



BENEFIT *Advisor*

In This Issue

In this sixth issue of the McGrawWentworth Benefit Advisor for 2004, we will examine the recent EEOC decision regarding retiree health care coverage. The EEOC has proposed a rule formalizing their position that offering different benefits to employees, pre-Medicare and post-Medicare, does not violate the provisions of the ADEA. Many employers offer retirees these disparate benefits. If finalized, the EEOC ruling will amend the ADEA to codify the federal position on offering different benefit levels to retirees.

We welcome your comments and suggestions regarding this issue of our technical bulletin. For more information on this Benefit Advisor, please contact your Account Manager or visit the McGrawWentworth web site at www.mcgrawwentworth.com.

“EEOC Ruling: Retiree Health Care”

The recent EEOC ruling on how retiree health benefits interact with the Age Discrimination in Employment Act (ADEA) may leave more than a few benefit professionals confused. The EEOC confirmed an employer can vary benefits depending on whether or not retirees are eligible for Medicare. In fact, the rule states this benefit design would not violate the ADEA. However, this ruling contradicts the findings of the Erie County case, a pivotal case in retiree benefits.



Many benefit plans, unaware of the risks involved, have taken this approach for years. This Advisor reviews:

- The historical approach employers have taken to retiree benefits.
- The Erie County case’s effect on retiree plans and the EEOC’s position on offering different benefits for different age groups.
- A discussion on how this rule affects employers who sponsor retiree health plans.

While this decision may seem logical and a sleeper for many organizations, it has created an explosive political situation. The AARP is considering legal action to challenge the EEOC’s authority to make exceptions to the ADEA.

Historical Approach to Retiree Health Care

Retiree health benefits were commonplace just twenty years ago. According to the General Accounting Office of the United States, 80% of employers offered retiree health benefits in the 1980s. Today, those numbers are significantly reduced. The General Accounting office reports:

- 33% of large employers offer retiree health plans
- 10% of small employers offer retiree health plans

Retiree health care benefits have placed a substantial burden on employers. Retiree benefits costs alone have forced many employers to discontinue the benefits. Benefit costs have increased because health care costs have increased. The number of retirees covered has also increased. Other factors have contributed to a decline in retiree health coverage, including the impact of FAS 106 accounting standards.

FAS 106 requires companies to recognize the cost of post-retirement health and life insurance benefits over a period of 20 years (or over a period rep-

resenting the future service of the participants).

The federal government does not require employers to provide retiree health care benefits. Organizations frequently set up retiree plan designs to offer comprehensive coverage for retirees under age 65, pre-Medicare coverage. Once a participant turned 65 and became eligible for Medicare benefits, coverage under the retiree plan typically decreased because Medicare picked up most of the expense. Employers adopting this plan design were complying with the Older Worker Benefits Protection Act of 1990. Under this act, employers could reduce or even eliminate benefits when the retiree became eligible for Medicare without violating the ADEA.

In 2000, the Third Circuit United States Court of Appeals issued a decision contradicting this practice. The Third Circuit includes Delaware, New Jersey, Pennsylvania and the Virgin Islands.

Erie County Retiree Association v. County of Erie

The Erie County retirees sued the county of Erie alleging their retiree plan design violated the ADEA. Their plan offered retirees under age 65 the choice of a POS plan or an indemnity plan, but it offered retirees over age 65 only a Medicare HMO plan.

The court ruled Medicare eligibility was age-related. Thus, the Erie County plan violated the ADEA, unless the plan could meet the equal benefit and equal cost safe harbor set forth in the ADEA. The ADEA equal benefit/equal cost safe harbor allows differences in compensation, conditions or employment privileges for older workers if a plan passes certain tests. To satisfy the benefits test, a plan may not provide lesser benefits to older participants than to younger

participants. To satisfy the cost test, employers may not require participants to pay a higher percentage of the cost.

The court found the Erie County plan failed the equal cost test because re-

tirees over age 65 had to pay Medicare Part B premiums. On paper, the Erie County decision was a victory for the retirees. However, the result was that Erie

County lowered its benefits and increased the cost for its pre-65 retirees to avoid violating the ADEA.

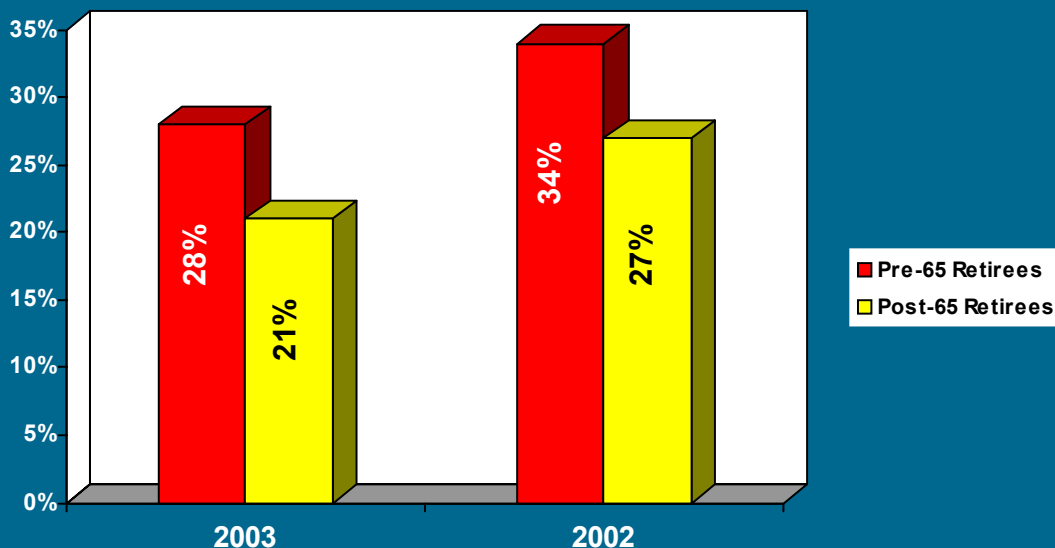


Impact on Retiree Health Care Plans

The EEOC compliance manual, released in November 2000, said employers could not reduce or eliminate benefits when a retiree became

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Percentage of Employers Offering Retiree Health Care



Source: Mercer National Survey of Employer-Sponsored Health Plans

eligible for Medicare. The manual specifically referred to the Erie County decision. In particular, employers had to provide retiree health benefits that:

- Offer the same level of benefit to both pre- and post-Medicare retirees.
- Cost the same for both pre- and post-Medicare retirees.

Employers, labor unions and benefit professionals contacted the EEOC en

masse to question the wisdom of adopting the Erie County decision. These professionals were concerned this approach would accelerate the demise of retiree

health plans. The argument was many employers would simply eliminate retiree benefits or reduce pre-65 benefits significantly to comply with the EEOC mandates.

Because of these concerns, the EEOC has not taken action against retiree plans that reduce benefits once participants are Medicare eligible. However, in July 2003 the EEOC did request comments on a Notice of Proposed Rule Making (NPRM) it issued to address retiree health coverage

EEOC Final Rule

After considering the comments on the proposed rule, the EEOC issued a final rule. This rule allows:

- Employers and labor organizations to offer a wide range of plan designs that incorporate Medicare benefits or a state medical program without violating the ADEA.

- Employers to provide more comprehensive coverage to retirees under age 65 without violating the ADEA.
- Employers to provide supplemental coverage for Medicare-eligible retirees without having to prove the coverage is identical to pre-Medicare retirees.
- Employers to take advantage of the tax-free subsidy for offering certain prescription benefits under the Medicare



Prescription Drug Improvement and Modernization Act that will affect some plans on January 1, 2006.

The rule is reasonable considering the costs and complex issues employers face when they offer this benefit. The EEOC is trying to make it possible for employers to maintain their retiree plans.

The Battle Isn't Over

However, the EEOC does not have final authority to implement this rule. The Office of Management and Budget (OMB) and several other regulatory agencies will review and comment on it. Once this process is complete and the final text of the rule is agreed upon, it will be published in the Federal Register.

The AARP vehemently opposes this rule. Michael Naylor, the AARP's Director for Advocacy, argues the EEOC cannot make exceptions to the ADEA. The AARP intends to take legal action to ensure the EEOC does not adopt the rule.

The AARP may pursue legal action, but it is well within the authority of the EEOC to amend the ADEA. The ADEA allows the EEOC to make exceptions to the act when it is in the public's interest.

Conclusion

If the EEOC rule is adopted, it will make formal a position retiree health plans have been taking for a long time. While the Erie County decision affected the EEOC guidelines, the EEOC did not strictly enforce the provisions because of the strong reaction of employers, labor unions and benefit professionals. Thus, this ruling may not significantly change retiree benefits.

Retiree plans in the Third Circuit need to be cognizant of a discrepancy between Federal law and case law regarding retiree benefits.

The AARP is aggressively challenging the EEOC on this issue. The exemptions outlined in the rule, in its opinion, clearly discriminate against older people. The AARP is a powerful lobby in Washington. It will be interesting to see whether the strong voice of the AARP overrides the practical nature of this rule.

If you have any questions regarding retiree health plans or this EEOC rule, please contact your Account Director. **MW**

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McGraw Wentworth
3250 West Big Beaver Road, Suite 500
Troy, MI 48084
Telephone: 248-822-8000 Fax: 248-822-4131
www.mcgrawwentworth.com