Milliman

Joel Wehner

Medicare Part D Prescription Drug Benefit

FAS 106 Actuarial Valuation Issues

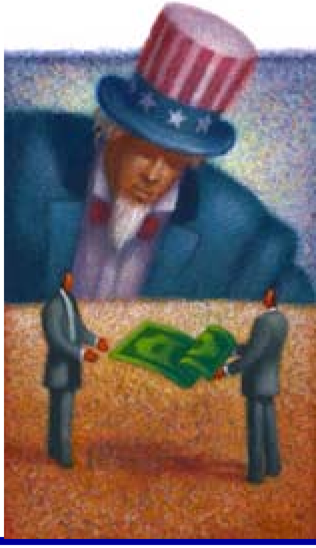
Paragraph 35 of FASB Statement 106

- Employer's share of expected future health care cost reduced by
  - Effects of coverage by Medicare or other health care providers
  - Effects of cost-sharing provisions of the plan, such as deductibles, copayments, etc.
  - Actuarial present value of future retirees' contributions

- Resulting amount is net employer share of cost used to determine APBO

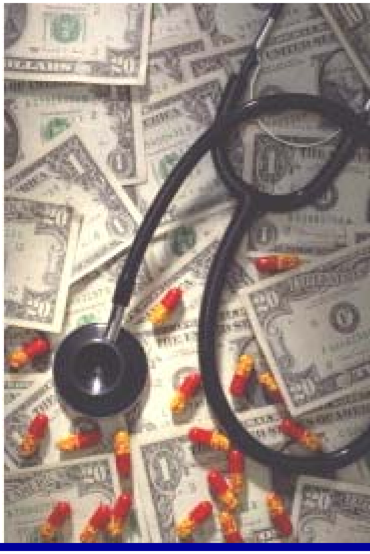
Paragraph 40 of FASB Statement 106

- Certain medical claims may be covered by governmental programs under existing law
- Benefit coverage by those governmental programs shall be assumed to continue into the future
- Presently enacted changes in the law that will affect future benefits shall be considered in the current measurement period



Medicare Prescription Drug Improvement and Modernization Act of 2003

- Introduced two new features to Medicare that employers need to consider
- Federal subsidy of 28% of each beneficiary's annual prescription drug cost between $250 and $5,000
- New opportunity for retirees to obtain prescription drug benefits under Medicare



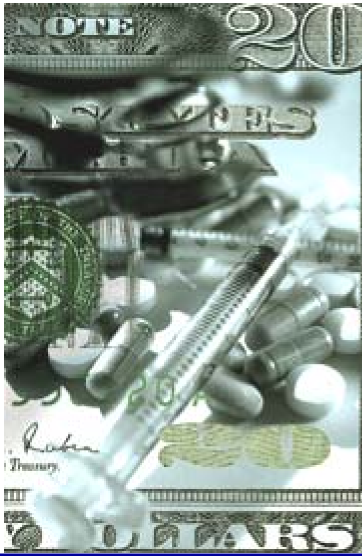
28% Federal Subsidy

Medicare

- Eligibility for subsidy based on whether employer provided prescription drug benefits for retirees are at least actuarially equivalent to Medicare Part D benefits

- Detailed regulations regarding how to determine actuarial equivalency have not been issued

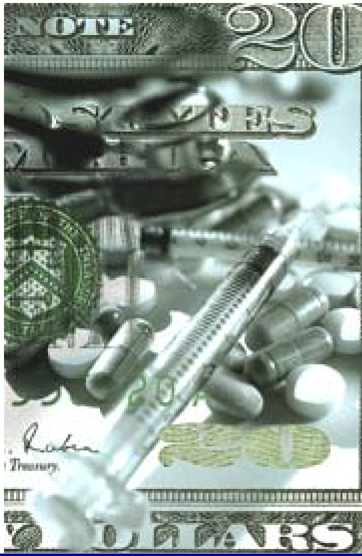
- Also need guidance regarding
  - Evidence required to demonstrate actuarial equivalence
  - Documentation requirements to attain subsidy
  - Definition of payment/reimbursement mechanism for subsidy



28% Federal Subsidy

- Amount of subsidy dependent on how many Medicare-eligible retirees choose not to enroll in Medicare Part D

- Open question: *Is subsidy substantially similar to other Medicare benefits subject to FASB Statement 106, or does subsidy represent payment to employer not subject to 106?*



Effect on Per Capita Claims Cost

- Current or future retirees enrolling in Medicare Part D will result in reduced employer's share of prescription drug costs
- Overall effect of new Act will change health care cost trends and change consumer behavior

Action Steps

- Make preliminary determination of actuarial equivalence, using best estimates
- If plan determined not actuarial equivalent
  - Amend plan to actuarial equivalent level of benefits
  - Amend plan to reduce or eliminate benefits
  - Leave plan as is
- If plan determined actuarial equivalent, determine if recognition would be significant event

Significant Event

- Any reduction in liability due to subsidy must be combined with other gains and losses
- Cumulative gains and losses typically are only amortized to the extent they exceed a corridor
- Possible that overall effect of subsidy could be determined not to be significant
- Amount determined to be significant will be subjective, made with input from employer, actuary and auditor

Transition Dates and Issues

- If determined not to be significant event, any changes must be incorporated in next regular measure date (for calendar-year plans, this would be as of December 31, 2004

- If determined to be significant event, employer has two transition alternatives
  - Apply retroactively to first fiscal quarter that commenced after enactment of the Act on December 8, 2003
  - Apply prospectively commencing with first fiscal quarter following June 15, 2004

Employers Unable to Determine Actuarial Equivalence

- Must disclose
  - Existence of the Act
  - Disclosure that APBO and net periodic post-retirement benefit costs do not reflect any amount associated with subsidy
  - Statement that employer is unable to conclude whether benefits provided are actuarially equivalent to Medicare Part D
- If later determined that plan is actuarially equivalent and it is a significant event, effects of subsidy must be disclosed at date actuarial equivalency is determined

Disclosures for 1st Period That Employer Discloses Effect of Subsidy

Medicare

- Must disclose
  - Reduction in APBO due to subsidy attributed to past service
  - Effect of subsidy on net periodic post-retirement benefit cost which includes
    - Any amortization of experience gain due to subsidy
    - Any reduction to service cost due to subsidy
    - Any reduction to interest cost on APBO due to subsidy
- Any other disclosures required by paragraph 5(r) of FASB Statement 132

Other Issues

- Plan amendments made to increase or decrease prescription drug benefits due to effect of this Act have different amortization treatment

- Subsidy is excluded from employer's taxable income which may result in temporary differences with employer's post-retirement benefit cost

- Current FASB staff position: Effects of this Act <u>do</u> come under provisions of FASB Statement 106

Consulting Issues

- Should the plan be amended to reduce or increase prescription drug benefits?
- Should the employer disclose effects early or wait for more guidance regarding actuarial equivalence?
- How to determine if measuring the effect is a significant event?
- Caution: It is still early and employers should be careful before making major binding decisions on the design of their post-retirement medical plans