.A.A.; Jean Moore, F.S.A., M.A.A.A.; Anna Rappaport, F.S.A., M.A.A.A.; George Wagoner, F.S.A., M.A.A.A.; Mark White, F.S.A., M.A.A.A.; Dale Yamamoto, F.S.A., M.A.A.A.