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Managing Retiree Benefit Risks

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Agenda

- Landscape of retiree benefits
- Impetus for change?
- Risks of change?
- Impact on organizations?
- Emerging trends
 - Re-thinking the employer's role
 - Spectrum of designs
 - Case studies
- Summary and key message



Landscape of Canadian retiree benefits

Employers

- Approximately 40% to 50% provide retiree benefits
 - Varies by size of employer, industry, geography and type of workforce
 - Most common form "traditional first dollar plans" with little or no premium-sharing
- Not well planned, documented or communicated – "soft promise"

Employee/Retiree

- Haven't had to pay yet
- Not including potential health care costs in financial planning
- Likely will be unable to insure their own risk – fear of going without coverage
- General increased use of services and change in utilization with age
 - Want access to new things that will come along

Landscape of Canadian retiree benefits

- Many employers are changing their retiree benefit plans – 2008 Quick Poll (CB = Collectively Bargained Plans, NCB = Non-Collectively Bargained Plans)

	In Last 3 Years		In Next 3 Years	
	CB	NCB	CB	NCB
Reduced Coverage	24%	35%	25%	20%
Improved Coverage	29%	18%	5%	5%
No Change	47%	47%	29%	31%
Unsure	N/A	N/A	41%	44%

- Past and future changes largely focused on future hires and active employees
- Improvements often given to current retirees, but few apply reductions to current retirees

Impetus for change?

- Since 2000, Canadian accounting standards have forced employers to take notice
- Plan sponsors must measure and report liabilities on the balance sheet and charges to net income in excess of cash payments
- Liabilities generally unfunded (effective funding is difficult/impossible)
- Top reasons cited for reducing retiree benefits in 2005 and 2008 survey
 - 55% of survey respondents say "Accounting costs/liabilities too large" or "Accounting costs/liabilities growing too fast"
- Costs impact the bottom line, competitiveness, marketability and ultimately the market share

Impetus for change?

- Accounting costs much greater than annual benefit payments and growing faster than revenue and other line items
 - Mini-Survey of 10 companies (2000-2006), liabilities increased 96%, accounting expense increased 65%, revenue increased 18%
- Future changes to the accounting standards that are coming for 2011 will increase balance sheet liabilities, and increase volatility of accounting expense
- Employers need sustainable and predictable future costs
 - Continuing shift away from government-sponsored programs
 - Retirees will need to bear some responsibilities
 - Increased need for global competitiveness on HR costs

Risks of change – Types of risk

- Legal – ability to make changes may be constrained by contract provisions
- Human Capital
 - Notice Period
 - Attraction/retention
 - Productivity/morale
- Financial – will changes impact business?
 - Profitability
 - Saleability/ability to be acquired
 - Ability to merge



Risks of change – Assess legal risk

How?

Savings Increases ↓
Risk Increases ↓

- Break down workforce into the following main groups and assess legal risk of change by group:

Non-Unionized	Unionized
<ul style="list-style-type: none">▪ New hires▪ Actives not close to eligible to retire▪ Actives close to eligible to retire▪ Actives who are eligible to retire but still working▪ Current retirees	<ul style="list-style-type: none">▪ Actives▪ Current retirees

- Considerations for changes
 - What are your financial and HR objectives?
 - Who will be affected? When will it happen?
 - What will it take to implement these changes?

Risks of change – Human capital risk

- Notice period may encourage those eligible for retirement to retire sooner than otherwise would in order to preserve entitlements
- May be difficult to attract older workers if no retiree benefits offered
- May be difficult to retain older worker who is attracted to benefits package with another company
- Unhappy retiree population may negatively affect current employee groups, corporate reputation, community perception

Risks of change – Financial risk

- Costs will continue to grow
 - Government cost shifting to continue; utilization to continue to grow
 - Health care inflation to outpace general inflation for foreseeable future
 - New technologies expected to continue
- Liabilities doubled in 6 years for 10 firms
- If savings are not achieved soon:
 - Impact ability to turn a profit, raise capital, borrow, grow, invest
 - Inability to merge, be acquired
 - Erode market share due to uncompetitiveness
- As retiree populations grow, cash impact also increases

Impact on organizations?

- What's happening today:
 - Large organizations are making changes – public/private
 - For current retirees and/or future retirees
 - Visible and controversial
 - Public is sensitized
 - Dayco v. CAW
 - Ormrod v. Etobicoke Hydro-Electric Commission
 - Kranjcec v. The Queen (Ontario Government)
 - Bennett v. British Columbia
 - B.C. Nurses Union v. Municipal Pension Board of Trustees

Emerging trends – Plan design

2008 Quick Poll on Retiree Benefits

Nature of changes

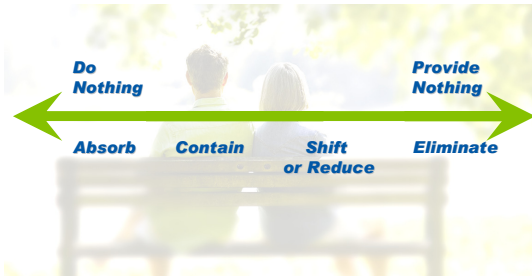
- Minor/Moderate** 51% reduce coverage, cap certain services, increase retiree contributions
- Significant** 21%-36% more significant reductions or implementing alternative designs
- Elimination** 32%-50% eliminating coverage for future retirees

Result: Aim is for "cost" control by employer

Outcome

- Changing employer role as a provider of retiree health care
- Spectrum of alternative designs developing
- Communication and administration of multiple plans

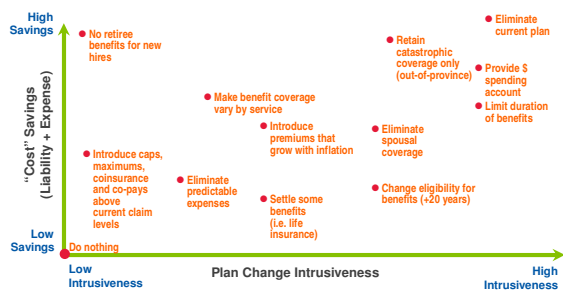
Emerging trends – Plan design
(other than alternative designs)



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Emerging trends – Plan design
(other than alternative designs)

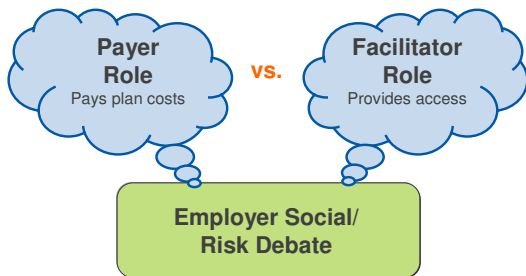


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Emerging trends – Plan design

Re-thinking the Employer's Role - alternative



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Emerging trends – Plan design

Re-thinking the Employer's role – 4-Step Process

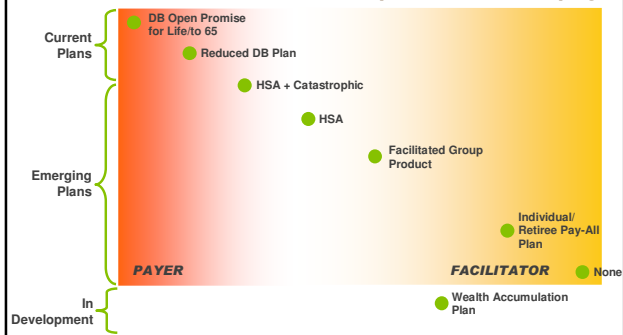
1. Develop employer philosophy/objectives considering
 - a) Company's responsibility in meeting retirees needs
 - b) Time horizon for change – years, *not* months!
2. Find sustainable level of involvement
3. Design and implement plan
4. Ensure there is a process to monitor and manage plan
→ Governance



Emerging trends – Plan design

Alternatives

Solution spectrum still developing



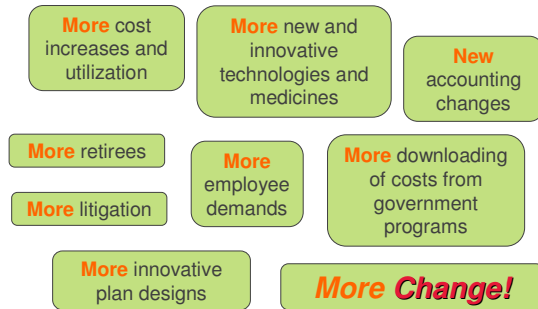
Emerging trends – Legal and other

- Lengthy notice periods and complicated choices for active employees
- High risk of litigation for changes that affect existing retirees – “soft promise”
- Unions may agree to consider changes for future retirees (or new hires), but protection of existing retirees paramount
- Build communication program around notice period:
 - Common law concept of constructive dismissal applies only to active employer
 - Legal interpretation of your promise to retirees is often uncertain
 - Notice period depends on extent of changes and who is impacted
 - Notice period is legally ineffective for retirees
 - Special considerations for notice to inactive employees (e.g. disabled members)
 - Consider company's tolerance for risk

Emerging trends – Legal and other

- The Big Problem:
 - Employers historically being “soft” on retiree benefit promises
 - Employees/retirees becoming extremely aware of the value of retiree health benefits
 - Numerous class action suits
 - Projected workforce shortages
 - Unions often draw a line in the sand
 - “Ageism” is the term of the decade

What will the future bring?



Summary and key message

- Cost of current traditional retiree benefit plans are becoming unmanageable and are exposed to future risk; Number of retirees and their needs for health care services is expected to continue to grow at a rapid rate
- Accounting requirements are here to stay; but their pending changes will only worsen the financial impact of non-cost managed plans
- Times have changed, many employers have implemented changes already
 - Many different approaches, many different impacts
 - Several lawsuits
 - Is your plan still competitive? Comparable? Creating the behaviour you want?



Summary and key message

- There is still time to re-think the employer's role
 - Solution "identification" time
 - Design - meet objectives
 - Time horizon very, very long
- Long term cost sustainability required






Case studies

Case Studies
Reduced DB Plan



Company Information	Manufacturer
Situation	Retiree benefit costs increasing too rapidly; company felt it needed a plan to be competitive
Changes made	Manufacturer introduced reductions to plan for existing retirees, including reimbursement levels, elimination of coverage for certain services, and dispensing fee cap
Impact on Company	Manufacturer – 5% reduction in liabilities; informal complaints, no formal legal action


Case Studies
HSA + Catastrophic



Company Information	Health care industry Currently no retiree plan
Situation	Workforce aging and key decision makers interested in what is available after retirement; want to ensure plan is sustainable for company; company felt it needed a plan to be competitive but only wanted to cover basic costs for every one and have insurance when needed
Changes made	Introduced HSA + Catastrophic plan where catastrophic premium is deductible from HSA \$2,000 deductible; drugs and nursing covered

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Case Studies
HSA



Company Information	Large employer with multiple union groups Some union groups have traditional DB plans Some union groups have no retiree coverage
Situation	Lack of harmony in plans Significant costs on a cash and accounting basis
Changes made	Proposal to introduce HSA for union groups with no coverage Address legacy plans at another date


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Case Studies
Facilitated Group Product




Company Information	Financial institution Currently have retiree flex plan with retiree premiums and many retirees
Situation	Wanted to align retiree and active plans while controlling rate of growth in retiree costs Wanted to encourage later retirements
Changes made	For future retirees only, facilitate access to same plan as active employees, supplementing costs with fixed \$ flex credits based on age at retirement
Impact on Company	15% reduction in liabilities

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Case Studies
Retiree Pay All 

Company Information	Manufacturer Had traditional first dollar plans for union and non-union groups
Situation	Wanted to eliminate retiree obligations
Changes made	For all retirees, 2 years notice period of elimination of coverage; For future retirees, access to individual plan
Impact on Company	Reduced liability to \$0 after 2 years notice; faced class action suit; settled out of court for cash payment about 30% of accounting liabilities Legal fees significant

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Case Studies
Wealth Accumulation Plan – Phase 3 Future 

- Notional allocation of funds per year of active service
- Upon retirement, fund balance converted to annuity stream used to purchase insurance or reimburse health care costs
- Legal and tax structure undeveloped

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