April 30, 2004

Questions and Answers Regarding the EEOC's Rule on Retiree Health Coverage and Medicare

Issue

In July of 2003, the EEOC issued a proposed rule clarifying that employers would not be in violation of the Age Discrimination in Employment Act (ADEA) when they provide health benefits solely to pre-Medicare retirees or when they provide benefits to Medicare-eligible retirees that are different from the benefits they provide to pre-Medicare retirees. On April 22, 2004, the EEOC finalized that proposed rule; however, the final rule does not take effect until it is approved under an interagency review process.

Discussion

The EEOC's rule on retiree health coverage is consistent with Congressional intent and legislative history on ADEA. The rule is intended to allow the continuation of the long-standing and widespread practice of providing different benefits to early retirees than to Medicare-eligible retirees. The clarification is needed because in the case of *Erie County Retirees Association v. County of Erie*, one court (in the Third Circuit) disregarded the clear legislative history on ADEA and its application to retiree health coverage. In this case, which was decided in 2000, the court held that an employer that voluntarily provides retiree health benefits may be prohibited from reducing these benefits once an individual becomes eligible for coverage under Medicare. The fundamental problem is that the court decision would, if widely applied, result in almost all employers reducing the benefits provided to early retirees in order to meet a nondiscrimination test that would require them to provide the "same" benefits to early retirees and post-65 retirees. In fact, this is exactly what happened to the retirees of the Erie County after the *Erie County* decision – Medicare-eligible retirees received no better health benefits while younger retirees were required to pay more for health benefits that offered fewer choices.

As set forth in its new regulations, the Equal Employment Opportunity Commission (EEOC) agrees that the practice of coordinating employer-provided retiree health coverage with eligibility for Medicare should not be considered a violation of the ADEA. The EEOC correctly concluded that treating the coordination as an ADEA

violation would be contrary to the interests of retirees because it would result in a significant decrease, not enhancement, of health care coverage to retirees.

There are serious threats to the continued existence of employer-sponsored retiree health coverage. Rapidly rising costs, unfavorable accounting treatment of retiree health obligations, and the lack of federal policies designed to encourage employers to provide retiree health benefits have all played a major role in the decline of this important benefit for millions of American workers. A coalition of employers and unions (including the AFL-CIO, NEA and AFT) all agree, the EEOC's rule will help stabilize the availability of retiree health coverage, especially for those retirees who are not yet eligible for Medicare.

Questions and Answers

Question. Under the Erie County case, an employer is permitted to provide benefits to Medicare-eligible retirees that are different from the benefits provided to pre-Medicare retirees, as long as the "equal benefit/equal cost" test is satisfied. Can this test (which is unworkable under the Erie County case) be fixed by simply allowing employers to take the cost or value of Medicare into account in determining if they satisfy the test?

Answer. No. Permitting employers to take the cost or value of Medicare (net of premiums paid by the retirees) into account in applying the test would not solve the problem caused by the Erie County case. For example, assume that (1) an employer provides pre-Medicare retirees with coverage worth $8,000 annually, and (2) the annual net value of Medicare is determined to be $7,000. In that case, the employer would need to provide Medicare-eligible retirees with coverage worth $1,000 in order to pass the "reformed" equal benefit/equal cost test.

There are two major problems with this approach. First, it would not have the desired result of improving the coverage of Medicare-eligible retirees. For example, assume that the employer in the above example currently provides no coverage for the Medicare-eligible retirees. The likelihood is far greater that such an employer would respond to this new test by reducing the pre-Medicare coverage from $8,000 to $7,000. Because of economic pressures, it is very rare for an employer to take on new retiree health obligations. Thus, it is unrealistic to assume that the employer in this example would opt to provide Medicare-eligible employees with $1,000 of coverage.

The second major problem with this reformed equal cost/equal benefit test is the valuation issue. For this test to work fairly, the value of Medicare would need to be determined accurately for each employer's Medicare-eligible retirees. This value will vary considerably by geographic area, age, gender, income level, past occupation, and other demographic factors. It could also vary by the Medicare plans elected by the retirees, a key feature of the Medicare reform legislation recently enacted by Congress. Another complicating factor is that the government's cost may not reflect what an

employer would have to pay for the same benefits. A valuation that does not take the above factors into account would be completely unrealistic; a valuation taking these factors into account would be enormously difficult and very uncertain.

Valuation of an employer's own plans is also quite difficult. For example, claims experience can vary significantly from one year to the next, making any year's valuation problematic. Moreover, employers often group within one risk pool a wide variety of different plans covering retirees in different areas, with no reliable mechanism to value the separate plans.

The EEOC stated in the preamble to its regulations on retiree health coverage that it "closely examined whether it would be possible to apply the equal benefit/equal cost test" to the widespread practice of coordinating retiree health benefits with Medicare. The EEOC concluded "after extensive study" that the test was not workable in this context for many of the reasons stated above.

If the equal benefit/equal cost test is extremely burdensome and uncertain, employers would have no incentive to apply it. Employers would almost certainly avoid the expense and uncertainty by reducing pre-Medicare benefits, which they are already doing in large numbers. This is exactly what the EEOC concluded and there is no reason to believe otherwise.

Question. Couldn't an employer avoid all of this complexity of the equal cost test by simply doing what the Federal government does, i.e., provide the same benefit to Medicare retirees as it provides to pre-Medicare retirees with an offset for Medicare benefits?

Answer. There are three basic types of retiree health plan designs:

- *"Wraps"*: Medicare-eligible retirees and pre-Medicare retirees receive the same benefits; however, the Medicare-eligible retirees receive the benefits from two sources – Medicare and the employer-provided plan.

- *"Supplements"*: Medicare-eligible retirees receive Medicare and an employer-provided supplement (such as prescription drug coverage); pre-Medicare retirees typically continue in the same employer plan that covers the active employees.

- *"Bridges"*: Medicare-eligible retirees only receive Medicare; pre-Medicare retirees typically continue in the same employer plan that covers the active employees.

The Federal government provides Wrap coverage for Medicare-eligible retirees, but for many large employers, such an option is not affordable. Such employers therefore provide either relatively modest supplemental benefits beyond those covered

by Medicare or provide coverage only to early retirees who are not yet eligible for Medicare. It is not realistic to assume that any significant number of employers would take on the additional expense of providing Wrap coverage similar to that offered to Federal employees. Rather, faced with this alternative, employers are much more likely simply to reduce coverage for pre-Medicare retirees.

Question. What would happen if Erie County were the law and coordinating employer-provided plans with Medicare was prohibited by the ADEA?

Answer: Wraps would not be directly affected. Supplements and Bridges would generally be prohibited. Employers would have to choose among:

- increasing the Medicare-eligible retirees' benefits to match the pre-Medicare retirees' benefits;
- reducing the pre-Medicare retirees' benefits to match the Medicare-eligible retirees' benefits; or
- eliminating medical benefits for all retirees.

Because of economic pressures and rapidly rising medical costs, "leveling up" is not a realistic option for almost any employer. In fact, in some cases, the elimination of all retiree medical benefits would be the simplest option, as it would avoid the complexity of redesigning the pre-Medicare retiree benefits to meet the Erie County test.

Question. Would the EEOC's rule give employers more incentive to drop retiree health plans, as some have argued?

Answer. No. Clarifying that the law permits the coordination of employer-provided retiree health plans with Medicare will *remove* a reason for employers to drop retiree health plans as described above. This is why the teachers' unions and other organizations have been major supporters of the EEOC's regulation.

Question. Are the interests of pre-Medicare retirees being pitted against the interests of Medicare-eligible retirees? Would the EEOC's rule favor the former over the latter?

Answer. The interests of the two groups are not in conflict at all. We are not aware of any employer that is providing additional benefits to Medicare-eligible retirees because of concerns regarding the ADEA and the Erie County case. Outside the Third Circuit, most employers believe that the Erie County decision was incorrectly decided and is not the law governing retiree health coverage. Therefore, they have not modified their plans to conform to the decision by this one court back in 2000. Even within the Third

Circuit, we are not aware of any employers that increased benefits for Medicare-eligible retirees in reaction to the decision.

In this context, we do not envision the EEOC rule as having any negative effect on Medicare-eligible retirees. The regulation would simply prevent more employers from reducing benefits for pre-Medicare retirees.

Question. How would the new Part D benefit affect the ADEA issue?

Answer. For employers providing a Wrap, there would be no ADEA effect. Medicare simply would be providing a greater proportion of the benefit. If the EEOC rule is issued in final form, employers providing a Supplement or a Bridge would not have to be concerned that their Supplement or Bridge might cause their plan to be in violation of the ADEA. However, if the EEOC rule is not adopted in final form, employers that provide supplemental or bridge coverage future court decisions could hold that they are in violation of ADEA and it is likely they would be forced to reduce coverage to pre-Medicare eligible retirees to try to ensure they were providing the "same" level of benefits to retirees of all ages.