WHAT IS ON OUR AGENDA

- Larger Retirement Benefits Context
- Comparison of DB and DC Alternatives
- Case Study of Pepperdine University – no plan
- Case Study of DePauw University – rich DB plan
- In the Transition Zone
- Questions and Commentary
NATIONAL CONTEXT

- Increasing fiscal woes of our national social insurance programs for retirees
- Potential inversion of the public – private partnership for retiree health care

INCOME SHORTFALLS
SCHEDULED RETIREMENT BENEFITS
Social Security, Medicare, and Medicaid

Source: 2004 Annual Report, Social Security and Medicare Trustees

LOCAL CIRCUMSTANCES

- Demographic realities
  - increasing life spans
  - exploding post-65 populations
- Retirement patterns
  - postponed retirement decisions
  - prolonged active insurance (with Medicare secondary)
- Financial constraints
  - escalating health care trend
  - unsustainable health care obligations
The population over 65 is expected to double by 2030. The elderly over 85 are the fastest growing segment of society. 


Insurance Access and Postponed Retirements

More faculty retire late and stay 18-36 months longer with no retiree medical

Source: Mellon Faculty Retirement Project (2000)

Unsustainable Health Care Obligations

Source: PricewaterhouseCoopers Actuarial Study (Employer Plan with 50% defined benefit arrangement)
LOCAL RESPONSES OF TRADITIONAL DB APPROACH

- trimming benefit design
- reducing employer contributions
- narrowing eligibility criteria
- grandfathering cohorts
- fixing subsidy at capped amount
- eliminating benefit altogether

DEFINED BENEFIT → DEFINED CONTRIBUTION
WEIGHING THE ALTERNATIVES

<table>
<thead>
<tr>
<th></th>
<th>DB</th>
<th>DC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uncontrolled financial promise</td>
<td>Predictable expense</td>
<td></td>
</tr>
<tr>
<td>Typically notional account</td>
<td>Fully funded trust</td>
<td></td>
</tr>
<tr>
<td>Pay-as-you-go premium subsidies</td>
<td>PREFUNDED, INVESTED CONTRIBUTIONS</td>
<td></td>
</tr>
<tr>
<td>Growing accounting liabilities</td>
<td>NO UNFUNDED OBLIGATIONS</td>
<td></td>
</tr>
<tr>
<td>Pre-ADEA employer paternalism</td>
<td>POST-ADEA EMPLOYEE RESPONSIBILITY</td>
<td></td>
</tr>
<tr>
<td>Unsustainable paradigm</td>
<td>SUSTAINABLE BENEFIT COST SHARE</td>
<td></td>
</tr>
</tbody>
</table>

CHARACTERISTICS OF EMERGING DC PLATFORM

- Predictable employer cost
- Sustainable benefit commitment
- No unfunded health care obligation
- Prefunded savings with long-term compounding
- Favorable tax treatment
- Inevitable shift away from employer-only risk
- Increasing individual responsibility for health care
CURRENT FUNDING OPTIONS
Retiree Medical Benefits

- Traditional defined benefit
- 401(h) carve-out
- HRA
- HSA
- 403(b) and 401(k) retirement plans
- VEBA trusts 501(c)(9) - EMERITI

CONTRIBUTOR OPTIONS

<table>
<thead>
<tr>
<th>Benefit Approach</th>
<th>Employer</th>
<th>Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB plan</td>
<td>employer notional, rarely funded</td>
<td>none</td>
</tr>
<tr>
<td>401(h) carve-out</td>
<td>employer notional, rarely funded</td>
<td>possible</td>
</tr>
<tr>
<td>HRA</td>
<td>employer notional, rarely funded</td>
<td>none</td>
</tr>
<tr>
<td>HSA</td>
<td>employer funded</td>
<td>yes, in active service</td>
</tr>
<tr>
<td>403(b) – 401 (k)</td>
<td>employer funded</td>
<td>typically, yes</td>
</tr>
<tr>
<td>VEBA Trusts</td>
<td>employer funded</td>
<td>yes, in active service and in retirement</td>
</tr>
</tbody>
</table>

INVESTMENT OPTIONS

<table>
<thead>
<tr>
<th>Benefit Approach</th>
<th>Employer</th>
<th>Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB plan</td>
<td>rarely funded and hence not invested</td>
<td>none</td>
</tr>
<tr>
<td>401(h) carve-out</td>
<td>generally invested with pension assets</td>
<td>possible</td>
</tr>
<tr>
<td>HRA</td>
<td>employer notional, not funded</td>
<td>none</td>
</tr>
<tr>
<td>HSA</td>
<td>employer funded, perhaps invested</td>
<td>employee funded, perhaps invested</td>
</tr>
<tr>
<td>403(b) – 401 (k)</td>
<td>employer funded, individually invested</td>
<td>employee funded, individually invested</td>
</tr>
<tr>
<td>VEBA Trusts</td>
<td>employer funded, individually invested</td>
<td>employee funded, individually invested</td>
</tr>
</tbody>
</table>
### ACCOUNT OWNERSHIP

<table>
<thead>
<tr>
<th>Benefit Approach</th>
<th>Employer</th>
<th>Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB plan</td>
<td>yes, plan asset</td>
<td>only lifetime benefit promise</td>
</tr>
<tr>
<td>401(h) carve-out</td>
<td>yes, plan asset</td>
<td>only lifetime benefit promise</td>
</tr>
<tr>
<td>HRA</td>
<td>yes, employer asset</td>
<td>only lifetime benefit promise</td>
</tr>
<tr>
<td>HSA</td>
<td>no</td>
<td>yes</td>
</tr>
<tr>
<td>403(b) – 401 (k)</td>
<td>no</td>
<td>yes</td>
</tr>
<tr>
<td>VEBA Trusts</td>
<td>no</td>
<td>lifetime rights, becoming a plan asset at death of all eligible dependents</td>
</tr>
</tbody>
</table>

### DEATH BENEFIT / SURVIVOR RIGHTS

<table>
<thead>
<tr>
<th>Benefit Approach</th>
<th>Plan Status</th>
<th>Participant Rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB plan</td>
<td>plan asset</td>
<td>lifetime of participant</td>
</tr>
<tr>
<td>401(h) carve-out</td>
<td>plan asset</td>
<td>lifetime of participant</td>
</tr>
<tr>
<td>HRA</td>
<td>employer asset</td>
<td>lifetime of participant</td>
</tr>
<tr>
<td>HSA</td>
<td>individual asset</td>
<td>lifetime of participant and spouse; taxable benefit to others</td>
</tr>
<tr>
<td>403(b) – 401 (k)</td>
<td>individual asset</td>
<td>taxable, unqualified death benefit to designated beneficiaries</td>
</tr>
<tr>
<td>VEBA Trusts</td>
<td>plan asset</td>
<td>lifetime of participant, spouse, and federally eligible dependents</td>
</tr>
</tbody>
</table>

### ACCESS TO INSURANCE AND REIMBURSEMENTS

<table>
<thead>
<tr>
<th>Benefit Approach</th>
<th>Retiree Group Insurance</th>
<th>Other Medical Reimbursements</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB plan</td>
<td>yes</td>
<td>no</td>
</tr>
<tr>
<td>401(h) carve-out</td>
<td>yes</td>
<td>typically, no</td>
</tr>
<tr>
<td>HRA</td>
<td>typically, not</td>
<td>yes, tax-free</td>
</tr>
<tr>
<td>HSA</td>
<td>typically, not</td>
<td>yes, tax-free; but not for retiree insurance premiums</td>
</tr>
<tr>
<td>403(b) – 401 (k)</td>
<td>none</td>
<td>after-tax basis</td>
</tr>
<tr>
<td>VEBA Trusts</td>
<td>yes, multiple insurance options</td>
<td>yes, tax-free</td>
</tr>
</tbody>
</table>
EMERITI’S COMPREHENSIVE DC SOLUTION

- Joint employer and employee savings opportunities
- Employee-directed, life-cycle fund investments
- Tax-advantaged earnings and disbursements
- Participant and eligible dependent access to medical benefits
- Group insurance coordinating with Medicare
- Group insurance with catastrophic and Rx coverage
- Tax-free reimbursement of qualifying medical expenses

PEPPERDINE UNIVERSITY CASE STUDY

No Prior Retiree Medical Benefit

Pepperdine Case Study
Perceived Need

- An adaptable means of providing retiree health care coverage not previously available in the marketplace
- An answer to strongly expressed desires of the faculty and administration
### Pepperdine Case Study

#### Expected Value of Emeriti's DC Approach

- Provides total, cost-effective solution to retiree health
- Offers access to post-retirement health benefits to those who have already retired
- Creates incentives for employees to retire
- Removes FAS 106 liability as a financing consideration

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#### Decision-Making Process

- Introduction through Emeriti on-campus workshops and AICCU external presentations
- Benefits Committee Review and Recommendation
- Planning and Budget Committee Review and Re-prioritization Project

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#### Funding This New Benefit

- Internal Reallocation of Resources
- Re-prioritization of University Programs
Pepperdine Case Study
Key Funding Elections

- Contributions starting at age 40 and continuing for 25 years
- Benefit funding projections based on middle insurance option
- Institutional funding commitment at 50% of projected cost
- Flat contribution amounts increasing at 4% per year
- Voluntary participant contributions before and after retirement
- Provision for special contributions for tenured faculty at retirement

Pepperdine Case Study
Participant Eligibility

- Class 1 - active, regularly assigned, full-time staff employees working a minimum of 30 hours per week (including 9-12 month employees) and three years of continuous service in an eligible class
- Class 2 - full-time faculty members employed under a regular (non-adjunct or non-participating) faculty contract serving in a half-time appointment (0.5 FTE) each academic year and three years of continuous service in an eligible class
- Class 3 - retirees with a minimum of 10 years of service in an eligible class who are eligible for Medicare

Pepperdine Case Study
Next Challenge

- Education of Employees about New Benefit
DEPAUW CASE STUDY

Rich Defined Benefit Retiree Medical Benefit

DePauw Case Study
Perceived Issues

- Rapidly aging workforce
- Slowing retirement patterns
- Decreasing opportunities for institutional renewal
- Escalating compensation costs
- Spiraling insurance premiums (active and retiree)
- Exponential growth of FAS 106 liabilities

DePauw Case Study
Expected Outcomes of Emeriti’s DC Approach

- Capping and reduction of accounting liabilities
- Savings in reduced compensation costs for health care (active and retiree)
- Purchasing power of larger insurance pool
- Health savings opportunities for employees
- Increased incentives for older employees to retire
DePauw Case Study
Growing FAS 106 Liability
DePauw University
Accumulated Postretirement Health Benefit Obligation

DePauw Case Study
Projected FAS 106 Reductions
DePauw University
Projected Accumulated Postretirement Health Benefit Obligation

DePauw Case Study
Benefit Financing Strategies and Projected Savings

• Savings from capped current retiree health care obligation, with elimination over 25 years
• Cost differential between current carrier premiums and Emeriti insurance rates
• Redirected forfeitures from non-vested employees to future plan costs
• University contributions to retiree premiums limited to future total compensation increases
• Reduced active health care expenses due to earlier retirements and reduced health utilization
DePauw Case Study
Funding Considerations for Current Retirees

• Effective January 1, 2006, current retirees transition from previous carrier to Emeriti insurance options
• Annually, retirees choose among all Emeriti insurance options and have access to the Emeriti reimbursement benefit
• First year, DePauw contributes $200 monthly toward cost of premium
• Thereafter, DePauw makes premium subsidies indexed to planned percentage increase in total compensation

DePauw Case Study
Funding Considerations for Active Employees

• Effective July 1, 2005, DePauw contributes $100 monthly to prefunded VEBA account
• Thereafter, DePauw prefunds its annual contribution indexed to planned percentage increase in total compensation
• Vesting in DePauw’s contribution is subject to the Rule of 80 (combined minimum age 55 with 15 years of service)
• As a transition policy, current employees satisfying Rule of 80 are eligible for DePauw’s pay-as-you-go premium subsidy in retirement for a period of years (up to 25 years max.) minus years of prefunded contributions

DePauw Case Study
Next Challenge

• Education of Employees about New Benefit
AFFECTED COHORTS IN THE DC TRANSITION

- Younger employees with no benefit expectations
  - typically, DC prefunded, flat-dollar contributions
- Older, active employees with a DB funding promise
  - typically, various actuarial permutations / combinations of DC contributions and DB premium subsidies
- Current retirees with a DB insurance benefit in place
  - typically, pay-as-you-go DB premium subsidies

BEING REALISTIC IN THE DC TRANSITION

- No quick fixes for mounting obligations, decades in the making
- Inevitable trade-offs between current budget and long-term balance sheet
- Inevitable trade-offs between higher initial costs and reduced long-term expenses
- Inevitable trade-offs in total compensation
- Rational accommodations between employee health security and employer financial well-being

CONCLUDING QUESTIONS AND COMMENTARY

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### CONTACT INFORMATION

**EMERITI**
- Email: kcool@emeritihealth.org
- Phone: (866) 685-6565 – toll-free
- URL: www.emeritihealth.org

**PEPPERDINE**
- Email: james.c.moore@pepperdine.edu
- Phone: (310) 506-4397
- URL: www.pepperdine.edu

**DEPAUW**
- Email: pschmitt@depauw.edu
- Phone: (765) 658-4181
- URL: www.depauw.edu