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NON-PENSION POST RETIREMENT BENEFITS—DESIGN AND FUNDING

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- o Size of potential liability
- o Taxation of benefits
- o Deductibility of contributions
- o Future inflation effect
- o Projected decline in governmental benefits
- o Financial accounting requirements

MR. DAVID V. AXENE: I am looking forward to today's discussion on non-pension postretirement benefits. We are fortunate to have three experts on this topic. Through today's discussion, hopefully all of us will go away understanding more of the complexities of this subject. The first two panelists will present information from the United States perspective. The last panelist will present the Canadian perspective.

As an introduction to this topic, I thought I would first describe a few situations I am familiar with. Perhaps the most interesting one is a large company (about 14,000 employees) that offered paid-in-full retiree medical as an alternative to a Cost of Living Adjustment (COLA) pension benefit. The pension benefit provided fixed benefits, and the requested COLA program had a 3% cap. The company negotiators were concerned about the financial impact of offering the COLA benefit. After all, they had heard from their consultant that COLA benefits are expensive. Their decision was reached without actuarial advice or input. The financial advisors assumed that the cost of retiree medical would be minimal. They found that Medicare Supplement rates quoted by the carrier were only $30 per person per month. In comparison, 3% of the current average pension benefit was about $20, but in just two years it would be greater than $30. They innocently assumed a good decision had been made.

A few months later, the client started to wonder how wise this decision was. They casually asked for our commnent. After analyzing this particular situation, it was apparent they had made the wrong choice. The unfunded liability for the retiree medical program was larger than the pension plan's unfunded liability. The projected funding requirement exceeded the current pension funding. In this case, the COLA would have been much less expensive than the retiree medical.

Another interesting situation involves a company that had just gone out of business. Just prior to their liquidation, the manufacturing plants were sold to another company. The sale included the assumption of retiree liability, including a retiree medical program. The purchase price included an allowance, for both current and future retirees, of approximately $11 million. However, our liability estimates were in the range of $50 - $75 million for a potential group less than 1,000 individuals.

Although much of our discussion will center around retiree medical, other retiree benefits have substantial liabilities. For example, retiree life insurance is another benefit where actual costs are much higher than initially anticipated by most plan sponsors.

Let me introduce our three speakers. The first speaker will be Mr. Thomas G. Nelson, a consulting actuary in the Chicago office of Milliman and Robertson, Inc. Tom is a health actuary specializing in employee benefit plan consulting. The second speaker will be Mr. James F. A. Biggs from the New York office of Peat, Marwick and Mitchell. Both Tom and Jim serve on industry committees dealing with the retiree benefit issue. The third speaker is Mr. J. Edward Nixon. Ted will describe the Canadian perspective of retiree benefits, a much different one than the U.S. perspective. Last but definitely not least is our recorder, Mr. Charles J. Rysz, a consulting actuary with Coopers & Lybrand in Chicago.

After the speakers are through, we will entertain questions from the audience and also discuss this topic more informally.

MR. THOMAS G. NELSON: Good morning. I'm glad you could join us today in discussing this very topical area in employee benefits. I had a story to tell similar to Dave's. One of the employers I was consulting with chose to introduce a retiree life and medical program rather than grant a pension benefit increase. We evaluated the program a few years later when the Financial Accounting Standards Board's (FASB) activity caused the client to address the issue. Our estimate of the present value of future benefits was in the $2 - $5 billion range. So these liabilities can have a big effect on a company's bottom line.

I only wish that our topic's name was a little more glamorous. I continue to struggle with an inferiority complex that stems from such endearing labels as "nonpension postretirement benefits" - or even better, "other postretirement benefits." Perhaps during the question and answer period some member of the audience might be able to coin a phrase that more befits the importance of the topic.

This is a particularly important time for actuaries in this area. Employee benefit policies are being shaped, and we as actuaries have a lot to offer.

Additionally, this meeting itself is very important since it is the Society's first after a number of important events, such as:

- the passage this summer of the Deficit Reduction Act of 1984 (DEFRA),
- the federal court decision a few weeks ago regarding the Bethlehem Steel retiree medical plan, and
- the publication in July of the FASB's proposal on accounting disclosures for nonpension postretirement benefits.

With regard to nonpension postretirement benefits, I'm going to be talking about:

- o the reasons for the growing interest in these benefits,
- o the accounting (both currently and in the future) for these benefits, and
- o some noteworthy considerations I've encountered in being involved in a number of postretirement valuations.

BACKGROUND

Let me start with some background information regarding these "other" benefits. My focus will be on the life and (primarily) the medical coverages.

The value of postretirement benefits has received growing interest recently from accountants, actuaries and financial personnel. Postretirement life and medical benefits have been specifically pinpointed for study due to their significance as business costs, in the present and especially in the future. In the surveys with which I am familiar, roughly two-thirds of medium and large employers report providing either (or both) benefits to retirees. Additionally, all indications are that a vast majority of employers who offer such benefits have never fully assessed the expected financial implications of these commitments.

The present reasons for analyzing medical and life programs include (Slide 1):

- o Anticipated accounting changes
  - particularly influenced by the recent activities of the Financial Accounting Standards Board.
- o Employers' interest in
  - the projected size of the liability and costs, and
  - ways to better control the financial aspects of their obligation.
- o Auditors' present requirements.
- o Potential tax savings to be gained through prefunding
  - DEFRA contains important limitations on tax-deductible funding levels.
- o Recent court decisions dealing with the permanence of the obligations.

Up to this point employers have been fairly unanimous in treating these benefits on a pay-as-you-go basis. In fact, while thinking about this topic in preparation for today, I could recall only one employer that I had seen who, due to some special circumstances and the auditor's insistence, accrued expenses on other than a pay-as-you-go basis.

Unfortunately, the pay-as-you-go approach disguises the upward curve of expected future costs. In the instances with which I am familiar, the costs for both relatively mature and immature populations climbed so high as to make one question whether existing plans could survive the future under pay-as-you-go.

Until recently, I think it is safe to say that most employers had not truly studied the costs associated with an ongoing postretirement medical and life program. As we have already noted there have been a number of instances in which employers, unaware of the significance of postretirement benefits, have promised these coverages in either negotiations or in program expansions. Ideally, employers would have enough financial details at their fingertips to enable them to make informed decisions on matters such as these.

Today we are finding that employers are much more interested in learning the estimated values of postretirement benefits. The types of information that employers have found most helpful include (Slide 2):

- o present values of expected future benefits,
- o expected future cash flows,
- o potential accrual/funding levels under different actuarial cost methods, and
- o sensitivity tests on certain assumptions over reasonable ranges of values.

The assumptions used in estimating future expected benefits are very important. Before listing a few of the more important assumptions, I'd like to provide some of the projection results that I have seen:

- o pay-as-you-go costs over the next 10 to 15 years escalating by a factor of 3 to 15 times current costs,
- o leveled expense accruals over the active working lifetimes of employees tripling, quintupling or more beyond current costs, and
- o actuarial estimations of the present value of future expected benefits totalling 20 to 150 times the current annual pay-as-you-go cost.

ACCOUNTING

I have mentioned the popularity of the pay-as-you-go accounting approach of retiree programs. A significant force in the growing awareness for employers has been the accounting profession's study of the treatment of "other" benefits on financial statements. On July 3, 1984 the FASB proposed specific disclosures in accounting for postretirement life and health coverages.

Prior to this Exposure Draft on disclosure, the FASB project had been linked with a similar pension accounting project. In February of 1984 the pension and "other" postemployment (OPE) topics were split, with a separate schedule assigned to each. I will cover the FASB's current schedule for the OPE project in a moment, but first I'd like to summarize the project's development to date.

The publication in recent years of the FASB's Discussion Memorandums and Preliminary Views is part of a FASB project of ten years' duration. While the recently-proposed disclosure requirements are not overly demanding, the overall changes in accounting requirements contemplated are substantial and, for many employers, would materially affect reported operating results and shareholders' equity.

The FASB's position on disclosures is viewed as an interim step on their part, and is due to the absence of disclosure currently on employer financial statements. Major considerations such as the measurement and recognition of OPE costs and liabilities will be resolved at a more deliberate pace because of the likely magnitude, and lack of knowledge about, the related costs.

The essence of the FASB statements to date has been that pay-as-you-go or terminal funding for these retiree benefits will not be acceptable in the future. Group life and medical appear to have been deemed as both measurable and material in the accountants' eyes, and not properly represented by the popular current approaches. The accounting Board has not yet defined an acceptable method or methods of attributing the cost of benefits to accounting periods. To soften the substantial one-time cost that might be associated with an accounting change, alternative transitional approaches have been suggested as well.

The appropriate Academy of Actuaries committees have been communicating with the Board on this project, and will continue to do so. Academy Statements 81-29 and 83-44 are formal statements on the topic for those who are interested.

As it now looks, a research project studying measurement and recognition methods will be undertaken by the FASB around the first of the year. No further Discussion Memorandums are expected, but an Exposure Draft can be anticipated in 1985. The current goal is to produce a Final Statement on "other" benefits in the first half of 1986, shortly after a similar statement on pensions.

The proposed accounting has stirred reactions - positive and negative - to its proposals; just as important, it has awakened many multiemployer and corporate plan managers to the emerging costs associated with these coverages. However, because these retiree benefits may be described as deferred compensation, and because the pay-as-you-go costs in most retiree programs can be expected to climb dramatically over the next decades, leveled accruals of expenses over the active working lifetimes of employees are being considered by the FASB. Medical and life postretirement valuations, borrowing concepts and computer projection capabilities from the pension actuarial area, have been undertaken with increasing frequency. As I suggested earlier the purposes of these projections have generally been twofold, providing:

1) financial statement information regarding estimations of present and future obligations, and

2) educational information for management in its quest for better control of the financial aspects of its operations.

It should be noted that no funding requirement has been, or is expected to be, included in the proposals. Of course, prefunding these liabilities would imply investment income on a tax-efficient basis if the strict limits of DEFRA were not exceeded.

NOTEWORTHY CONSIDERATIONS

Sensitive Variables

Postretirement valuations depend upon many assumptions, some of which are similar to those used in defined benefit pension valuations. In my experience there are a number of particularly sensitive variables which warrant special attention in projecting OPE costs, including (Slide 3):

- the plans of benefits offered, now and in the future, especially the pattern for medical benefits after attainment of Medicare eligibility
- the historical enrollment and claims experience by coverage
- the demographic characteristics of the covered population, including age, sex and geographic location by coverage, as well as the maturity of the ratio of active members to retirees
- the voluntary/involuntary nature of the provision of benefits to retiring employees, including the contribution amounts (if any) required of covered persons
- the inclusion of coverage for dependents
- the disability and early retirement provisions
- the governmental trends toward lessened medical liability for the aged

Extent of Employer Obligation

In the past, one of the most discussed topics about these benefits has been the level of guarantee made by employers to retirees and actives. Interest in this question has been increased due to recent court cases. Many interested parties have felt that employer obligations are less certain than in the case of pensions. The types of employer obligations to provide postretirement benefits varies, ranging from contractual obligations due to collective bargaining to expressed temporary resolutions by management. Questions regarding guarantees by employee status, whether currently active or retired, have also arisen.

It appears that at least some courts will decide that a binding commitment has been created if a plan sponsor communicates a long term commitment to provide postretirement benefits. The recently-decided Bethlehem Steel case, which will be appealed, was decided in favor of current retirees; the decision hinged upon whether employer communications reserved the right to alter benefits for existing retirees. In that case, the judge found that Bethlehem communications were not uniform in their disavowal of a lifetime obligation to retirees. Viewpoints such as these edge us closer to accounting, and even funding, changes for postretirement benefits.

Deficit Reduction Act of 1984

Many health and welfare plan issues were raised by DEFRA (Slide 4). Among other things, the law gave the Treasury Department the opportunity to define a "qualified actuary" for plan funding purposes; to set standardized mortality and interest assumptions for actuarial calculations; and to study the need for funding, vesting, and participation standards for health and welfare plans. The Academy is now in the process of forming a Task Force to address any policy-level issues that arise as the government studies health and welfare plans.

Each of the issues I mentioned relates to our topic today, but I will focus on the funding and standards issues since the other two would be more speculative at this point. The funding of retiree life and medical reserves under the Act is to be in accordance with the following:

- Treasury rules that prescribe that funding of retiree benefits be based on reasonable and consistently applied actuarial cost methods, which take into account experience gains and losses, changes in assumptions, and other similar items.
- Actuarial assumptions that are reasonable in the aggregate.
- Funding that is no more rapid than on a level basis over the remaining working lifetimes of current participants.
- Funding of medical benefits that assumes no future inflation in claim costs.
- Safe harbor amounts for retiree medical benefits that may be prescribed by Treasury regulations.
- Nondiscrimination standards that are similar to pension requirements.
- Medical benefits provided under a qualified plan for any retiree who has an individual medical benefit account are to be applied against the pension plan benefit and contribution limits.
- Key employee medical benefits that can be associated with a pension plan qualified under Internal Revenue Code (IRC) Section 415 are to be applied against the pension plan's benefit and contribution limits.
- Unrelated business income taxes that will be imposed on investment earnings on funds in excess of allowable reserves.
- Separate accounts for key employees that will be established, with no nontaxable payments for such key employees to stem from other accounts.

- o Deductible contributions for funded life benefits that can only consider a $50,000 coverage maximum, plus claims incurred and unpaid and administrative expenses; excess contributions will be taxed as unrelated business income.

As its name implies, the Deficit Reduction Act focused on fiscal matters relating to many areas. The mandated study of participation, vesting and funding standards for health and welfare plans hints at a direction that is more employee-protective than tax-base-protective. The closest available parallels for helping us define these types of standards are found in the pension area, and particularly in ERISA and its regulations. However, very important differences exist between pension and welfare benefits, resulting in difficulties in applying the concepts and terminology of one to the other.

- o Minimum pension participation rules have been established by law to be administratively efficient, excluding very new and young employees due to the anticipation of excessive costs associated with their expected high turnover. Mandated participation rules do not exist for employee welfare plans. However, competition for employees has dictated the availability of nearly universal and immediate death, disability and medical coverage for active workers. Retired workers are not universally offered nonpension coverages however.

- o Pensions benefits are generally provided in accordance with a service-related formula. Upon retirement both the employer and employee understand what the anticipated benefit will be. In contrast, employee welfare benefits such as medical coverage are usually based upon the cost of services provided, making future benefits subject to increasing costs due to inflationary pressures, as well as changes in utilization patterns, in government-sponsored programs such as Medicare, and in technological innovation. The lack of service-based formulas for health and welfare benefits makes those programs more difficult to relate to service; this in turn makes the accrual of benefits and any meaningful vesting schedules more difficult and arbitrary.

- o Even considering recent court cases, employer obligations to retirees under welfare plans are less certain in comparision to the obligations of pension plans. Often, welfare plan provisions stating management's prerogatives (to continue, alter or cease to provide postretirement benefits) exist with no mandated vesting of benefits for workers and retirees. Partial vesting (for example, 50% of full benefits) can easily and sensibly exist for pension benefits, while the administration of such a concept for welfare (especially medical) benefits would require study and coordination. Similar examination would be needed in cases where an individual has obtained vested welfare benefits through more than one employer.

The Health and Welfare Plan subcommittee of the Academy has recently submitted testimony to Congress regarding this study by Labor and Treasury. Their deadline for recommendations is approaching quickly - February 1, 1985.

Because so much is happening today in "other" postretirement benefits, we have had to pare our comments to fit the allotted time. The question and answer period and the follow-up workshops should provide opportunity for more discussion.

MR. JAMES F. A. BIGGS: Complaining about the activities of the accounting profession has been a popular diversion for the actuarial profession over the last decade or so. If there were a favorite actuarial parlor game, it might be called "Bash the Bookkeeper." I've probably done more of this than most of you, because I know more accountants than you do. But today's topic is an area in which all of us should really be grateful to the accounting profession, and particularly to the FASB, for at least two reasons:

- From the standpoint of professional satisfaction of members of an organization which believes in substituting demonstrations for impressions, I think we can only welcome any activity that encourages employers who are your clients or your policyholders to focus much more closely on issues which many have not carefully examined in the past.

- From the standpoint of pure unadulterated greed, this activity is bound to create a great deal more work and presumably a fair amount of revenue for most of us.

It's a little ironic that the favorite targets of criticism of employee benefits actuaries are the Federal government and the accounting profession. If it weren't for all the trouble caused by the Federal government, the accounting profession and the AFL-CIO, consulting actuaries might actually have to go out and develop some business on their own.

In the past, most employers have been making decisions with respect to postretirement life and medical benefits on the basis of inadequate information. Many of them haven't really known what those benefits were costing them currently. They were being billed under their life and medical programs with a composite premium applicable to both active and retired lives; therefore, they did not know what was being charged for the retirees. Further, the claims information they received at the end of the year frequently was not maintained, or reported, separately for the retired life group. Even when employers have known what they were paying currently for pensioner coverage, they were likely to have had little or no idea of the ultimate level of cost. In most cases they haven't tried very hard to find out, for a number of reasons:

- There was no obligation to fund this larger amount since employers were being billed on the basis of current one-year-term premiums.

- There was no obligation under existing rules to record this ultimate cost as an expense in financial statements. Managers who did choose to recognize this cost as an expense would find themselves at a disadvantage either in pricing the product or in reporting earnings at the end of the year.

- There was, for some, a belief or hope that Medicare would ultimately assume all or virtually all of the health care burden.

- o Finally, there was a feeling on the part of many employers that, if these benefits became too expensive, they could be reduced or eliminated in the future.

Tom Nelson has mentioned the Bethlehem Steel case, which casts considerable doubt on this last hope. Let me mention two recent developments which go even further in this direction. The first is a Michigan case reported by Commerce Clearing House. The employer closed a plant, and terminated the retiree medical benefits. The United Auto Workers (UAW) went into court not only claiming breach of contract for taking the medical benefits away, but arguing for damages to compensate for the mental distress that had been caused to these aged citizens because the employer had committed this heinous act. The trial court made its decision recently and found in favor of the Union. The second cloud on the horizon is a seminar on legal issues in managing employer's health care cost which was reported just recently in the BNA Pension Reporter. Obviously, in many cases a particular course of medical treatment is not going to produce the results that were hoped for by the patient and the doctor. At that seminar a number of attorneys discussed the potential liabilities of both health care providers and employers if patients who do not recover as fully as they had hoped bring suit on the grounds that the treatment they received through an employee benefit program was adversely affected by the concerns of either the provider or the employer about the cost of their care.

Obviously, there are serious obstacles in the way of cutting back on these benefits. Therefore, let's look at the size of the obligations that employers are already facing. Dave Axene and Tom Nelson have both told you a few war stories. Let me add a couple of my own. The first is a situation in which we were asked to review a potential acquisition candidate. The prospective purchaser was already well sensitized to the issue of unfunded pension liabilities. Indeed, the notes to the target company's financial statements indicated that there was roughly $50 million of unfunded present value of vested benefits, and the purchaser was concerned about this. But we looked at the pension situation and concluded that:

- o the present value of vested pension benefits was being calculated on a conservative basis;

- o the pension assets had increased in value; and

- o on a termination basis, the assets not only would cover the vested benefits but probably the nonvested accrued benefits as well.

Further, we felt that the pension costs were being determined in a conservative manner, so that we were able to give considerable reassurance to the purchaser.

Then we turned to the subject of retiree medical and death benefits. There had been no analysis by the seller of the long range cost of these benefits, so we did some rough estimates based on the present benefit packages and the present premium rates with no provision for escalation. Using traditional pension costing techniques, we came up with these results:

- o the estimated annual expense on an accrual basis would be from two to two and one-half times the present retiree premiums, even though this was quite a mature group; and

- the estimated accrued liability for retirees and their spouses would be approximately $80 million (and remember that this makes no provision for escalation); for the active employees, the pro rata accrued liability would be in the neighborhood of $60 million.

So here we were talking about an "accrued" obligation for these benefits which was about three times the size of the unfunded pension liability which the purchaser had been concerned with in the first place.

The second example is an analysis performed for one of our clients who was interested in the impact of the FASB's proposals in relation to the company's retiree medical benefits program. We developed costs and accrued liabilities under a variety of assumptions and actuarial cost methods. We did this under each of the three alternative transition methods which the FASB had suggested in their Discussion Memorandum, so we got a whole array of possible answers. In each of these cases, we determined the amount the employer might have to record as a liability on his balance sheet as well as what the annual cost might be.

Under one "low cost" scenario the annual cost, at least in the first few years, would have been about comparable to the premiums which the employer was currently paying. However, under that scenario a liability would have been recorded on the employer's balance sheet which would have more than wiped out the corporation's entire net worth.

Under a different scenario the client would have recorded no liability initially but the annual cost would have ranged from 130% to over 1,000% of the present premiums, depending on the inflation assumptions used.

Still another approach, at the high end of the spectrum, would have required both the recording of a liability of more than 10 times the employer's net worth and an annual expense of more than 10 times the premiums currently being paid. Clearly, the degree of variation in these results is very large, but the numbers computed on any reasonable basis are too large to ignore.

In one sense, you might say that the FASB is in the business of preventing people from ignoring unpleasant facts such as these. The Board is responsible for issuing accounting standards which define what are "generally accepted accounting principles" in the private sector in the United States. The Board has no jurisdiction whatsoever over the funding of these benefits, whether we are talking about pension benefits or any other benefits, but the Board does define the accounting and reporting rules both for the plans and the plan sponsors. The Board's specific rules are adopted within a framework of general principles, two of which I might express as a nonaccountant this way:

- Costs should be matched with revenues. If employees perform services in a particular time period, all of the costs associated with providing those services (to the extent that those costs are measurable) should be charged in that period.

- The statement of condition, or the balance sheet as we normally call it, should reflect any obligations which have been incurred at the date of the statement.

Note that the costs and obligations we are talking about here need not be legally binding to be included in this process. Pension accounting under Accounting Principles Board Statement No. 8 (APB-8) has required the recognition of both vested and nonvested pension benefits; furthermore, it has required the recognition of benefits whose payment was not legally enforceable. Thus, even if employers were able to walk away from their postretirement life and medical benefits plans without obligation, that would not necessarily mean that the cost should not be recorded as if the program were going to continue.

The FASB is not deterred in setting standards by arguments about the way in which the standards will affect people's conduct. If you tell them that accounting for retiree benefits on a true accrual basis will cause employers to cut back these benefits or take them away from people, they will regard this as an overdue recognition by the employer that the level of benefits was too expensive in the first place and should never have been provided. They maintain that information is neutral and that proper financial statements must "tell it like it is."

Another organization which you should be aware of is called GASB, or the Government Accounting Standards Board. GASB has only come into existence this year. It is the United States' counterpart to FASB in establishing accounting standards for the public sector. Pension accounting is a high priority on the GASB agenda, but to the best of my knowledge they have not scheduled any activity with respect to other postretirement benefits.

I think it was H. L. Mencken who, a good many years ago, said that for any problem there is a simple and obvious solution and it is almost certainly wrong. It is amazing that he could have reached that conclusion without watching even one televised presidential debate.

The simple and obvious approach to accrual accounting for postretirement life and medical benefits would be to apply current pension funding techniques. However, as Tom Nelson has noted, there are a number of ways in which these benefits, at least the medical portion, are qualitatively different from pensions. And the measurement problems are obviously quite different from those in the pension area. Actuaries are uniquely qualified to identify these differences and to develop possible alternative techniques for both cost determination and the allocation of cost to different time periods.

Whatever techniques are adopted, accounting standards only govern <u>when</u> cost will show up in the financial statements. The ultimate cost will <u>not</u> be dictated by accounting standards, but by the terms of the plan and the demographics of the organization.

With this in mind, now that an employer's attention has been focused on this issue by the accounting proposals, he would be well advised to undertake a course of action which would include at least the following:

- Realistically examine the future cost of the program he now has in force. This would require particular attention to likely future increases in cost levels, including future shifting of the cost of medical care from governmental to private financing. It would require consistency between the inflation levels inherent in the projected benefit increases and the inflation level reflected in the rate being used to discount future benefit payments. And it would require recognition that the appropriate discount rate for benefits funded out of general corporate assets should be different from, and probably lower than, that appropriate for a Voluntary Employee Benefits Association (VEBA) or a qualified pension plan.

- Carefully review the plan documents, insurance contracts, and communication material used in connection with the plan, in an effort to make sure that no unintended promises are being made.

- Consider possible changes in plan design. Perhaps the most obvious of these changes would be to substitute various fixed dollar benefits for benefits which are now, in effect, open-ended because they are defined in terms of a package of services, whatever those services may cost.

- Consider alternative funding approaches. This could include use of the qualified pension plan or adoption of a VEBA. It could include a change in the degree of employee cost sharing. There might be some possibility, under present or future legislation, of utilizing the concepts of flexible benefits. And knowing the creativity of life insurance agents, I suspect that for some employers this would include consideration of the use of individual ordinary life insurance to provide the death benefits.

The problems we are talking about here are significant and they are difficult. The actuarial profession has an obligation and, if it will act promptly and creatively, an opportunity to play a major role in shaping the solutions.

MR. J. EDWARD NIXON: To round out the discussion of postretirement group benefits, I would like to add a few comments about the Canadian scene. It will be apparent that:

- the major accounting issues which exist in the United States are not factors in Canada,

- the value of postretirement group benefits is considerably less in Canada, and

- the degree of sophistication required for funding is not as critical in Canada.

I'll address design, taxation and underwriting or funding considerations for each benefit.

On the subject of design, life insurance, extended health care and dental benefits could be continued to retired employees in Canada. Generally, the level of benefits provided is quite modest, and certainly not all employers continue benefits to retired employees. In most cases, benefit coverage is fully paid for by the employer.

Life insurance could range from $3,000 to $10,000 -- or it could provide for a gradual reduction of the active life schedule to about $5,000 or $10,000 over the 5-year period following retirement. Coverage for senior executives could be somewhat higher. As more early retirement programs have used structured settlements over the past few years, life insurance coverage to these early retirees has been provided at higher levels than for normal retirees, at least during the early retirement period. Other death benefits such as AD&D and dependent group life typically are not extended to retirees.

Turning to extended health care benefits (EHC), there is a high degree of government-provided health care in Canada. Basic hospital, surgical and medical care benefits are covered under the government programs. Semi-private hospital, prescription drugs, some extra medical and professional services such as private duty nursing out-of-hospital, chiropractors, prosthetic fittings, out-of-country emergency coverage and vision care constitute the extended health care package underwritten by private insurers or Blue Cross. Individuals over age 65 receive drug benefits under the public plans so the privately-insured package for retirees is even smaller. Typical monthly premium rates for retirees would be in the range of $4.00 single and $8.00 family, possibly going as high as $6.00 and $12.00, respectively. Semi-private hospital, nursing and out-of-country coverage features are probably the most important elements for retirees.

It is not as common to extend dental coverage to retired employees. By comparison to extended health care, the dental cost is much more significant. The dental benefit schedule could be quite similar to that used in the United States. There is no public dental program in Canada for retirees. When dental coverage is continued upon retirement, usually it is the same plan as for active employees (although clearly orthodontia will have little application).

For structured early retirement programs, it is becoming more common to continue the EHC and dental benefits at least until age 65.

Finally, the insurers clearly prefer that all retired lives be covered if retiree benefits are provided.

Now, let's turn to <u>taxation</u>. All employer contributions to life, health and dental insurance programs are tax deductible for the company. In addition, insurance premiums or deposits to an Administrative Services Only (ASO) plan paid by an employer on behalf of the retired employee are not a taxable benefit to the employee (except for life coverage over $25,000). Similarly, benefit payments received by the retiree or his beneficiary are not taxable income.

For group life, the employer can pay an uninsured death benefit of up to $10,000 direct from his company without it being deemed taxable income to the beneficiary or the employee's estate.

For health and dental coverage, benefits traditionally are provided by an insured program or through a health and welfare trust. Benefit payments made direct to a retiree (or employee) by the company could be taxable income to the individual.

Finally, let's address the <u>underwriting</u> arrangements used for retiree benefits. Benefits generally are not specifically prefunded or terminally funded at age 65, except for the use of paid-up group life insurance; there is the potential for attracting unfavorable tax consequences to the company. This has been a grey area in the Income Tax Act.

Certainly the most common funding approach for life, health and dental benefits is to simply include the retirees as part of the active life funding, that is, to use a Yearly Renewable Term (YRT) approach -- insured in the case of life benefits and either insured or ASO in the case of health benefits.

However, many employers do purchase paid-up group life policies at age 65 for their retiree group life program. While such policies still have rather conservative interest rates (in most cases, in the 8%-9% range) some insurers do credit excess interest to a national fund consisting of the accumulated premiums less benefits paid and expenses incurred. Large purchasers can get current market interest returns on the premium rates.

Purchasing paid-up policies does have the virtue of allocating costs to the correct generation of employees. It also avoids the problem of the long slow buildup of retiree benefit expenses until the group matures.

For retiree health coverage, the cost of benefits is not large enough to worry about generally. Dental is a greater concern, but since paid-up policies are not viable given the inflation in these benefit costs there seems little alternative to the normal YRT approach.

There are some plans that (rather discreetly) have been building up unallocated deposit funds to fund retired life premium costs. Generally, these have been done by padding the normal active life group premiums so that a surplus fund callable by the employer develops. While there appears to be no specific income tax provision permitting an employer to prefund benefit costs in this manner, this practice has not been policed by Revenue Canada until recently. However, in the last few years Revenue Canada has attacked surplus funds, as well as claim fluctuation reserves (CFRs) and their interest earnings, under group insurance policies. Thus, they may be becoming more vigilant on the prefunding of retiree benefits.

The accounting issues raised in the United States have not surfaced in Canada. There is no booking of a liability upon the employee's retirement.

While the common approach is to use normal YRT group insurance funding, obviously the retiree group can have its own premium rate structure to meet the employer's needs. Most larger employers do segregate premiums and claims on retirees so they can monitor experience separately.

Since there is so little prefunding of retiree benefits it may be desirable in corporate acquisition and divestiture situations to take note of the off-balance sheet liability associated with the maintenance of these benefits to the existing group of retired lives. If the company involved has a large retired life group, this liability could be significant depending upon the schedule of benefits. A purchaser who was intending to dramatically reduce employee benefit expenditures probably would get a legal challenge if he cut off the retired lives. However, I know of no situations where the value of postretirement group benefits has been a factor in setting the sale/purchase price in an acquisition situation. Similarly, I know of no specific cases where employers have cut off retiree benefits and been challenged in the courts.

Employers and consultants generally have paid little attention to the language used to communicate the provision of benefits to retirees. Employers probably feel they have the same right to alter these benefits as they have for active employees.

In summary, Canada does not have the problems with retiree benefits that exist in the United States primarily because the most important benefit -- health care, is provided through public plans. Early retirement programs associated with the recession have tended to increase the focus on retiree group benefits however.

MR. AXENE: Before we open it up to questions, I want to mention a couple of other reasons there is increased interest in postretirement benefits, especially in the United States.

First of all, our life and health actuaries are considering a new topic called "valuation actuary." At the same time, we are looking at the idea of a "qualified actuary" for postretirement benefits, so there is some similarity. Again, the insurance company actuary's perspective is a little bit different than the consulting actuary's perspective. While all of us on the panel are consulting actuaries, I am sure there will be some input from insurance company actuaries later. Frank Keenan, who is leading tomorrow's follow-up workshop on this topic, works for an insurance company, so you'll probably hear more about that tomorrow.

Another issue that is quite interesting is what the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) did to Medicare eligibles that are still actively working. Perhaps not too far down the road Medicare might consider making Medicare secondary for retirees also. If you think the liabilities we have talked about are big, consider what they would be without Medicare offsets.

In the recent meeting I went to, I heard the phrase "the greying of America." We younger folks might not think it too much of a problem, but the significant number of people currently entering this retiree level makes our topic that much more important right now.

It's an election year in the United States. A candidate in my state of Washington wanted to have something innovative in his platform. He happened to work for a client of mine. So he asked me, "What's the present value of medical care for a person age 65? Couldn't we mandate insurance coverage for that?" In other words, he was trying to think of something new and he had no idea what the magnitude of it was. I mentioned that in a study we had done, one of the numbers was $20,000 while another was about $14,000. These were numbers at age 65, with Medicare offsets. Then he wanted to know, "What is the present value for a person under age 65?" My reply was that the number would increase because of a lesser reduction in costs from to Medicare at age 65. The magnitude of these numbers is quite significant.

Are there any questions from the floor?

MR. DONALD S. GRUBBS, JR.: As we are all very much aware, medical costs and dental costs have been escalating in recent years in the United States. The portion of those costs paid by Medicare has been declining, leaving an increasing proportion to be paid either by employers or employees or both. Jim, you mentioned that the actuary has expertise in projecting costs. If the actuary is to fully advise the client so that the client can make intelligent decisions on benefit design, doesn't the actuary need to measure the cost to be borne by employees and advise the employer about the extent of those potential costs -- with and without postretirement coverage and in light of potential changes in those coverages -- to make his client aware of those costs?

MR. BIGGS: Don, when you speak of the costs to be borne by the retirees or the employees, are you talking about their ultimate out-of-pocket costs under the escalating cost scenario that you described?

MR. GRUBBS: Yes.

MR. BIGGS: Employee benefit programs are designed to meet employee needs of various kinds. Those needs can be met, in our traditional three-legged stool concept, from governmental sources, employer sources and personal sources. So yes, I think it's appropriate for the employer to be considering, as part of his design process, what the government likely will be paying, what the employee likely can afford to pay and at least seek to cover that gap. In this area, obviously because of the enormous uncertainties, the answers are much less clear. I think one of the things that the conscientious actuary has to do in this area is present a range of results under a variety of scenarios, because clearly there is no one answer that he can give to the employer as "best estimate" of the long-range cost of a retiree medical program.

MR. NELSON: If I could just add something to that. In concert with the Bethlehem Steel case, I think employers should accentuate the responsibilities of each party involved. Employers will be looking, in every instance they can, to underscore the fact that there may be, either for present retirees or upcoming retirees, an additional liability on their part and it isn't going to be just an employer-pay-all situation.

MR. JOE P. STERNFELD: This is a sort of related question. You say, in all these scare stories you've been giving, how expensive all this is going to be. You talk about ranges of costs. All of this seems sensible. It seems to me the most difficult assumption is what's going to happen to Medicare and what proportion of the expenses are going to be borne by the government. The way the plans are written now, the less the government pays the more the employer has to pay for these retirement, life, and medical benefits. Could you give us some idea of the kinds of assumptions you have been using as to what is going to happen to Medicare, or have you just avoided the issue by assuming it is going to continue to pay the same proportion as it does now?

MR. BIGGS: Generally speaking, what we've attempted to do is to make some estimates of what the accounting and financial statement consequences would be if the FASB were to require that techniques similar to the present determination of pension cost must be used to determine the cost of postretirement life and medical benefits. Generally speaking, in the pension area, we typically assume that present legislation will stay in place. If there are escalators built into that legislation, we may recognize them, but we generally don't assume, in advance, that the law is going to be changed. So we have been following that same principle essentially in looking at the Medicare issues, assuming for now that the present Medicare legislation will continue, but at the same time advising the employer that this is one of the biggest variables in the picture.

MR. AXENE: I think that it is important that we don't discuss specific assumptions as being right or wrong because I think we are prohibited from discussing some of those items. But let me give you an illustration of the sensitivity of some of the assumptions that I have seen. A pension plan was assuming an 8% interest discount on pension benefits, with an 8% assumed annual salary increase into the future and a reasonable termination assumption. The key became the medical trend factor. Essentially the investment income and the salary increase from a pension plan perspective were balancing items, 8% in either direction. So what we were looking at was the impact of the sensitivity of the spread between the medical cost and those other two assumptions already in use on the pension plan. Putting in a zero percent spread, we came up with, I'll call it, 100; putting in a one percent spread, the value of the liability increased by about 50%; putting in a two percent spread, it went up 300% - 400%.

So it becomes very, very important what spread you use in your assumptions. If you value something with a zero percent spread and you come up with $100 million, but in fact health care inflation continues in excess of general economic levels, that number could be anywhere understated by two-thirds, one-half, three-quarters or whatever. It becomes very sensitive, depending on the actual assumption that you choose. So, as an actuary setting prospective assumptions down the road, how do you choose the right number? Based on what Jim Biggs and other people have mentioned, it is very important to give ranges. Not many of us are economists and not many of us know what is going to happen too far down the road. So the spread assumption is probably the most significant one that you might include.

As to the kinds of investment income rates people are able to use right now, I think the relationship of your medical inflation number to the assumption that you are using for inflation or discount is what's important. Prospectively, a commercial carrier right now may be using an inflation assumption and setting premium rates in excess of 10%. Current investment income rates are probably in excess of 10%, but where do long-term rates belong? Essentially, if you are using, say, a 7% or 8% interest (discount) assumption in your plan, it may not be appropriate to use a 12% trend assumption with the resulting five point spread because when considering the relationship of actual investment income to the discount rate, you aren't really using what you thought the best estimate of a current assumption was anyway. So the biggest mistake someone could make would be to use a conservative interest assumption and realistic inflation assumption because you'll just probably kill both the corporation and the president of that company.

MR. ROBERT J. MYERS: One of the panel members put forth the possibility that health benefits under employer-sponsored plans with respect to retirees might in the future be made primary, as against Medicare being secondary. Although this is now the case for active employees aged 65-69 and for spouses aged

65-69 of active employees under age 70, I believe that it is extremely unlikely that this will be done with respect to retirees. Such a change would be extremely undesirable and would alter the character of the Medicare program. It is just as unlikely, in my opinion, that private pensions will be offset against Old Age Survivors and Disability Insurance (OASDI) benefits for persons who are covered under both systems simultaneously.

Although a reduction in governmental health benefits will have adverse cost effects on retiree health benefits under employer-sponsored plans, it is conceivable that the reverse situation could occur. For example, if a nationalized health insurance program were to be adopted in the United States -- as was widely proposed in the early 1970's -- it could well be that any advance funding of postretirement health benefits will have been redundant. In the present economic and political climate, the adoption of such a program seems most unlikely. I certainly would not like to give the impression that I favor such action because, in fact, I do not. However, there is always a possibility of it occurring at some time in the distant future because there are strong believers in such an approach.

MR. BIGGS: That may depend on what happens November 6th.

MR. RALPH BRASKETT: To comment on what Jim Biggs and Tom Nelson said, we did a study for what we would call a medium-sized and very immature employer, with maybe half a dozen retirees collecting benefits. We did everything on the aggregate method because the client is familiar with that and because that's the way his pension plan is funded.

Working with the Bankers' Life, we found the spread was the most important thing. If you held the salary scale, medical care inflation rate and interest rate all equal, there was very little difference in the annual contribution (for lack of a better term) or the number you are going to put on your balance sheet to expense under the aggregate method. The minute you start fooling around with the spreads between those three numbers, you got some changes in the contributions as a percentage of covered payroll. So the spread, as Tom was saying, seems to be the important thing, at least under the aggregate method. The minute you shift to some other method, I have trouble understanding what past service liability for actives means in a postretirement medical situation because I don't know how to prorate the benefits over years of service. You obviously get different numbers, then the interest rate just becomes super. If you make the interest rate high enough you can smash any liability down, as we well know from working in pensions.

Now I want to ask some questions of Tom Nelson on DEFRA. You said "key employee situation." Is that where you take the pension liability, and you find out the plan's top-heavy because its over 60%? Is that what you are talking about? Or, are you talking about a key employee as defined in TEFRA, but regardless of whether or not the qualified plan is top-heavy? I got real lost at that point.

MR. NELSON: I'm confused about that myself. In my review of DEFRA, as opposed to TEFRA, my understanding was that key employees -- and I am not positive on the identification of the definition of those, but I understand it to be consistent with pension plans -- must have separate accounts and their medical benefits must stem from these accounts.

MR. BRASKETT: Okay, but here's my question. Do you have to do that only when your pension and profit sharing plans are top-heavy under the TEFRA definition? Or do you have to do it for all key employees regardless of whether the plan is top-heavy or not?

MR. NELSON: My understanding is the latter, although I don't know for sure. I have no legal opinion on it.

MR. BRASKETT: Yes. Well nobody does, and it was just passed in the revenues. They've got nine million TEFRA regulations to get out before they start even fooling around.

MR. NELSON: I'm telling you what I read last week in the law.

MR. BRASKETT: The other question I had for you is that most group plans right now are fairly discriminatory in what they will provide, especially in the medium-sized client life and health market. My understanding is that now, if you want to fund, health benefits cannot be discriminatory; life benefits can be discriminatory if they are related to preretirement pay and have a cap of $50,000. Am I correct?

MR. NELSON: Yes.

MR. BRASKETT: So there are really eligibility standards for the first time, if you are going to try to deduct what is funded?

MR. NELSON: I guess it translates to that, yes.

MR. BRUCE E. NICKERSON: A comment on that. Under the new law there are discrimination requirements if you are going to be providing postretirement benefits, whether or not funded. If the plan is discriminatory as defined in the law, either with regard to eligibility for benefits or with regard to amounts of benefits, there is a 100% excise tax on the employer with regard to benefits provided on retired employees. So, yes, discrimination is pretty well out. Either that or retired life benefits are out, whether or not funded.

Regarding the spreads, just a comment that it is easy to get into a little bit of a trap in dealing with the time frames. I would suggest that, for example, we think of the gross national product deflator as a measure of inflation and we take a look at a bit of the demographic shift that is projected. If we take a look at those two things and start with a macro assumption as to just how much, say 20 or 25 years from now, of the national gross product can be deemed to be used for providing health care on people in those age ranges, implicitly there would be a limit to how much of a spread is conceivable over the long run. If you use a spread that shows that 25 years from now 50% of our gross national product is going to be used for providing health care on people over age 65, then you know you've used a wrong assumption. Regardless of how you get to the result, that result simply cannot happen. That's a good discipline I would suggest for anybody looking at what the spread differentials might be.

MS. MICHELE M. DOMASH: I'm a pension consulting actuary. In listening to all this, I keep noticing that we are talking about health care costs and we're providing retirees health care. I was wondering if it is popular or possible to offer a supplemental medical premium program whereby the employer would pay "x" dollars per month towards a retiree's medical premium. Maybe that way you could link it to service and avoid the whole problem of inflation, medical costs and things of this sort. Is this a possibility?

MR. BIGGS: It's certainly a solution, and I think I may have suggested something along those lines. In the short run, when determining the cost of the program for accounting purposes, if you define your benefits in flat dollar terms you can forget about the escalator. That will obviously bring your estimated cost down dramatically. For purposes of determining the number that you would record in the employer's financial statement as a pension cost, I think yours is a very viable solution to the problem. On the other hand, I think the other type of calculation -- and we're doing this sort of thing more and more in the pension field and presumably ought to be doing it in the health field as well -- is the one that says to the employer: in the real world, as best we envision it, here are what the costs are likely to be because of the pressures that you will be experiencing to cause you to give benefit increases in the future. And so, in that type of management decision-making report, I think we get back into the same questions about potential inflation that we were discussing before, with the tremendously important difference that the employer does retain the option not to take these actions in the future if he can't afford them.

MS. DOMASH: In the pension area you see somebody going into a career average plan or defined contribution program in an effort to conserve costs. I was just wondering if they had done something of that sort in the medical area.

MR. BIGGS: The other practical problem, particularly in negotiated plan situations, is that the unions tend to push very hard to have the program for retirees be identical to the program for active employees. If you've had an active employee program which is defined in terms of a package of services and if retirees can vote, you have great pressures to provide the same program.

MR. GRUBBS: A comment and a question. To clarify, DEFRA added a section to the Internal Revenue Code. It dealt with two things: deductions and discrimination. Regarding discrimination, it added a section to the Code dealing only with 501(c)(9) trusts. These are plans funded through a trust, not through insurance. So it clearly prohibits discrimination where plans are funded under such a trust. It clearly does not apply to group insurance that is not experience-rated. However, some experience-rated plans are covered and some are not covered, and it's not entirely clear to me which ones are covered. Maybe a panelist will comment on that.

MR. NELSON: I haven't looked at the insured side of it. I have heard other actuaries ask the same questions. I don't know the answer and I don't know if anybody up here is that familiar with it. I think it's going to take just a little bit of time to figure out what some of the wording means.

MR. NICKERSON: In response to Don Grubbs's last comment, I've looked at this at great length and I find I cannot support that it "clearly does not apply to insured plans." I find that Section 419 of the new law applies to funded welfare benefit plans. A funded welfare benefit plan occurs in any situation where an employer is paying monies to a third party who is providing benefits to employees. A lawyer friend of mine who has had a great deal of dealings with those congressional committees agrees with me that an insurance company is a third party to whom monies are paid and who pays benefits to employees. So, I'm holding that question in abeyance until I see some regulations, and I'd like to suggest that perhaps some other people also be a little more cautious in that regard for the time being. I hope Don is right.

MR. GERALD RICHMOND: Reference was made to the fact that a variety of cost methods and actuarial assumptions are used in projecting costs. If there is a bibliography, could the panel be helpful by putting into the record any papers or articles that have been written on what cost methods and assumptions have been used and what results have been, and so forth? My second question is, have insurance companies been interested in making available paid-up life insurance or even paid-up medical policies for retirees and plan sponsors? If not, what methods do most plan sponsors commonly use in providing the health benefits and life insurance benefits to retirees in the United States?

MR. BIGGS: I'll take first crack at that. As far as bibliography is concerned, I suspect that most of the work that exists -- calculations, assumptions and so on -- is incorporated in reports that various firms have done for their clients. As a result, it's not really in the public domain. There was a pretty good short article on this subject in the October 1984 issue of Emphasis which is the newsletter of the Tillinghast organization. It related to what Dave was talking about before. The actuary who wrote the article estimated the actuarial present values of health care coverage considering future inflation rates. For an individual retiring at age 65, the estimate was $50,000; for an individual retiring at age 55, it was $80,000.

As far as paid-up coverage is concerned, it seems to me that some of the insurance companies, and the Aetna certainly was a leader, were promoting the idea of group paid-up and term a number of years ago. I don't know if they are still doing that. Of course, what they were promoting was the purchase of the paid-up insurance with the employee's own contributions. Under the Internal Revenue Code, if the employer buys paid-up insurance, I think the cost of that coverage is taxable income to the employee because the employer is buying permanent insurance rather than term insurance.

We recently encountered this problem in connection with an organization which is liquidating. They had been providing medical coverage and life coverage for their retired employees for some time. They wanted to continue this coverage for the remaining lives of those retired people. And yet, if they would buy paid-up life or paid-up medical insurance for these retirees, the entire single premium cost would be taxable to the retiree in the year in which the purchase is made. This is not exactly the result that we were looking for.

MR. CHARLES L. TROWBRIDGE: I am now retired, but I am very interested in this topic. It is bringing back a lot of past history to me. Most of the people in this room have not faced this problem of funding or prefunding retired life benefits. But some of us way back in the 1950's got into this through that Aetna client that you are talking about and through the companion development that went under the name of "group permanent," which was sponsored by Bankers' Life Company of Iowa and the Connecticut General and one or two others.

The whole concept in those days was that group term coverage was fine as long as you didn't expect to continue with coverage after retirement. But the idea was, just like in individual insurance, that if you wanted to wind up with paid-up insurance at retirement, you would have to do something like life paid-up at 65. And the development within the Bankers' Life Company and Connecticut General was group life insurance on a permanent basis, typically life at 65 or ordinary life, with the general idea that this was not for pension purposes but just for the purposes of winding up with paid-up insurance at retirement. It's exactly the same problem that you are talking about now except that this was thirty years ago.

The Aetna form of it, where the paid-up insurance came out of the employee's contributions, didn't have any tax problems. But the other form of it, group life paid-up at 65, died almost before it was born. The original designers of this product thought that, like other group insurance, it would be nontaxable to the employee. However, they soon found that group permanent insurance was taxable to the employee. So the thing died before it was ever born.

Nonetheless, the concept was there years and years ago and now we're almost coming back with the same thing. You're in effect saying, "fund it now" using some of the methods used for pensions. Group permanent would have done it a little differently because in effect you'd build up cash values which would be released when a person quit. Also, you didn't discount for termination and that kind of thing, but otherwise you're practically doing the same thing. If the law ever changed to permit prefunding through a group-permanent kind of arrangement, the whole thing might be revised sometime. The Aetna version of it never did have tax problems, but it produces a kind of peculiar amount of paid-up insurance that doesn't fit into a schedule that makes sense. It was originally developed for some big case, I think it was International Harvester, but I think it was dropped somewhere along the line.

MR. AXENE: I'm not a tax accountant; I think I'm an actuary. But one of the things that often happened with the retired life coverage that was quite famous a few years ago -- the Section 79-type coverage -- was the taxability or constructive receipt of monies that had been funded and then turned into something after you turned age sixty-five and retired. I am not quite sure if the law specifically addressed health benefits, but I know that it created some interesting problems on the change from a funding vehicle into a life insurance policy. So I would imagine some of those things would still apply.

S L I D E 1

NONPENSION POSTRETIREMENT BENEFITS

REASONS FOR STUDY

- o ANTICIPATED ACCOUNTING CHANGES
  - FASB
- o EMPLOYER INTEREST
  - SIZE OF LIABILITY & COSTS
  - BETTER CONTROL
- o AUDITOR REQUIREMENTS
- o TAX SAVINGS DUE TO PREFUNDING
- o RECENT COURT CASES

S L I D E 2

NONPENSION POSTRETIREMENT BENEFITS

TYPES OF ANALYSES

- PRESENT VALUE OF EXPECTED FUTURE BENEFITS
- EXPECTED FUTURE CASH FLOW
- POTENTIAL ACCRUAL/FUNDING LEVELS
- SENSITIVITY TO CERTAIN ASSUMPTIONS

SLIDE 3

NONPENSION POSTRETIREMENT BENEFITS

NOTEWORTHY ASSUMPTIONS

- PLAN DESIGN
  - BENEFIT CHANGES
- CLAIMS & ENROLLMENT
  - TRENDS (INFLATION, UTILIZATION, ETC.)
  - AGE/SEX/GEOGRAPHY
  - MATURITY OF ACTIVE/RETIREE RATIO
- DISCOUNT RATE
- VOLUNTARY/INVOLUNTARY NATURE
  - CONTRIBUTIONS
- COVERAGE
  - DEPENDENT
  - DISABLED
  - EARLY RETIREE
  - FULL/PART-TIME
- GOVERNMENTAL TRENDS

SLIDE 4

NONPENSION POSTRETIREMENT BENEFITS

DEFRA HEALTH/WELFARE ISSUES

- DEFINITION OF "QUALIFIED ACTUARY"

- REGULATIONS ON ACTUARIAL ASSUMPTIONS

- RULES ON RETIREE FUNDING

- STUDY OF STANDARDS

    - PARTICIPATION, VESTING, FUNDING