



buck

**Independent Actuarial Review of
The Retirement System for Employees
of the City of Cincinnati
Prepared for
*The City of Cincinnati Task Force***

June 3, 2008

EXECUTIVE SUMMARY

The Cincinnati of Cincinnati Task force has asked Buck Consultants to perform an independent actuarial review of the recent actuarial calculations provided to the Retirement System for Employees of the City of Cincinnati. Below are the highlights of our review:

1. We find that the results as of December 31, 2006 are within our expectations. Our estimated Present Value of Benefits and Accrued Liability was 6.85% and 1.50% higher than Mercer's reported result, respectively. Actuarial Standards of Practice generally require two different actuaries to generate results within 5% of each other in order to call it a "match". However, given that we did not have the actual data and had to make estimates, being slightly outside this 5% range is not cause for concern. **Note that in matching we valued the total liability including the credit due to the Medicare Part D Subsidy (which is not allowed to be recognized under GASB).**
2. We estimated an expected reduction of \$62.8 million as of December 31, 2007 from switching current actives to an "80/20" PPO. This was very close to Mercer's estimate of \$64.5 million.
3. Our review of the actuarial assumptions that Mercer utilized in the valuation is summarized as follows:
 - An 8% discount rate is within standards of practice for public plans
 - The amortization period (currently 15 years) for funding the shortfall could reasonably be extended to 30 years for benefits other than the Early Retirement Window, which should be amortized over a shorter period
 - Retirement rates are currently age based (maybe move to age & service based)
 - The Group 1 female spouse participation rate of 25% may be low
4. Keeping benefits at the current levels and contributing \$40,000,000 per year results in a stable funded status over the short term, but eventually the funded status declines because the contribution is not adjusted for inflation. A policy of contributing the normal cost plus a 30-year open amortization of the shortfall is projected to maintain a funded status of about 92%.
5. The current plan design of the post-retirement medical plan is richer than the average employer, according to the 2007/2008 Survey Report on Employee Benefits from Watson Wyatt Data Services. The survey also shows that current retiree contributions (Group 1) are much lower than other employers, with the new structure for Group 2 retirees being slightly higher as a percentage of total cost than the other employers in the survey (57% versus 45%-47%).
6. Several potential plan design alternatives/programs for the post-retirement medical plan are summarized in Section 8.

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SECTION 1: ESTIMATED LIABILITY FOR POST-RETIREMENT HEALTHCARE

We have performed an estimate on the valuation liability for the post-retirement healthcare (medical, dental, and vision) plan and come up with an estimate based on the data summary, plan provisions, and actuarial assumptions described in the “Retirement System for Employees of The City of Cincinnati Actuarial Valuation Report as of December 31, 2006” prepared by Mercer. Please keep in mind that this was only an estimate and not a range determined by a detailed valuation process.

We have estimated the Present Value of Benefits (which is the complete and total expected liability of the plan for all participants who are currently retired or actively working including prior and future service) as of December 31, 2006 to be **\$1,066,000,000**. The Present Value of Benefits as calculated by Mercer as of December 31, 2006 is **\$997,643,922**. Our estimate is 6.85% higher than the Mercer reported result, which is a reasonable difference given that we did not have exact data and had to make several estimates.

Range for Actuarial Accrued Liability (the portion of the Present Value of Benefits that is allocated for service-to-date) as of December 31, 2006 is **\$918,000,000**. The Actuarial Accrued Liability as calculated by Mercer as of December 31, 2006 is **\$904,423,237**. Our estimate is 1.50% higher than the Mercer reported result.

The following were the assumptions that we made in our estimate:

- We valued the total liability including the credit due to the Medicare Part D Subsidy (which is not allowed to be recognized under GASB).
- We did not have actual census data for full-time employees, so we assigned an age and service based upon the data summary in the Mercer Report as of December 31, 2006.
- We did not have actual census data or a data summary for part-time employees, so we estimated their demographics.
- Based on information supplied by the City, we assumed that 58% of all active employees are male and 59% of all retirees are male.
- We did not have the complete 2006 City of Cincinnati Rate of Termination Experience Table (only rates for ages 25, 30, 40, 50 and 60 were shown in the Mercer Report). Interpolation was used to estimate rates for the other ages.
- We did not have the complete 2006 City of Cincinnati Disability Experience Table (only rates for ages 25, 30, 40, 50 and 60 were shown in the Mercer Report). Interpolation was used to estimate rates for the other ages.

SECTION 2: ESTIMATED IMPACT TO LIABILITY FOR POST-RETIREMENT HEALTHCARE UNDER THREE SCENARIOS

Prior to January 1, 2008 the City of Cincinnati has a post-retirement medical plan in place in which the City pays for approximately 96% of all out-of-pocket expenses (services) with the participants paying the other 4% in the form of deductible, copays, or coinsurance. These percentages do not take into account the contributions (i.e. \$64.20 or \$62.40 for the HMO). On January 1, 2008 the City is changed the plan design for future retirees to be the same as the active medical plan (which is an “80/20” PPO plan) with some minor tweaks to the retiree contributions. Per the City’s request, we have estimated the savings as of December 31, 2007 for the post-retirement healthcare plan under the following three scenarios:

- 1) Current plan of benefits (96/4) for current retirees and 80/20 for actives
- 2) 80/20 for current retirees and actives

As in Section 1, note that these are estimates and not values determined by a detailed valuation process. We performed relative value analysis on the retiree Indemnity, PPO, HMO and active 80/20 PPO to determine the difference in cost and assumed that the retiree contributions for Group 1 retirees in the 80/20 PPO to be equal to the actives, and the “point system” for Group 2 (with a floor contributions equal to the actives).

Below is a summary of the savings to the Accrued Liability (AL) as of December 31, 2007:

	<u>Buck</u>	<u>Mercer</u>	<u>Difference</u>
1) Grandfather Current Retirees, New Retirees 80/20	\$62,800,000	\$64,500,000	\$1,700,000
2) All Retirees Move to 80/20 Plan	\$151,300,000	N/A*	N/A*

**Mercer did not provide an estimate as of December 31, 2007 for this plan change. Mercer did provide and estimate for this change as of December 31, 2006, however, they also provided a valued for the change due to 1) of \$90,000,000, which is much different than \$64,500,000 (we therefore concluded that the plan change being valued was significantly different from the December 31, 2006 and December 31, 2007 Report).*

SECTION 3: RANGE OF CONTRIBUTIONS TO THE PLAN FOR 2008 AND 2009

The City's funding policy uses the valuation contribution results to set the contribution rate for the second succeeding year. The contribution for 2008 is based on the December 31, 2006 valuation; the contribution for 2009 is based on the December 31, 2007 valuation. A summary of the contributions is as follows:

	2009		2008	
	Dollar	% of Pay	Dollar	% of Pay
Normal Cost	\$32,569,388	21.91%	\$34,208,326	21.52%
Employee Contributions	\$10,848,052	7.30%	\$11,596,852	7.30%
City Normal Cost	\$21,721,336	14.61%	\$22,611,474	14.22%
Amortization Payment	\$29,301,420	21.29%	\$38,922,823	24.49%
City Contribution	\$53,376,572	35.90%	\$61,534,297	38.71%

The Normal Cost represents the annual cost of the plan. For CRS, the normal cost is calculated to remain level as a percent of pay as long as the assumptions, plan provisions and group characteristics remain the same. The employees contribute a fixed percent of pay to the plan in the form of member contributions. The City is responsible for the remainder of the plan liabilities. Currently, over half of the City contribution is an amortization payment for unfunded actuarial accrued liabilities. The City's funding policy is to amortize unfunded actuarial accrued liability generated each year as a level dollar over a closed 15-year period. Liabilities generated by the early retirement window are to be amortized over 15 years using an increasing schedule of payments that levels off in year 5. Note that if the plan had enough assets to cover the liabilities of the plan, the City Contribution would be comprised of its portion of the normal cost.

In the public sector, much latitude exists when financing the unfunded actuarial accrued liabilities of the system. There are no minimum or maximum funding requirements similar to those that exist in the corporate world. The Governmental Accounting Standards Board, or GASB, establishes a maximum period before a Net Pension Obligation is on the books of the employer. That maximum period is generally a 30-year amortization determined as a level percent of pay. If the amortization period is extended to a 30-year level percent of pay amortization period, a summary of the 2008 and 2009 contributions would be:

	2009		2008	
	Dollar	% of Pay	Dollar	% of Pay
Normal Cost	\$32,569,388	21.91%	\$34,208,326	21.52%
Employee Contributions	\$10,848,052	7.30%	\$11,596,852	7.30%
City Normal Cost	\$21,721,336	14.61%	\$22,611,474	14.22%
Amortization Payment	\$17,120,223	11.51%	\$19,290,382	12.14%
City Contribution	\$38,841,559	26.12%	\$41,901,856	26.36%

SECTION 4: RANGE OF CHANGE IN ASSETS/LIABILITIES

Liabilities

The task force asked for a reasonable range for the change in assets and liabilities due to the change in investment return assumption from 8.75% gross of fees (8.40% net) to 8.00% net of fees, effective December 31, 2006. Mercer provided us with the retirement plan and post-retirement healthcare projected cash flows, and we have assumed that these are correct and used these as the basis for the liability calculations below. When we discounted the Mercer cash flows at 8.00%, we calculated a present value of benefits (not accrued liability) of \$997,643,917. This is \$5 lower than the \$997,643,922 as stated in the report (which is the sum of \$584,317,911 for inactives and \$413,326,011 for actives from page 6 of the report).

The calculation of discounting items back to the valuation date is a simple exercise such that there should not be any variance between two actuarial firms since we matched the current present value of benefits. We have calculated a projected increase to the present value of benefits of \$49,881,603 (or 5.26%) as a result of decreasing the discount rate from 8.75% gross of fees to 8.00% net of fees. Since we were not provided the cash flows for the accumulated liabilities, we will provide a range for the impact on the accumulated liabilities due the discount rate change. **This range is \$44.7 million to \$45.7 million for the accumulated liability for post-retirement medical.**

The discounted Mercer pension cash flows at 8.00% that we calculated at \$1,971,525,208 was close (within 0.15%) to the accrued liability (not the present value of benefits) of \$1,968,675,503 (which is the sum of \$1,349,628,548 for inactives and \$619,046,955 for actives from page 7 of the report). **We have calculated a projected increase to the accumulated liability of the pension plan of \$88,482,874 (or 4.70%)** as a result of decreasing the discount rate from 8.75% gross of fees to 8.00% net of fees.

Assets

Unlike the corporate accounting world where the discount rate and the rate of return assumptions are determined independently and are almost always different, the investment return assumption in the public sector is used to discount benefit cash flows to determine the liabilities of the retirement system. The change in investment return above is captured in the liabilities above; there is no immediate change to the asset values used in the valuation. However, when determining future contributions of the system, lower returns on the system assets are assumed, resulting in higher contribution requirements. An additional impact on the assets involves the development of the actuarial, or smoothed value, of assets used to determine contribution requirements under the plan. Under the actuarial value, the assumed investment return is reflected immediately each year. The difference between the assumed return and the actuarial return is reflected over a 5-year period. The reduction in the investment return has the affect of more conservatively reflecting the asset return over the course of time.

SECTION 5: REVIEW OF RETIREMENT SYSTEM ASSUMPTIONS AND METHODS

We have reviewed the assumptions and methods used in the “Retirement System for Employees of The City of Cincinnati Actuarial Valuation Report as of December 31, 2006” as prepared by Mercer Human Resource Consulting. We have also reviewed the “Demographic Experience Analysis” presentation dated November 2, 2006, also prepared by Mercer. We have not attempted to replicate the results of the experience review presentation. Below we address the overall appropriateness of each assumption and method based on the information available:

Assumptions

Actuarial assumptions are used to estimate the amount of benefits to be paid in the future. There are two broad types of assumptions: economic, or money assumptions, and demographic, or people assumptions. Economic assumptions include expectations for investment returns, medical and wage inflation, and salary increases. Demographic assumptions include when and if people are expected to terminate, become disabled, retire or die. Our review of the assumptions is as follows:

Investment Return: In the public sector, the investment return assumption for pensions is used not only to project assets of the retirement system, but also to discount the benefit cash flows of the system to determine the liabilities. The assumption is typically based on the long-term expectation of the asset return based on the system’s asset allocation. The asset class allocation targets from the December 2007 Investment Policy is as follows:

Asset Class	Target %
Domestic Equity	43.5%
International Equity	17.0%
Fixed Income	17.0%
Alternative Assets	22.5%
Total	100.0%

The above allocation does support the use of an 8.00% net investment return currently used by the retirement system. This return is within the range of investment returns commonly used in the public sector, which is currently 7.75% to 8.50%. This range has narrowed considerably from the broad 7.00% to 9.00% observed within the past 10 years. In addition to the advice of the actuary, the advice of the system’s investment consultant should also be sought out to assist in the determination of the appropriateness of the 8.00% return over the long term.

Governmental Accounting Standards Board (GASB) statement 43 and 45 dictate the considerations to use when determining the investment return assumption for post-retirement health care benefits. If these benefits are not actuarially funded, the return

SECTION 5: REVIEW OF RETIREMENT SYSTEM ASSUMPTIONS AND METHODS (CONTINUED)

assumption used is based on the returns generated on internal funds, which is currently around 4.00%. If the benefits are actuarially funded, as is the case for the Retirement System, the investment return is determined in the same fashion as pensions. Assuming the post retirement health care benefits will be fully funded on an actuarial basis, the 8.00% assumption is appropriate.

Mortality: The mortality assumption is generally based on standard industry tables adjusted to account for observed deviations in experience. In addition, the assumption is usually set with a level of conservatism to account for future increases in life expectancy. The current table, the UP 1994 mortality table projected to 2009, provides for future improvements in mortality and is appropriate. In the future, consideration should be given to generational mortality tables, which automatically update life expectancies. While currently not an industry standard, this likely will become the standard within the next decade.

The mortality assumption currently used for post-retirement is also used for pre-retirement purposes. Generally members do not die directly from the active population, but terminate or become disabled before dying. To account for this, it is common to use 50% to 75% of the post retirement mortality as a pre-retirement mortality assumption. The impact of such a change is generally minor, but should be given consideration.

Turnover: Turnover is generally set using a select and ultimate pattern, which means that termination is high in the first few years of a career and then levels off and become based on age instead of service. The current assumption is based on this type of pattern. The sample rates of the 2006 City of Cincinnati Rate of Termination Experience Table provided by Mercer in the report are consistent with our expectations for a governmental agency and are appropriate.

Disability: The sample rates of the 2006 City of Cincinnati Disability Experience Table provided by Mercer in the report are lower than our expectations for a governmental employer (which means we would expect to see a higher rate of disability). Disabilities generally occur at a rate of 4 disabilities per year per 1,000 lives – and given the physical nature of many of the City’s jobs, we would expect this rate to be higher for the City of Cincinnati. However, adjusting this table would have only a minor impact on the post-retirement medical plan liability. All that being said, disability is very dependent on how the claims are administered by the Retirement System. Recent experience in the experience review indicates that the reduction in the disability assumption is warranted, and the assumption seems appropriate given the current level of disabilities.

SECTION 5: REVIEW OF RETIREMENT SYSTEM ASSUMPTIONS AND METHODS (CONTINUED)

Salary: The salary assumption is typically disclosed as three components: base inflation, productivity and merit and longevity. The base inflation and merit and longevity components combine to make the base wage inflation. These components are not identified separately. The current assumption used is based on service, with rates starting at 7.50% in the first year of service and declining to 4.00% for service from 30 years of service and above. Based on the demographic assumption presentation, this presentation appears to be appropriate. The rates indicate that the base wage inflation is 4.00%. From this a base inflation component of 2.5% to 3.5% with a corresponding productivity component of 1.5% to 0.5% can be inferred. All of these amounts are reasonable assumptions. The merit component starts at 3.5% at hire and declines to 0.0% after 30 years. This is a typical pattern that we see in the public sector, and again, is reasonable.

Retirement: As noted in the experience review presentation, the retirement patterns are largely based on the past experience of the plan, which is appropriate. The rates are based on age, which can be appropriate for age based service, such as age 60 and 5 years of service, but may not be appropriate for service based retirement such as 30 and out. It is not clear whether a retirement assumption based on service was considered. The general levels of retirement shown are consistent with what we have seen in the public sector systems. The large increase in the number of reduced early retirements should be explored to make sure that other one time influences, such as early retirement incentives, did not contribute to the increase.

Medical Claim Costs: The Pre-Medicare eligible costs of \$12,958 for Group 1 and \$13,033 for Group 2 as well as the Medicare eligible costs of \$4,888 for Group 1 and \$4,639 for Group 2 are the highest we have ever observed on any post-retirement medical valuation. However, we feel that given the richness of the benefits offered, these claim costs are in line with expectations – although please keep in mind that we did not have the opportunity to review actual claims data.

Medical Trend Rates: The initial (first year) trend of 8.5% for Pre-Medicare is somewhat lower than what we would like to see. Currently, 10% is generally the lowest we employ for Pre-Medicare. Medicare eligible (first year) trend of 9.0% is reasonable, we would not (in the current environment) select a lower first year rate however. We are aware of the many published medical trend surveys which report medical costs increasing at rates of 6% to 8% - but please keep in mind that most of these surveys do not adjust for plan design and/or contribution differences (so plans that become less rich due to benefit

SECTION 5: REVIEW OF RETIREMENT SYSTEM ASSUMPTIONS AND METHODS (CONTINUED)

cutbacks artificially deflate the survey's results). The ultimate trend rate of 5.0% is reasonable, we have seen 4.5% utilized but would not typically go any lower than 4.75% in the current environment.

Medical & Rx Aging: The aging rates shown on page 27 of the report are in line with our expectations.

Participation: The 100% assumption for Group 1 is exactly what we would expect. We also agree with the methodology of selecting participation rates by retiree contribution percentage for Group 2. However, we might expect a higher percentage than 80% to elect coverage at the 25% cost share. Also, given the high claims cost, the participation rates may be lower than 50% for both the 50% and 75% cost share groups. We really do not have a strong argument against the table on page 27 of the report but as Mercer mentions, it may be that actual experience results in significant revisions to this table as it becomes available.

Medicare Reform Impact: The Medicare Part D Annual Subsidy amounts of \$570 for Group 1 current retirees and \$560 for all other retirees are outside the range we typically see, but we believe these are reasonable based on the prescription drug plan design and claim costs for the City. All of the assumed subsidy amounts are over 24% higher than what was assumed for the 12/31/05 valuation (while at the same time claim costs increased only 12% on average). The 2006 subsidy reconciliation should have been completed or will be soon – those results should be compared on a per participant basis to the assumed costs.

Other Health Benefits (Medicare Part B): The assumed increases for Medicare Part B are in line with our expectations.

Other Health Benefits (Dental): The assumed claim costs and annual trend increases are in line with our expectations.

Other Health Benefits (Vision): The assumed claim costs are in line with our expectations. However, the 3% trend rate will eventually lead to a claims cost that is higher than the maximum benefit. Note though that any change to the vision trend rate would have a de minimus impact on the valuation liability.

SECTION 5: REVIEW OF RETIREMENT SYSTEM ASSUMPTIONS AND METHODS (CONTINUED)

Option Electives: 75% of male participants and 25% of female participants having a spouse who is covered under medical, dental, and vision seems to be appropriate to us for the Group 2 employees. However, we feel that a higher percentage of Group 1 female participants would have a spouse that would also elect medical since the plan of benefits is very rich and the contributions would be \$0 in most cases.

Actuarial Methods

While actuarial assumptions are used to estimate the value of benefits to be paid in the future, actuarial methods are used to determine how the benefits are to be funded. Our review of the actuarial methods follows.

Actuarial Cost Method: The purpose of the actuarial cost method is to allocate the costs of the benefits of the system over time. The actuarial cost method of the retirement system is the entry age normal cost method. Under the entry age normal cost method, the retirement benefit costs of an active member are funded as a level percent of the members payroll over the member's career. The level percent of pay feature results in a more level contribution pattern than other methods. It also results in current taxpayers paying for the services of the member while the member is still working. The entry age normal cost method is used by three-quarters of all public retirement systems in the United States. We believe that its use is appropriate.

Asset Valuation Method: For purposes of determining the contribution requirements, an actuarial, or smoothed value, of asset is commonly used in the actuarial valuation of public retirement systems. For the Retirement System, the asset valuation method used reflects the assumed rate of return immediate and phases in the difference between the actual return and the expected return over 5 years. The effect of this method is that the contributions are more level than they would have been without the asset valuation method in place. We believe that the method is appropriate.

Amortization Method: The unfunded actuarial accrued liability of a public retirement system is generally amortized, or paid off, over several years. The retirement system policy was established for the December 31, 2003 valuation. At that point, the unfunded actuarial accrued liability of the system was amortized as a level dollar amount over a closed 15-year period. Unexpected changes in unfunded actuarial accrued liability that have occurred with each subsequent valuation have also been amortized in a similar fashion. Unlike the world of corporate pensions where the amortization method is prescribed, there is a fair amount of latitude in the public sector. The selection of the amortization method tends to be a trade off between affordability and benefit security.

SECTION 5: REVIEW OF RETIREMENT SYSTEM ASSUMPTIONS AND METHODS (CONTINUED)

The primary decisions when selecting an amortization method are:

- The amortization period is the number of years over which the unfunded liability is amortized. It is analogous to the term of a mortgage. The Governmental Accounting Standards Board (GASB) statements 25 and 27 for pension and 43 and 45 place a limit of 30 years on the amortization period. If the period used is longer than 30 years, a net pension obligation is put on the books of the sponsor. When contributions increase rapidly, there is a tendency among public sector retirement systems to extend the amortization to 30 years to lower contributions. Unfortunately, there is not a tendency to lower the amortization to keep contributions from decreasing when contributions are otherwise determined to be lower. Some retirement systems chose to implement a policy where the contribution rate is fixed from year to year and solve for the amortization period. As long as the resulting amortization period is under 30 years (or some other policy amount), the contribution amount can remain at the predetermined level. If the amortization period exceeds the policy amortization period, the contribution is increased until the underlying amortization period is less than the policy.
- Amortization periods are determined to be either *closed or open*. A closed method works similar to a traditional mortgage. For CRS, the amortization method is a 15-year closed method, which means that after 15 years of making payments towards a portion of the unfunded liability, that unfunded liability is paid off. Under an open method, the unfunded liability is amortized over the same period year after year. Theoretically, the unfunded liability is never paid off. Many retirement systems use open periods for the total unfunded liability of the system, as opposed to the closed method with many bases used under CRS.
- The amortization method can either be *level dollar or level percent of pay*. The level dollar method is similar to a traditional mortgage. The payments are determined in such a way that the *dollar* amounts do not change from year to year. The CRS amortization amounts are determined as a level dollar. A more common approach in the public sector is to determine amortization amounts as a level percent of pay. Under level percent of pay amortization, the amortization payment is determined in such a way that the rate stays level as a percent of pay. The dollar amounts increase with payroll. This treatment is common in the public sector because of the prevalence of the entry age normal cost method. To fund on a level percent of pay basis, both the level percent of pay entry age normal cost method must be used and the amortization method must be determined as a level percent of pay. The current method of using level dollar amortization and level percent of pay cost method is internally inconsistent and should be reviewed.

SECTION 5: REVIEW OF RETIREMENT SYSTEM ASSUMPTIONS AND METHODS (CONTINUED)

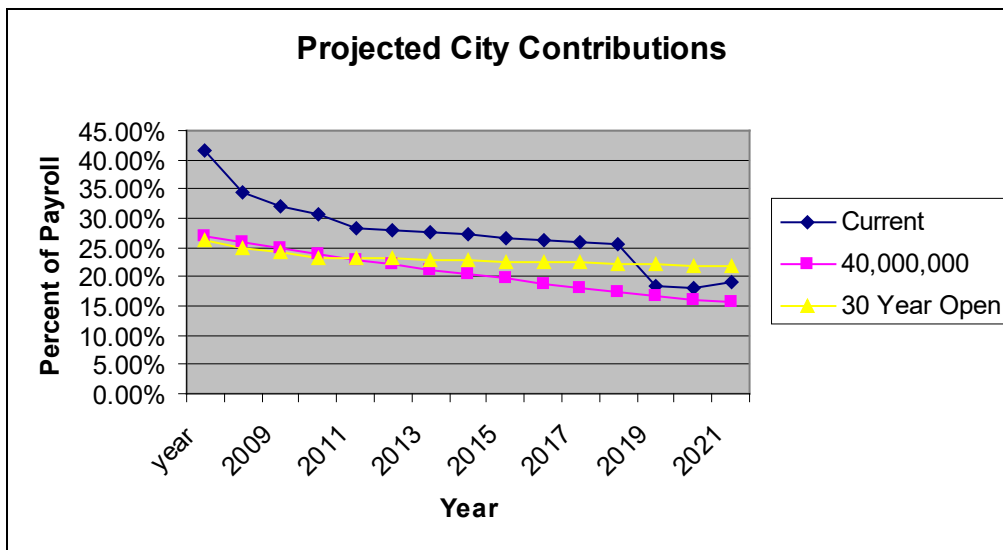
The amortization method is a significant contributor to the contribution pattern of the retirement system. We encourage policy makers to review the current amortization method. We have projected contributions using the current and alternate amortization methods commonly used in the public sector.

SECTION 6: PROJECTED CONTRIBUTIONS AND FUNDED STATUS

We have developed a 15-year projection of the projected City contributions and funded status of CRS under three alternate funding scenarios:

- The current policy of funding
- City contributions of \$40,000,000 per year
- A thirty-year open level percent of pay amortization

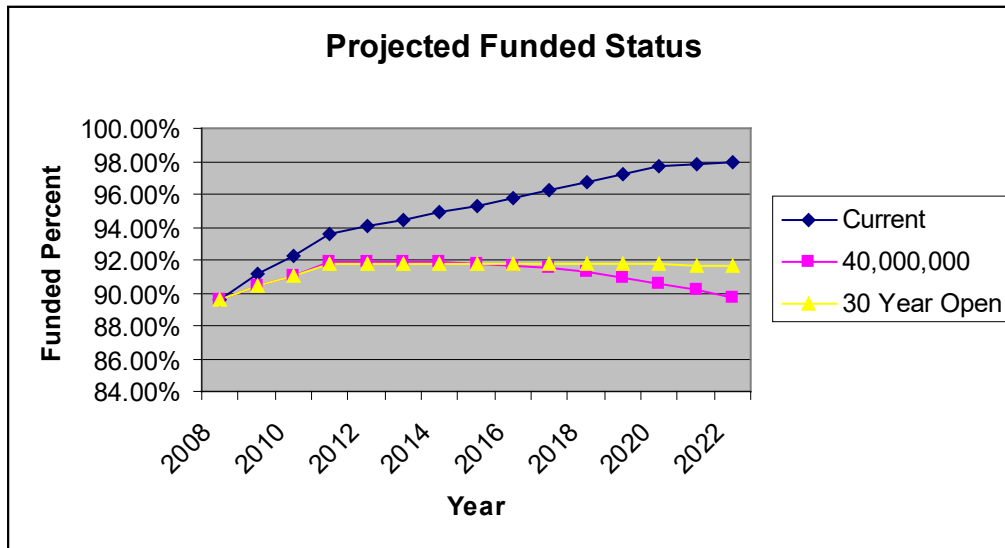
A projection of the percent of payroll contribution is as follows:



The total projected dollar contributions over the 15-year period are \$785, \$600 and \$685 million for the current policy, \$40 million per year, and 30-year open level percent of pay amortization, respectively.

SECTION 6: PROJECTED CONTRIBUTIONS AND FUNDED STATUS (CONTINUED)

The projected funded status over that period of time is depicted in the following graph:



Predictably, the current policy results in the highest funded status, effectively reaching 100% funded status in 15 years. A policy contributing \$40,000,000 per year results in a stable funded status over the short term, but eventually the funded status declines because the contribution is not adjusted for inflation. The funded status continues to decline beyond the 15-year period. The 30-year open policy is projected to maintain a funded status of about 92%. This stays remarkably level well after the 15-year projection period, primarily because the contribution is adjusted for wage inflation.

The Early Retirement Window is currently being amortized over a 15-year period. Best practices suggest that the cost of an Early Retirement Window be paid off over a period that does not exceed the payroll savings period. Generally this is 5 years or less.

SECTION 7: BENCHMARKING POST-RETIREMENT MEDICAL

Compiled below is summarized information from the 2007/2008 Survey Report on Employee Benefits from Watson Wyatt Data Services on pre-65 retirement medical plans for all employers. Post-65 retirement medical plans are not contained in the survey – information for comparative purposes for post-65 plans is hard to capture due to Medicare integration with the employer plan. We wanted to compare the City to all employers (as opposed to just other municipalities) as more than likely the City does not compete for employees with other governmental entities. Please note the following on the Survey Results below:

- We used the “2,500 Employees or More” category to compare to the City in each of the items below.
- Only In-Network cost sharing arrangements are displayed.
- Any percentages shown reflect the portion of costs that the plan pays.

Retiree Medical Plan Design Feature (Pre-65)	City of Cincinnati Current Retiree Medical Plan				Survey Result
	Traditional	PPO	HMO	80/20 Plan	
Single Deductible	\$50	\$0	\$0	\$300	\$460
Single Out-of-Pocket Maximum	\$450	\$300	\$500	\$1,500	\$1,878
Office Visit	80%	92%*	100%	80%	90.8%
Inpatient Hospital/Surgery	100%	98%**	100%	80%	86.2%
Prescription Drug Generic Copay	\$5	\$5	\$3	\$10	\$10
Prescription Drug Brand Copay	\$5	\$12	\$3	\$20	\$25

**The PPO charges a \$10 copay which we estimate to be approximately 92% of the charges.*

***The PPO charges a \$100 copay then pays 100% which we estimate to be approximately 98% of charges*

The survey also indicated that 52% of employers had implemented an increase to the deductible in the prior plan year and/or planned to increase the deductible again in the next plan year.

SECTION 7: BENCHMARKING POST-RETIREMENT MEDICAL (CONTINUED)

We also looked at Retiree Contributions. Summarized below is information from the 2007/2008 Survey Report on Employee Benefits from Watson Wyatt Data Services on pre-65 retirement medical plans for all employers. As on the prior page, we used the “2,500 Employees or More” category. **Note that all contributions shown are for retirees who are retiring in 2007.**

Monthly Retiree Contributions	City of Cincinnati 2007 Retiree Medical Contributions (in dollars)*		Survey Result
	Group 1 HMO	Group 1 (Non-HMO)	
Retiree Only Pre-65	\$5	\$0	\$329
Retiree + Spouse Pre-65	\$11	\$0	\$709
Retiree Only Post-65	\$5	\$0	\$168
Retiree + Spouse Post-65	\$10	\$0	\$350

**Have not included Group 2 contributions since there will not be any Group 2 retirees until 2012*

However, the City of Cincinnati’s plan costs are much higher than those in the Watson Wyatt Survey, so we have provided a table showing the retiree contribution as a percentage of total cost for an apples to apples comparison.

Retiree Contributions	City of Cincinnati 2007 Retiree Medical Contributions (as a % of total cost)*		Survey Result
	Group 1 HMO	Group 1 (Non-HMO)	
Retiree Only Pre-65	<1%	0%	45%
Retiree + Spouse Pre-65	<1%	0%	47%
Retiree Only Post-65	1%	0%	45%
Retiree + Spouse Post-65	1%	0%	46%

**Have not included Group 2 contributions since there will not be any Group 2 retirees until 2012*

The survey also finds that 52% of employers have increased retiree contributions in the prior plan year and/or plan to increase contributions in the next plan year. Additionally, 5% of employers plan on switching to a defined contribution or fixed dollar plan for retiree medical in the near future.

SECTION 7: BENCHMARKING POST-RETIREMENT MEDICAL (CONTINUED)

Shown below are the survey results compared against those who will retire as a Group 2 Retiree. The chart below shows all possible Group 2 contributions:

- If age plus service at termination exceeds 90, the Plan pays 100% of the cost.
- If age plus service at termination is between 80 and 90, the Plan pays 75%
- If age plus service at termination is between 70 and 80, the Plan pays 50%
- If age plus service at termination is between 60 and 70, the Plan pays 25%
- If age plus service at termination is less than 60, the Plan pays 0%

Monthly Retiree Contributions	City of Cincinnati 2007 Retiree Medical Contributions (in dollars)						Survey Result
	Group 2 @ 100%*	Group 2 @ 75%*	Group 2 @ 50%*	Group 2 @ 25%*	Group 2 @ 0%*	Group 2 Avg**	
Retiree Only Pre-65	\$0	\$217	\$434	\$651	\$867	\$497	\$329
Retiree + Spouse Pre-65	\$0	\$434	\$867	\$1,301	\$1,735	\$993	\$709
Retiree Only Post-65	\$0	\$125	\$249	\$374	\$498	\$285	\$168
Retiree + Spouse Post-65	\$0	\$249	\$498	\$747	\$996	\$571	\$350

*Based on December 31, 2006 claims costs being grossed up to total cost

**Estimated the current active population's retirement status for post-retirement medical assuming everyone makes it to retirement eligibility

As on the prior page, we have provided a table showing the retiree contribution as a percentage of total cost.

Retiree Contributions	City of Cincinnati 2007 Retiree Medical Contributions (as a % of total cost)						Survey Result
	Group 2 @ 100%	Group 2 @ 75%	Group 2 @ 50%	Group 2 @ 25%	Group 2 @ 0%	Group 2 Avg	
Retiree Only Pre-65	0%	25%	50%	75%	100%	57%	45%
Retiree + Spouse Pre-65	0%	25%	50%	75%	100%	57%	47%
Retiree Only Post-65	0%	25%	50%	75%	100%	57%	45%
Retiree + Spouse Post-65	0%	25%	50%	75%	100%	57%	46%

SECTION 8: POTENTIAL CHANGES TO CURRENT HEALTHCARE BENEFITS

As laid out in the previous section, the current medical benefits for the retirees of the City of Cincinnati are higher in value when benchmarked against other employer plans. Below we outline several potential changes to the retiree medical plan, several of which have already been recommended by Mercer in their “Cincinnati Retirement System Alternative Benefit Cost Analysis” report.

- 1) **Dependent Eligibility Audit:** Ineligible dependents often make their way into the plan. Under such an audit, all dependents are required to send proof that they are legitimate dependents as defined by the plan. A higher number of aunts, uncles, neighbors, pets, etc. are being claimed as spouses and thus getting coverage in employer health plans. This would impact active employees as well as retirees.
- 2) **Revise Prescription Drug Copays:** Currently there is no difference in cost for generics and brand name drugs for the Traditional (Indemnity) Plan and the HMO which are \$5 and \$3 for all prescriptions respectively. Putting in a “tiered” copay arrangement for these plans in which the current copay would be for generics only and the brand name copay moving to 3 times the generic copay or \$10 more than the generic copay would help to dramatically increase utilization of generic drugs.
- 3) **Mandatory Mail-Order for “Maintenance” Prescription Drugs:** Prescription drug costs are typically around 60% of the total medical costs for post-65 retirees and 25% for pre-65 retirees, a significant portion of those costs are pharmacy dispensing fees. By having a higher utilization for mail-order drugs, dispensing fees would decrease. This would impact active employees as well as retirees.
- 4) **Consumerism:** Many employers are incorporating consumerism into their medical plans. There are many possible approaches. One such possibility is to increase the health plan deductibles to \$1,000, but then also providing \$1,000 to retirees in an account each year. Any unused balance in the account would roll-over to the next year. The theory is that the medical plan design is essentially still the same (\$0 cost to the retiree) but that since the account is “his/her money”, the retiree will not simply view healthcare as free or inexpensive anymore and will manage their services better.

Another possibility is to charge higher copayments for all services if the participant is targeted for a disease management program and does not follow the recommended steps.

SECTION 8: POTENTIAL CHANGES TO CURRENT HEALTHCARE BENEFITS (CONTINUED)

- 5) **Wellness Programs:** Can take many forms, but each has a common goal: to improve employee health and reduce the risk of disease. Common risk factors that wellness programs focus on are tobacco use, poor nutrition, lack of physical activity, excessive stress, and other unhealthy habits. Wellness programs involve raising awareness, health screening, and promoting healthy lifestyles, with a focus on changing employee behaviors and workplace environment and culture. Typical wellness components include, but are not limited to, health risk assessments, onsite health fairs, onsite fitness centers, workplace health “challenges”, online healthy lifestyle programs, personal health coaches, gym memberships, and Employee Assistance Programs (EAP).
- 6) **Communication Audit:** A systematic look at your health and wellness communication vehicles and channels. This review goes well beyond an inventory list of your current communication tools. It is a proactive, strategic analysis to help you evaluate where you are and where you want to be - and will provide actionable steps to get you there. The audit can help manage communication costs by identifying which current communications efforts do not yield benefits to employees and provide the opportunity to improve, eliminate or change those programs accordingly. Healthcare costs can be impacted by employees/retirees taking advantage of wellness, disease management, and consumerism programs.
- 7) **Medicare Coordination:** Our understanding is that Medicare eligible retirees have their medical claims processed secondary to Medicare on a “coordination of benefits” basis. Of the three potential Medicare methods, “coordination of benefits” results in the highest costs to the plan (and conversely the lowest costs to the retiree). Switching to “exclusion” or “carve-out” would result in savings to the plan by passing more of the cost along to the retiree.
- 8) **Changing Retiree Medical Plan:** The current retiree medical plans cover approximately 96% of all medical charges, as opposed to 80% for actives. The cost sharing provisions of the retiree medical plans could be changed to mirror the current active medical plans or perhaps increased to somewhere in-between 80% and 96%. Current retirees and actives hired prior to a cut-off date could be grandfathered under the current arrangement. Wellness benefits, such as annual physicals and annual OB/GYN visits, could be left unchanged.

SECTION 8: POTENTIAL CHANGES TO CURRENT HEALTHCARE BENEFITS (CONTINUED)

- 9) **Eliminating Indemnity Option:** Indemnity plans typically have no networks. So if a non-network provider is visited by the retiree, network discounts are not being applied to the cost of the service. Discounts are typically around 50% for Anthem. Current retirees and actives hired prior to a cut-off date could be allowed to continue with the Indemnity plan.

- 10) **Revise Retirement Eligibility:** Currently anyone with 30 years of service may retire with post-retirement medical benefits. This allows for many people to retire before age 50. A person's most expensive years for medical costs are between ages 50-64 (since Medicare doesn't apply until age 65). Revising the retirement eligibility to be a minimum age such as 55 would help to cut down on post-retirement costs (but the costs would still be incurred by the City, just on the active plan and not under GASB).

- 11) **Put Medical Plans Out to Bid:** Perhaps a better administrative fee arrangement and/or better discounts/rebates could be attained than what is currently in place. An RFP for both the medical and prescription drug plans could be sent out to the marketplace. Given Anthem's deep discounts and large network, it is more likely that savings would be achieved on the prescription drug plan versus the medical. Any change would impact not only retirees but the current active employees as well.

- 12) **Claims Audit:** We believe that the City has already performed such an audit recently, but in the event you have not, we wanted to make sure we mention this possibility. The biggest potential savings result from identifying services that are covered but should be excluded. This would impact active employees as well as retirees. Such audits need not be performed every year - every few years generally is adequate.