Outline of Possible Methods for Addressing the *Erie County*[1] Ruling

This outline was prepared by the American Academy of Actuaries'[2] EEOC-ADEA & Retiree Health Work Group.

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

[2] 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.

The American Academy of Actuaries' EEOC-ADEA & Retiree Health Work Group (work group) originally met with representatives of the Equal Employment Opportunity Commission (EEOC) on November 6, 2001. During the meeting we discussed a variety of issues related to the *Erie County* court decision and we offered our assistance as the EEOC formulates its position on the case.

We understand that the EEOC is actively working on a proposal to provide guidance to plan sponsors on how the Age Discrimination in Employment Act (ADEA) applies to employer-sponsored retiree health benefit plans. One possible approach would be for the EEOC to provide guidance to plan sponsors in the form of possible "safe harbor" methods that the EEOC believes meet the nondiscrimination rules under ADEA and that are consistent with the *Erie County* court decision.

The work group has outlined six possible approaches that could be used as "safe harbor" methods for meeting nondiscrimination-testing requirements under EEOC guidelines for retiree health care plans. Methods A and B are best classified as "equal cost rule" methods and methods C, D, E and F are best classified as "equal benefits rule" methods. The methods described would permit employers to meet the nondiscrimination requirements in a variety of ways. For a particular plan, one method may be more appropriate than another.

The following outline of methods is brief and not necessarily comprehensive. We look forward to assisting the EEOC in refining these or other descriptions.

Method A – Discounted Present Value Method

This method would look at the total employer commitment (i.e., employer-paid cost) to each of the pre-Medicare period and the post-Medicare period. As long as the total commitment to the post-Medicare period is greater than or equal to that of the pre-Medicare period, the employer would pass the test. There would be no adjustment for the value of Medicare as part of this test. The EEOC could specify the allowable range of assumptions to be used in the test. Assumptions such as discount rate, health care trend rate, and mortality table could be specified.

The Test: If the present value of the employer-paid post-Medicare coverage calculated at age 65 is greater than or equal to the present value of the employer-paid pre-Medicare coverage calculated at the beginning of the pre-Medicare period, the test would be passed. This calculation could be done at average age of retirement, and would not have to be done at each retirement age.

Method B – Cumulative Value Method

This method is similar to Method A except that the calculation is done on a current basis without trending or discounting. Again, the test would be passed if the total employer commitment (i.e., employer-paid cost) for post-Medicare coverage is greater than or equal to the pre-Medicare coverage. The EEOC could specify certain assumptions such as a mortality table for the life expectancy values to be used in this test.

The Test: If the sum of the current employer-paid plan costs over life expectancy of post-Medicare coverage is greater than or equal to the sum of the current employer-paid plan costs over life expectancy of pre-Medicare coverage, the test would be passed. This test is simpler than Method A, because there is no need for discounting and trending. This calculation could be done at average age of retirement, and would not have to be done at each retirement age.

Method C – Partial Medicare Recognition Method

This method would allow recognition for the value of Medicare (both Parts A and B) in performing the cost test on an annual basis. The EEOC or the Center for Medicare and Medicaid Services (CMS) could provide the value of Medicare to be used in the test.

The Test: If the sum of the post-Medicare cost per retiree and the Medicare recognition is greater than the pre-Medicare cost per retiree, then the plan would pass the test.

Method D – Bridge to Medicare Method

This method conceptually assumes that a plan can fill the gap between early retirement and Medicare if the purpose is specifically to provide a bridge to Medicare. This is similar to Social Security supplements allowed in qualified pension plans. In order to demonstrate this, the plan would have to comply with certain design constraints set by the EEOC. For example, the plan could be restricted to pay no post-Medicare benefits and the plan might not be allowed to cover non-Medicare services such as pharmacy benefits.

The Test: If a pre-Medicare only plan is offered and is specifically established as a bridge to Medicare, the test is passed.

Method E – Retiree Medical Account Method

This method would allow certain retiree medical account plans that provide an account to retirees that can be used for either pre-Medicare or post-Medicare coverage at the discretion of the retiree to meet the nondiscrimination rules. These plans seem to be unaffected by *Erie County* in that retirees themselves exercise their judgement about when they use the accounts to reimburse health care premiums or direct health care services and the benefit level is not inherently tied to age or Medicare eligibility. The definition of a qualifying retiree medical account (in terms of the acceptable range of features) would be set by the EEOC.

The Test: If a retiree medical account is provided by the employer, and the retiree is provided a lump sum at retirement that can be used for both pre-Medicare and post-Medicare coverage without restrictions on use, the test is passed.

Method F – Actuarial Equivalent Benefit Method

This method allows employers to demonstrate that their retiree medical programs (including the value of Medicare) pre- and post-Medicare eligibility are roughly equivalent although on a strict benefit-by-benefit provision review they may appear to be different. The EEOC could specify parameters of when this methodology could be used. For example, the plan sponsor may be required to receive an actuarial certification that the plans are actuarially equivalent.

The Test: If a qualified actuary certifies that the actuarial value of the post-Medicare benefit plan is greater than or equal to the actuarial value of the pre-Medicare benefit plan, the test is passed.