

## August/September 2010

The following news summaries were developed by Gabriel, Roeder, Smith & Company to inform clients and other benefit professionals of news in the benefits industry. Our thanks to Mary Ann Vitale for her diligent work on this issue. To receive this publication electronically, send an email to [web.admin@gabrielroeder.com](mailto:web.admin@gabrielroeder.com) with “SUBSCRIBE NEWS SCAN” in the subject line. To stop receiving this publication electronically, send “UNSUBSCRIBE NEWS SCAN” in the same manner. Copies of this and other benefit-related publications are available on the GRS website at [www.gabrielroeder.com](http://www.gabrielroeder.com).

Note: The authors of these summaries are not attorneys and the statements made are not legal advice or opinion. Qualified legal advice should be obtained before acting with regard to related laws and regulations.

---

### **NCSL Releases Report on State Pension Legislation Enacted in 2010**

On September 21, 2010, the National Conference of State Legislatures (NCSL) released a report on the major state pension and retirement plan legislation enacted in 2010. The report provides a comprehensive and detailed summary of selected legislation enacted from January 1, 2010, through September 1, 2010.

Consistent with recent economic events, cost containment and long-term sustainability of defined benefit plans were significant concerns for state legislatures. Several states established committees to study the future of their retirement systems. Many states enacted legislation in efforts to manage future pension costs through measures to reduce benefits for newly hired employees, increase employee contributions, establish early retirement incentives, and other benefit changes.

Other policy issues addressed by legislation included: benefit eligibility, contribution rates, funding issues, cost-of-living adjustments, governance and investment policy, health coverage, re-employment after retirement, and purchase of service credit. The report is organized by topics and summarizes the legislation enacted by state.

The report is accessible on the NCSL website at:

<http://www.ncsl.org/documents/employ/PensionReportSept1-2010.pdf>

### **NIRS Finds State and Local Government DB Plans Are a Durable Feature of Compensation**

The July 2010 issue of the *Journal of Pension Benefits* included an article written by Beth Almeida, Executive Director of the National Institute on Retirement Security (NIRS) titled, “DB Pensions: The Real Deal.” As discussed in the article, despite the recent economic challenges, state and local governments remain committed to offering defined benefit (DB) pension plans to over 14 million government employees. As noted by the author: “[T]he resilience of DB pensions in the public sector is less surprising to those who understand that these plans are ideally suited to serve the interests of all the key stakeholders involved - taxpayers, employees, and public employers.”

The major reasons cited for DB pensions to be a proven element of compensation in state and local government include:

- **DB pensions work for taxpayers by squeezing more value out of each dollar contributed.** Importantly, DB pensions make more effective use of contributions from both employees and taxpayers than defined contribution (DC) plans (e.g., 401(k) plans), by efficiently pooling risks and costs. For example, providing a life-time benefit of \$2,200 per month under a typical DB plan would cost 46% less than under a typical DC plan. The three main cost advantages of DB plans include:
  1. DB plans outperform DC plans with better investment returns over time;
  2. DB plans sustain better investment returns over time compared with DC plans; and
  3. DB plans pool longevity risks over a large group. By contrast individuals in DC plans must self-insure against the risk of outliving retirement savings.
- **DB pensions work for employees by providing life-long retirement security.** DB pensions are designed to provide retirement income over the lifetime of retirees, whereas DC plans are essentially savings plans. While both DB and DC plans are important for a secure retirement, researchers have established that DC plans will not provide the same retirement benefits when serving as the primary retirement vehicle. For example, to fund a target retirement benefit of \$2,200 per month at age 62, the required assets per employee would be \$354,962 in a typical DB plan as compared with \$549,903 in a typical DC plan.
- **DB pensions work for employers by recruiting and retaining talent in public service.** As a group, about 50% of state and local government employees have a college or advanced degree, which is more than double the percentage in the private sector. However, government employers face hiring difficulties since the salaries for highly-skilled public employee positions are about 12% lower than those in the private sector. The compensation gap is narrowed by offering high quality benefits for state and local government employees. In a 2006 survey, the Center for Retirement Research (CRR) at Boston College found that employees with a DB pension remain with an employer four years longer than those without a retirement plan and 1.3 years longer than those with only a DC plan. Those with both a DB and supplemental DC plan remain with an employer 3.1 years longer as compared with a DC plan only. Another study found that DB pensions significantly increase employees' commitment to their organizations while DC plan coverage has no effect on employee commitment.

The report concludes that maintaining DB pensions will assist public employers with recruitment and retention efforts and enhance employee loyalty. Plan sponsors who offer DB pensions that are properly structured and managed can provide reasonable benefits, maintain proper funding discipline, and ensure retirement security for employees.

The article is available at:

[http://www.nirsonline.org/storage/nirs/documents/pensions\\_are\\_the\\_real\\_deal-july\\_2010.pdf](http://www.nirsonline.org/storage/nirs/documents/pensions_are_the_real_deal-july_2010.pdf)

### **EBRI Finds Over 47% of Americans Ages 56 to 62 Remain at Risk for Insufficient Retirement Assets**

On July 13, 2010, the Employee Benefit Research Institute (EBRI) released its issue brief, *The EBRI Retirement Readiness Rating: Retirement Income Preparation and Future Prospects*, which indicates that over 47% of Americans ages 56 to 62 (i.e., the early baby boomers) are at risk of not having sufficient retirement assets to pay for "basic" retirement expenditures (e.g., food, housing, and transportation) and uninsured health care costs. By comparison, nearly 44% of those ages 46 to 55 (late boomers) and 45% of those ages 36 to 45 (Generation Xers) are estimated to be at risk. In addition, over 70% of households in the lowest one-third of preretirement income are estimated to be at risk.

The EBRI Retirement Readiness Rating was developed in 2003 and is based on a model that evaluates national retirement income adequacy. The 2010 model factors in many new retirement changes, such as automatic enrollment and automatic escalation of contributions to 401(k) plans, in addition to updated financial market performance and employee behavior. The model is based on a database of 24 million 401(k) plan participants.

The EBRI model simulates the length of time that retirement assets will cover minimum retirement expenditures plus uncovered costs for nursing home and home health care expenses. Assuming retirement at age 65 for early boomers, the study projects that 41% of the people in the lowest (preretirement) income quartile will have “run short of money” 10 years after retirement, compared to 23% in the second income quartile, 13% in the third quartile, and 5% in the highest income quartile.

Jack VanDerhei, EBRI research director, reported on the vast disparity between American’s confidence in having sufficient retirement funds and their actual savings levels. In the 2010 Retirement Confidence Survey, EBRI indicated that 29% of workers were very confident about having enough money to pay for basic expenses during retirement. However, Mr. VanDerhei warned that this confidence was based on “absolutely, completely uninformed optimism.”

The issue brief is available at: [http://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_07-2010\\_No344\\_RRR-RSPM.pdf](http://www.ebri.org/pdf/briefspdf/EBRI_IB_07-2010_No344_RRR-RSPM.pdf)

### **SSA Releases 2010 Fast Facts and Figures about Social Security**

In August 2010, the U.S. Social Security Administration’s (SSA) Office of Policy released *Fast Facts & Figures about Social Security, 2010*. The publication answers frequently asked questions (FAQs) about the programs administered by the SSA and focuses on data related to Social Security retirement, survivors, and disability benefits, as well as Supplemental Security Income (SSI). Most of the data are derived from the SSA’s Social Security Bulletin Annual Statistical Supplement and 2010 Social Security Trustees Report.

Some of the report highlights include:

- Overall, about 58 million people received SSA benefits or assistance in 2009, with benefits averaging about \$1,164 per month for retired workers, \$1,064 per month for disabled workers, and \$1,124 per month for non-disabled widows and widowers;
- In 2009, SSA paid benefits to about 17% of the U.S. population and 87% of the population over age 65;
- About 64% of the population over age 65 received at least 50% of their income through SSA payments and 34% received almost all of their income through SSA payments; and
- About 56% of the adult SSA benefits were paid to women.

The publication also provides a table of the gradual extended ages for full Social Security retirement benefits based on year of birth. For those born before 1938, eligibility for full retirement benefits is age 65. Beginning with those born in 1938, the age for full benefits increases by two months each year until reaching age 66 for those born in 1943. It remains at age 66 for those born from 1943 through 1954, and then continues increasing by two months each year until reaching age 67 for those born in 1960 and later.

The report is available at: [http://www.socialsecurity.gov/policy/docs/chartbooks/fast\\_facts/2010/fast\\_facts10.pdf](http://www.socialsecurity.gov/policy/docs/chartbooks/fast_facts/2010/fast_facts10.pdf)

### **Medicare Trustees Release 2010 Report on Financial Status of Medicare Funds**

On August 5, 2010, the Medicare Trustees released their annual report on the financial status of the Medicare funds. Total annual Medicare expenditures, which were \$509 billion in 2009 or 3.5% of Gross Domestic Product (GDP), are expected to grow to 5.5% in 2035, and 6.4% in 2084. The report warns that, after 2007, projections of

Medicare expenditures are understated due to projections of substantial reductions in physician payments scheduled under current law, but which are unlikely to occur.

The Medicare program consists of two component programs for the elderly and disabled: Hospital Insurance (HI) and Supplementary Medical Insurance (SMI). The HI program (Medicare Part A) pays primarily for inpatient hospital care and is financed by a payroll tax of 1.45% of taxable earnings. The SMI program consists of Medicare Parts B and D. Part B is a voluntary program that pays for physician, outpatient hospital, home health, and other services. Part D is a voluntary program providing access to outpatient prescription drug benefits. Approximately one-quarter of the SMI program is financed by beneficiary premiums, with the remainder financed by transfers from the U.S. Treasury's general fund.

According to the Trustee's report, the financial status of the HI Trust Fund has improved and is projected to be insolvent in 2029, 12 years later than projected last year. After the HI Trust Fund is exhausted, payroll tax revenues would cover only 85% of projected HI expenses in 2029, declining slowly to 76% in 2045, and rising slowly to 89% by 2084. The improvement in solvency is mainly due to the new health care reform legislation under the Patient Protection and Affordable Care Act. However, the report cautions that "the effects of some of the new law's provisions on Medicare are not known at this time, with the result that the projections are much more uncertain than normal, especially in the longer-range future."<sup>1</sup>

The financial outlook for the SMI program is better than the HI program, although rapid expenditure growth remains a serious issue. For both Part B and Part D, revenues are projected to equal expenditures for all future years, but only because beneficiary premiums and general revenue transfers must, by statute, be increased to meet expected costs for each year. However, the rapid growth of health care costs is expected to greatly accelerate the need to finance these benefits.

In an effort to address Medicare's long-term financial challenges, the Medicare Modernization Act created tools to monitor the program, including the "45-percent threshold." Under this provision, the annual trustees' report is required to include an estimate of the year in which general revenues will account for more than 45% of Medicare funding. The 2010 Trustees' Report is the fifth consecutive report that projects that the 45-percent threshold will be reached within the next seven years, i.e., 2016.

This triggered a Medicare funding warning for the fourth consecutive year and requires the President to respond with proposed legislation.

The report is available on the CMS web site at: <http://www.cms.gov/ReportsTrustFunds/downloads/tr2010.pdf>

### **Local Governments Are Implementing Changes to Fund Retiree Health Care Obligations**

In August 2010, the Center for State and Local Government Excellence released its report, *How Local Governments Are Addressing Retiree Health Care Funding*. The report is based on the Center's previous 2009 comprehensive survey of all 50 states and 2,136 local governments titled, *At a Crossroads: The Financing and Future of Health Benefits for State and Local Government Retirees*. The survey found that over 200 local governments anticipate adopting a long-term strategy to fund future retiree health care obligations. Some of the various OPEB strategies under consideration include:

- Establishing a governmental trust (under Internal Revenue Code § 115, medical 401(h) account, or voluntary employee beneficiary association (VEBA) trust (§ 501(c)(9));
- Issuing OPEB bonds;

---

<sup>1</sup> 2010 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplemental Medical Insurance Trust Funds, p. 2.

- Increasing the age and service eligibility requirements; and
- Eliminating retiree health care for all new hires.

According to the new report, many local governments are implementing changes in their retiree health care plans due to the economy, insufficient revenues, and competing budget priorities. An online survey was administered between January and February 2010 with an overall response rate of over 54% for the plans most likely to adopt prefunding mechanisms and changes to retiree health care plan design. The results indicated:

- 58% have adopted or plan to adopt a § 115 trust;
- 25% have adopted or plan to adopt a 401(h) account;
- 10% have adopted or plan to adopt a VEBA trust;
- 36% have increased or plan to increase vesting years of service;
- 11% have increased age eligibility requirements; and
- 39% have eliminated or plan to eliminate retiree health care for new hires.

In addition, very few have issued or plan to issue OPEB bonds.

The report is accessible at:

<http://www.slge.org/vertical/Sites/%7BA260E1DF-5AEE-459D-84C4-876EFE1E4032%7D/uploads/%7BE41F19B3-6C76-4D7D-9330-54CB5EBE4556%7D.PDF>

### **CBO Estimates Health Reform Law Will Reduce Federal Deficit by \$179 Billion over 10 Years**

On August 19, 2010, the Congressional Budget Office (CBO) released its report *The Budget and Economic Outlook: An Update*. The CBO estimates that the recently enacted Patient Protection and Affordable Care Act will reduce the federal deficit by \$179 billion over 10 years (from 2010-2019). By comparison, in March 2010, the CBO estimated that the new health care reform law would reduce the deficit by \$143 billion. The additional savings was attributable to technical changes and extending the projections to include the year 2020. By encompassing the additional year, CBO estimated that the health care legislation would reduce the projected budget deficit in 2020 by \$28 billion. However, the CBO cautions that the “estimates, like the ones for earlier years, are subject to considerable uncertainty.”

Furthermore, the report examined the effect of the health reform law on the labor force. CBO found that the new law will reduce the amount of labor used in the economy by 0.5%. The labor force reduction is mainly attributable to the expansion of Medicaid and the availability of subsidies that will reduce the cost of insurance obtained through newly created exchanges beginning in 2014. Due to these changes, beneficiaries may have additional resources that could encourage workers to work less or withdraw from the workforce. Additionally, older workers may retire earlier due to changes in the insurance market. Health insurance plans offered outside the workplace for older workers may become more appealing due to the elimination of provisions for pre-existing conditions and restrictions on pricing based on age or health status.

The CBO also reported that the “Cadillac Tax” on high-cost health insurance plans scheduled to begin in 2018 will reduce workers’ after-tax compensation and, therefore, encourage working longer. Under the new law, employers with 50 or more employees who do not offer health insurance will have to pay a penalty. This may cause some employers to reduce workers’ wages which may result in a reduction in hiring lower-wage workers.

The CBO report is available at: <http://tinyurl.com/36zqr5h>

## **CMS Projects Health Care Spending Will Reach \$4.6 Trillion by 2019**

On September 9, 2010, the online journal *Health Affairs* published the Centers for Medicare & Medicaid Services (CMS) report on *National Health Spending Projections: The Estimated Impact of Reform Through 2019*. The report updates the February 2010 projections under prior law by taking into account recent comprehensive health care reform legislation and other relevant changes in law and regulations. According to the CMS Office of the Actuary, the new health care reform law will increase health care spending from \$2.6 trillion in 2010 to \$4.6 trillion in 2019, an average annual increase of 6.3%. By 2019, spending is expected to account for 19.6% of gross domestic product (GDP), up from 17.5% in 2010. The health care share of GDP is estimated to be 0.3 percentage points higher than previously projected. Underlying this increase are larger differences in trends for spending and spending growth by payer, due to major changes in coverage and financing under the health care reform law.

During the first five years, the reform law is projected to significantly increase health care spending since millions of uninsured Americans are expected to have insurance coverage under the new health insurance exchanges and Medicaid. In 2014, when the exchanges begin, health spending is estimated to increase by 9.2% as compared to 6.6% estimated under the prior law. From 2015 to 2019, health spending is projected to rise more slowly by 6.7% as compared to 6.8% estimated pre-reform. Over 10 years, the implementation cost of the reform law will be about \$71.1 billion. By 2019, 92.7% of Americans are expected to have health care coverage, which is about 10 percentage points higher than the number estimated to be covered before the reform law.

The report can be found at: <http://content.healthaffairs.org/cgi/content/abstract/hlthaff.2010.0788>

## **AARP Finds Brand Name Prescription Drug Prices Increased Over 8% in 2009**

On August 25, 2010, AARP's Public Policy Institute reported that the average annual retail price for over 200 brand name prescription drugs commonly used by Medicare beneficiaries increased 8.3% in 2009. The increase was higher than the previous four years (i.e., 2005-2008) when the average annual increase ranged from 6.0% to 7.9%. On average, the retail prices for 207 brand name drugs included in the study have increased 41.5% from December 2004 through December 2009 compared to the general inflation rate of 13.3% over the same period.

The report concluded that, while the health care reform legislation will eventually close the Medicare Part D coverage gap, the escalating growth in drug prices could be slowed by increasing marketplace competition and transparency. AARP also suggested that drug costs could be reduced by allowing:

- prescription drug importation from abroad;
- generic drugs to enter the market faster; and
- Medicare to negotiate prices directly with prescription drug manufacturers.

The AARP report is available at: <http://assets.aarp.org/rgcenter/ppi/health-care/rxpricewatch.pdf>