May 17, 2011

Retiree Healthcare Contributions

Commission on Government Forecasting and Accountability
State of Illinois

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Contents

1

Executive summary

This report is in response to a request from the Commission on Government Forecasting and Accountability (COGFA) to study retiree healthcare contributions required of retirees and dependents under the State Employees Group Insurance Program. Specifically, this report compares the healthcare contributions currently required of State retirees and dependents to national benchmarks for public and private sector plan sponsors. The report then provides a series of scenarios which, if implemented, would bring the State's retiree healthcare contributions closer to these national benchmarks. The financial impact to the State and to retirees and dependents will also be projected and discussed. Lastly, the report will discuss administrative issues as well as caveats and considerations which should be evaluated in considering the findings of this report.

Mercer's annual survey is the oldest and most quoted benchmarking survey on employer sponsored health plans. The 2010 survey showed that, overall, retirees and dependents were required to pay slightly more than 50% of the total cost of retiree healthcare. The table below highlights the consistency of this benchmark across three stratifications of public plan sponsors (states, counties and cities) as well as the entire 2010 survey average for all plan sponsors with at least 500 employees. It is important to note that these benchmarks are for plan sponsors that *offer* retiree healthcare coverage. In 2010 Mercer's survey showed that nationally only 25% of plan sponsors with 500+ employees offered coverage pre-Medicare (only 19% for Medicare eligibles). It is important to note that very few plan sponsors with less than 500 employees offer retiree healthcare. These smaller employers account for approximately 80% of all workers in the US.

2010 Mercer Survey – Average participant contributions* for retiree healthcare				
Retiree status	States	Counties	Cities	National 500+
Pre-Medicare	54%	49%	53%	54%
Medicare eligible	54%	49%	59%	52%

*As a percentage of premiums (does not include out-of-pocket costs; e.g., deductibles and copays)

More benchmarking details are provided in Section 2 of this report.

In consultation with COGFA, Mercer has developed a series of retiree contribution scenarios which model parameters such as affordability (relative ability of retirees to pay healthcare contributions), years of service and retiree healthcare benefit begin date. Each of these scenarios has been designed to produce retiree contributions close to the 2010 survey benchmarks of approximately 50%. These scenarios are projected to produce a range of savings in FY2012 cash expenditures. The savings are projected to range from approximately $260 million to $300 million in FY2012. While this level of FY2012 cash savings is impressive, there is another significant benefit to be gained by the State of Illinois from the scenarios in this report. Mercer's understanding is that the State's GASB 45 liability as of 6-30-2009 was $27.1 billion (Gabriel Roeder Smith & Company actuarial valuation report). The scenarios in this report are expected to reduce the State's GASB 45 liability by several billion dollars. Mercer advises that the State work with their valuation actuary to run a current valuation report for the State utilizing the scenarios in this report to develop a more definitive estimate of the GASB 45 liability savings. The reduction in long-term liability would generally be viewed favorably by rating agencies and creditors.

The scenarios outlined in the report are not intended to be the final recommendation. Rather, these scenarios should provide a starting point for considering what direction to take the State's contribution strategy. For example, certain scenarios provide illustrations of 2012 contributions where upwards of 30,000 retirees are grouped together at the same rate. While useful for starting the discussion, it may be more practical to break the larger groups into smaller slices. Therefore, all projected savings will be subject to refinements resulting from any adjustments to the final contribution schedule.

Additionally, the actual FY2012 cash savings realized from each of the scenarios will vary from the estimates due to a number of factors such as implementation details and administration costs, actual healthcare cost trends differing from assumed and retiree decisions as to whether to continue coverage or to opt-out of coverage. Mercer did not receive information regarding collective bargaining agreements (CBAs). To the extent that certain retirees may be governed by CBAs, the savings presented within this report would be reduced if it is not possible to implement the contributions as was assumed.

In Mercer's experience, implementation issues are an important consideration in selecting a contribution strategy. Any change from the current state needs to be logical, equitable and manageable. The current program focuses exclusively on years of service. An annuitant's ability-to-pay and when retiree healthcare benefits begin are two

additional dimensions which are often considered when discussing equity. Ability-to-pay can be difficult to administer over time due to changing financial circumstances and income verification issues. However, there are approaches which can approximate a retiree's ability-to-pay which may be easier to verify and administer. These considerations will be discussed in more detail in Section 4 of this report. Mercer would also advise that consideration be given to phasing-in the proposed changes over a period of two or three years. The State's retiree medical benefit is richer than the current benchmark and movement to the benchmark contribution in one year would be a large change. Often, changes of this magnitude are phased-in to give participants time to plan and adjust. We recommend that any changes to the plan be communicated to both current and future retirees. A phased approach would reduce the initial cash flow savings shown throughout this report.

We would like to thank COGFA for allowing Mercer to partner in the development of this report. We would also like to thank HFS for pulling together data from multiple retirement systems and providing continuous support in scrubbing and reconciling the data. We also thank the DOR for providing numerous profiles of groupings of data to allow Mercer to analyze the dynamics of household income in the dimension of "ability-to-pay". The findings in this report assume that all of the data provided to Mercer was accurate and complete. Mercer did perform high level reasonability tests and found the data to be consistent with other sources and Mercer's knowledge of the State's programs. However, an audit of the data was not in the scope of the project and therefore not conducted. If data provided to Mercer is subsequently found to be in error then projections would need to be adjusted. Please see: "Section 5: Study Methodology" for a further discussion of how the data was used. ***It is important to note that all estimates (including those in this report) based upon the information available at a point in time, are subject to unforeseen and random events. Therefore, any projection must be interpreted as having a likely range of variability from the estimate.***

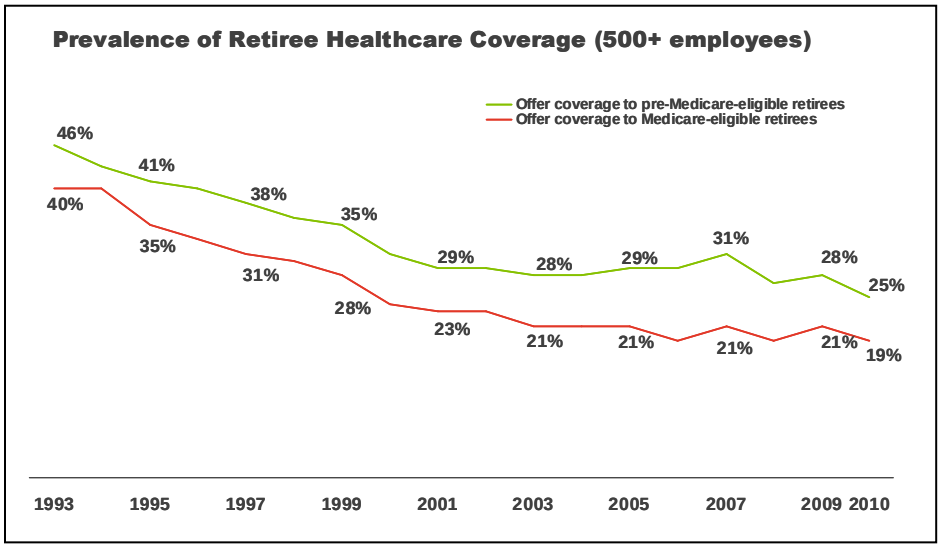
The information contained in this document (including any attachments) is not intended by Mercer to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code that may be imposed on the taxpayer.

2

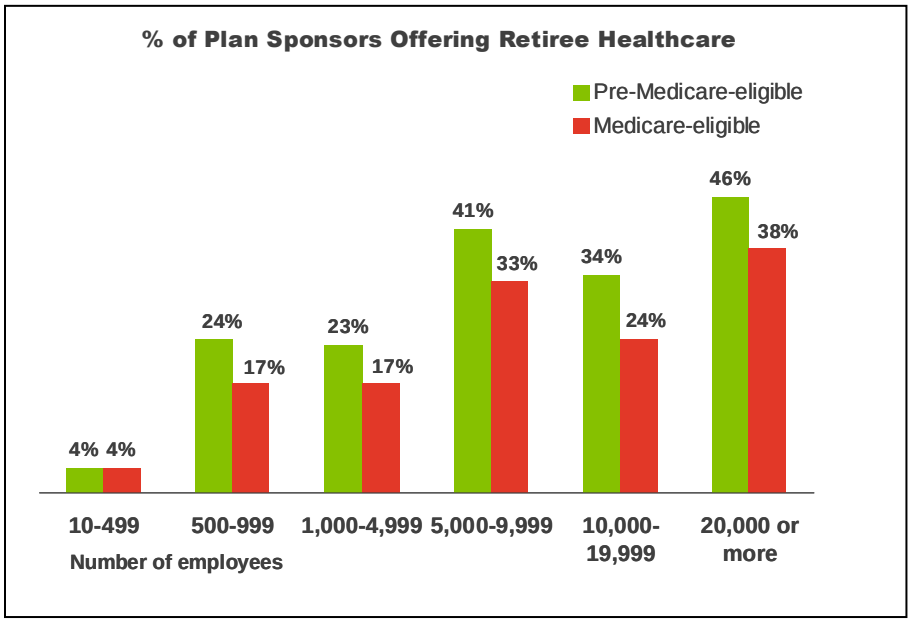
Benchmarking – Retiree contributions

The Mercer National Survey of Employer-Sponsored Health Plans is the oldest and most quoted survey of its type. Established in 1986, the survey has approximately 3,000 respondents each year answering many questions and providing unique data on a number of dimensions regarding active and retiree healthcare plans. For retiree medical plans, the survey data provides information on retiree contribution levels, current policies and expected changes to those policies. The survey is particularly rich in public sector respondents with approximately 200 large cities and counties across the country and 30 states. Plan sponsors across the country have utilized and come to rely on this survey for the past 25 years.

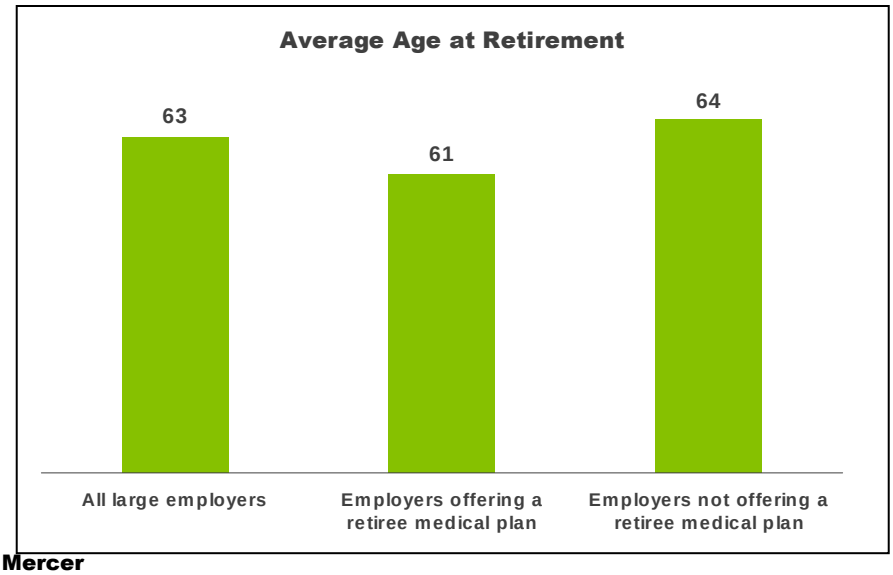
The chart below shows that the prevalence of sponsoring retiree healthcare coverage has steadily declined among large employers (500+ employees) in recent years. As noted earlier these plan sponsors employ roughly 20% of the U.S. labor force. Plan sponsors with less than 500 employees, represent the remaining 80% of the U.S. labor force, rarely offer retiree healthcare coverage.



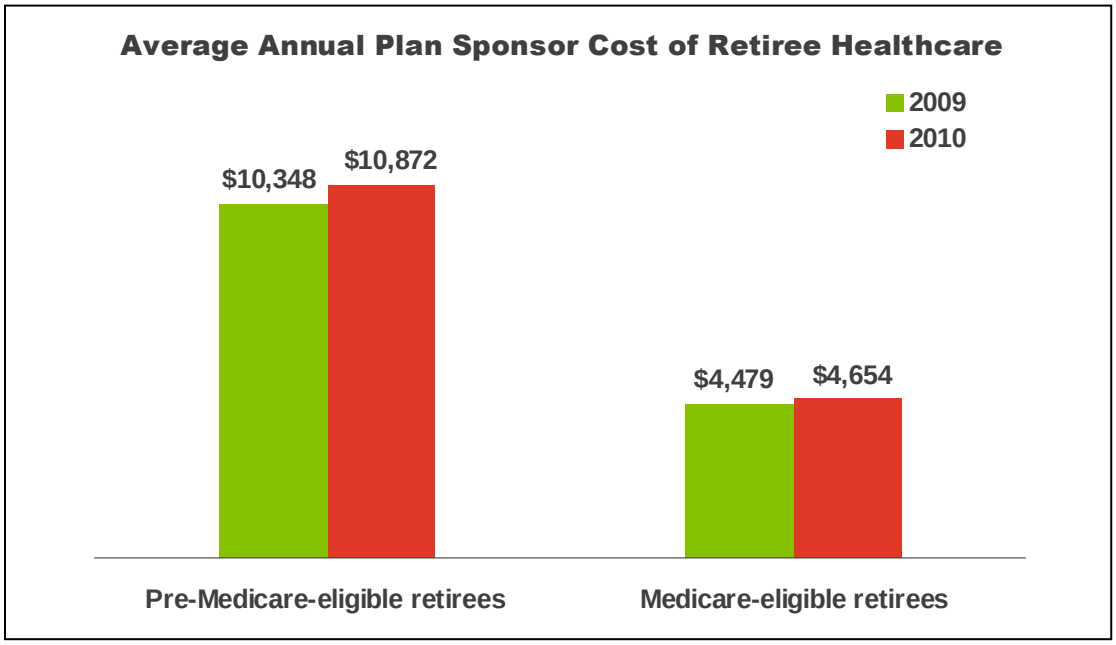
The chart below is a snapshot of the 2010 survey prevalence of retiree healthcare plan sponsorship by employer size. Among the 30 state government plan sponsors in Mercer's 2010 survey 97% offer coverage to pre-Medicare eligible participants and 83% offer coverage Medicare eligibles. While retiree healthcare coverage is usually provided for state government employees, for many non-government employees the prevalence and value of coverage has been reduced considerably. Since the early 1990s, employers have also reduced the benefit through less rich plan designs and / or higher retiree contributions. As noted previously, public sector plan sponsors, while continuing to offer retiree healthcare, have also changed contribution schedules to largely mirror private plan sponsors.



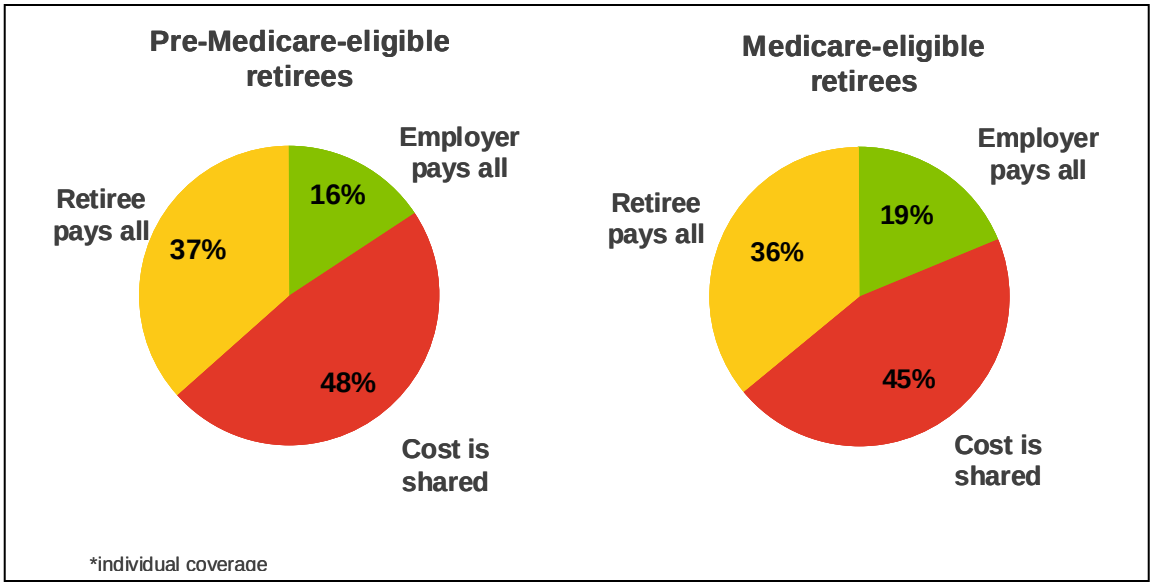
The table below shows how the availability of retiree healthcare can impact retirement patterns. As retiree healthcare coverage is eliminated or made less attractive (e.g., higher contributions) some participants will delay their retirement date as the 2010 survey data below suggests.



The table below shows the survey average annual plan sponsors costs per retiree for healthcare coverage (after participant out-of-pocket costs). The approximate 5% annual increase (2010 over 2009) is lower than historical increases and reflects plan design changes and active vendor management.



The chart below shows the distribution of all plan sponsors (500+ employees) in terms of how contributions are charged to participants.



As evidenced by the table below, one of the most common variables upon which to base retiree healthcare contributions is years of service (as the State does currently). An increasing number of Mercer clients are looking at combining years of service with other parameters. The scenarios in this report reflect those leading edge strategies.

2010 Mercer Survey – Percent of plans that vary contributions by years of service				
Retiree status	States	Counties	Cities	National 500+
Pre-Medicare	34%	35%	38%	30%
Medicare eligible	31%	43%	39%	34%

3

Scenarios and summary findings

In this section Mercer will detail the key statistics for each of several proposed scenarios which are highlighted below. Note that actual savings by scenario may be higher as no provision has been made for additional participants who waive coverage in the future.

The projected savings shown are derived purely through a transition of cost from the State to the retirees. The change in cost under each scenario listed will vary for each retiree based on many factors unique to that retiree. The savings shown in the scenarios are a blended Medicare/non-Medicare cost. To get a sense of the changes for each retiree that also accounts for Medicare status, several strawmen examples are included in the Appendix.

There have been several simplifications included in these scenarios in order to better convey the overall concept. Once a preferred scenario is determined, there are additional modifications that could be made, including, but not limited to:

- Charging dependents a greater percentage of cost than retirees; this is a typical contribution structure and is basically how the State charges contributions today. Although not reflected explicitly in these scenarios, it is certainly possible to reach the target contribution percentages while charging different percentages for retirees than for dependents.
- Using different pools of enrollees; the pool selection process was setup to reach the 50% contribution target in a straightforward manner. The State should not feel limited, for example, to the four ranges of benefit points listed in Scenario 2. To some, this may not create a great enough differentiation between certain classes of retirees.
- Refining the household income calculation; there are many ways to approximate household income. The State may wish to consider additional methods beyond what is presented here. For instance, a retiree with fewer years of service with the State is more likely to have additional pension income from another plan.

Scenario 1 – Years of service
This scenario is similar to the current offering of rewarding longer service with lower contributions. Today, most retirees have more than 20 years of service and, hence, make no required contributions to their retiree healthcare coverage. In fact, over one third of all participants (retirees plus dependents) are in households where the retiree had 30 or more years of service. Scenario 1 modifies the current approach by requiring more years of service to reach the highest subsidy from the State and requiring all retirees to make some contribution to the cost of coverage. However, like the current situation, this scenario does not address ability-to-pay or the healthcare benefit start date chosen by each retiree.

Scenario 2 – Benefit points
This scenario builds on Scenario 1 by incorporating the healthcare benefit start date into the evaluation of required contributions. Essentially, longer service retirees who delay the start of their benefits would contribute less than lower service retirees who begin taking benefits earlier. As described later, this scenario is viewed by Mercer as an improvement over Scenario 1 because it also brings more equity to the aggregate cost of the benefits provided to each retiree.

Scenario 3 – Ability-to-pay (pension income)
In Scenario 3, retirees with greater pension income will have a higher required contribution. This dimension brings affordability into the evaluation, complementing years of service and benefit start date. Pension income is not equal to household income and is not a perfect measure of a retiree's ability-to-pay, but it is a reasonable proxy. Using pension income would be much easier to administer and provide more certainty in future costs both for retirees and the State.

Illinois Department of Revenue statistics suggest that, on average, for State of Illinois retirees, State pension income accounts for approximately half of a retiree's household income. Social Security, investment income and any other sources of income constitute the remaining 50% of household income. As described in the details for this scenario, Mercer believes that this scenario is likely to have unintended consequences and therefore does not recommend any scenario based solely on ability-to-pay.

Scenario 4 – Benefit points and ability-to-pay (pension income)
This scenario blends Scenario 2 and Scenario 3. An eligibility grid is created comparing benefit points and pension income. The greatest cost is passed onto a retiree with fewer benefit points and higher income while the least cost is charged to someone with a greater number of benefit points and lower income. This scenario assists an individual with higher service (consistent with what is done today) who delays their retirement and may not have the means to afford higher monthly contributions.

Scenario 5 – Benefit points and ability-to-pay (household income)
This scenario is identical to Scenario 4 except household income is utilized for the ability-to-pay dimension instead of State pension income.

Scenario 1 – Years of service

For most retirees, after twenty years of service retirees receive coverage with no monthly contribution. Roughly three fourths of current retirees have at least twenty years of service and, therefore, do not have to pay contributions. Additionally, anyone who retired prior to January 1, 1998 is not required to contribute, regardless of years of service. Currently, dependent contributions do not vary based on the years of service, meaning that retirees that dedicate more time in service to the State do not get a richer benefit for their dependents than those that were only there for the minimum vesting years. The following scenario has four major changes from the current benefit offering:

- To obtain the richest benefit a retiree needs to have at least 30 years of service
- Even the richest benefit will require retirees to contribute
- Dependent contributions are a percent of total cost just like the retirees
- All enrollees contribute, regardless of retirement date

Years of service	Projected enrollees	Average per enrollee per year spend (FY2012)			
		Gross plan cost	Enrollee contribution	%	Net State cost
0 - 7	1,577	$5,484	($4,936)	90%	$548
8 - 10	5,726	$5,182	($4,146)	80%	$1,036
11 - 14	7,913	$5,472	($3,831)	70%	$1,642
15 - 19	12,309	$5,779	($3,468)	60%	$2,312
20 - 24	23,783	$6,237	($3,119)	50%	$3,119
24 - 29	24,394	$7,151	($2,860)	40%	$4,291
30+	37,967	$7,253	($2,176)	30%	$5,077
Scenario total	**113,669**	**$750,900,000**	**($331,100,000)**	**44%**	**$419,800,000**
Current state	**113,669**	**$750,900,000**	**($70,300,000)**	**9%**	**$680,600,000**
Difference	**0**	**$0**	**($260,800,000)**	**35%**	**($260,800,000)**

The table above shows the average proposed enrollee contribution varies based on years of service. Enrollee contributions vary from 90% of gross plan cost down to 30% for retirees (and their dependents) with at least 30 years of service. This contribution schedule is projected to increase collected contributions by roughly $261 million to an overall average contribution of 44% of gross plan cost.

Scenario 2 – Benefit points

A retiree and their dependents can receive retiree medical coverage for many years. The average cost per enrollee is greatest for those that are not Medicare eligible. For recent retirees and retirees in the future, this generally means those under the age of 65. If the State can push back the year that retirees enroll in health care benefits, the State can reduce their plan cost.

From an equity perspective, it makes sense to reward employees that begin collecting retirement benefits later, since they will, on average, cost less. This retiree contribution strategy looks at both how many years of service a retiree has, but also how old they are when they begin to draw on their retiree medical benefit. A retiree's benefit "points" determine the contribution, and the formula for points is equal to the age when benefits begin plus the retiree's years of service. The greater the retiree's points, the lower their contribution. The table below summarizes the results of this scenario.

		Average per enrollee per year spend (FY2012)			
Points	Projected enrollees	Gross plan cost	Enrollee contribution	%	Net State cost
0 - 78	28,092	$6,751	($4,388)	65%	$2,363
79 - 85	35,620	$7,129	($3,564)	50%	$3,564
86 - 92	29,026	$6,517	($2,281)	35%	$4,236
93+	20,931	$5,647	($1,129)	20%	$4,517
Scenario total	**113,669**	**$750,900,000**	**($340,100,000)**	**45%**	**$410,800,000**
Current state	**113,669**	**$750,900,000**	**($70,300,000)**	**9%**	**$680,600,000**
Difference	**0**	**$0**	**($269,800,000)**	**36%**	**($269,800,000)**

Mercer views this scenario as an improvement over Scenario 1 (and the current contribution formula based only on years of service). In this scenario, by combining the age at which retiree medical benefit coverage begins with years of service the net cost to the State is more consistent and level over the course of an enrollee's lifetime. Conversely, the cost to participants with limited service and/or beginning benefits during the most expensive period (pre Medicare eligibility) requires higher enrollee contributions. A downside to this approach is that existing retirees will not have the opportunity to delay retirement and reduce their contributions.

Scenario 3 – Ability-to-pay (pension income)

The current retiree benefit strategy does not take into account a retiree's ability to afford higher contributions. This scenario illustrates a retiree contribution strategy that only evaluates a retiree's ability-to-pay. Retirees with higher State pension incomes would be asked to contribute a higher percent of the gross plan cost. The table below summarizes the results of this scenario.

Pension income	Projected enrollees	Average per enrollee per year spend (FY2012)			
		Gross plan cost	Enrollee contribution	%	Net State cost
$0 - $15,000	28,189	$5,395	($540)	10%	$4,856
$15,000 - $30,000	25,941	$6,321	($1,896)	30%	$4,425
$35,000 - $50,000	27,668	$7,425	($3,713)	50%	$3,713
$50,000 - $100,000	24,778	$7,277	($5,094)	70%	$2,183
$100,000+	7,093	$6,926	($6,234)	90%	$693
Scenario total	**113,669**	**$750,900,000**	**($337,600,000)**	**45%**	**$413,300,000**
Current state	**113,669**	**$750,900,000**	**($70,300,000)**	**9%**	**$680,600,000**
Difference	**0**	**$0**	**($267,300,000)**	**36%**	**($267,300,000)**

A change in contribution strategy that only relies on ability-to-pay would be a significant change from the State's current strategy. The State would no longer be rewarding employees that spent most or all of their working years at the State over those who worked fewer years. Given that many employers no longer offer retiree medical coverage, this strategy will likely attract employees to work for the State for a period of time just to receive retiree benefits. Additionally, long service employees (who by definition would also have higher State pension incomes) would have much higher contributions than shorter service employees. Because of this, Mercer does not recommend moving to a strategy that only accounts for a retiree's ability-to-pay. Additionally, longer service State employees likely would have, on average, far fewer options to obtain coverage elsewhere as compared to shorter service State employees who may have other opportunities to earn retiree medical coverage through other employers.

Scenario 4 – Benefit points and ability-to-pay (pension income)

The previous scenarios have introduced elements of alternative retiree contribution strategies; Scenario 4 combines them all into one contribution strategy. Scenario 4 incorporates the retiree benefit point concept previously utilized in Scenario 2 to reward years of service and delayed benefit start dates and blends it with the ability-to-pay concept from Scenario 3.

			Average per enrollee per year spend (FY2012)			
				Enrollee		
Points	Pension income	Projected enrollees	Gross plan cost	contribution	%	Net State cost
0 - 78	$0 - $15,000	15,244	$5,753	($2,877)	50%	$2,877
	$15,000 - $30,000	4,900	$7,333	($4,400)	60%	$2,933
	$35,000 - $50,000	4,262	$8,317	($5,822)	70%	$2,495
	$50,000 - $100,000	3,031	$8,331	($6,665)	80%	$1,666
	$100,000 - $125,000	427	$8,080	($7,272)	90%	$808
	$125,000+	228	$8,255	($8,255)	100%	$0
79 - 85	$0 - $15,000	7,056	$5,165	($1,808)	35%	$3,357
	$15,000 - $30,000	9,521	$6,718	($3,023)	45%	$3,695
	$35,000 - $50,000	9,334	$8,128	($4,470)	55%	$3,658
	$50,000 - $100,000	7,853	$8,060	($5,239)	65%	$2,821
	$100,000 - $125,000	775	$7,727	($5,795)	75%	$1,932
	$125,000+	1,081	$7,738	($7,738)	100%	$0
86 - 92	$0 - $15,000	3,184	$4,829	($966)	20%	$3,863
	$15,000 - $30,000	7,549	$5,765	($1,729)	30%	$4,035
	$35,000 - $50,000	8,786	$7,160	($2,864)	40%	$4,296
	$50,000 - $100,000	7,460	$7,087	($3,544)	50%	$3,544
	$100,000 - $125,000	919	$7,184	($4,311)	60%	$2,874
	$125,000+	1,128	$6,988	($6,988)	100%	$0
93+	$0 - $15,000	2,705	$4,644	($232)	5%	$4,411
	$15,000 - $30,000	3,971	$5,181	($777)	15%	$4,403
	$35,000 - $50,000	5,286	$5,905	($1,476)	25%	$4,429
	$50,000 - $100,000	6,434	$6,044	($2,116)	35%	$3,929
	$100,000 - $125,000	1,091	$6,048	($2,722)	45%	$3,326
	$125,000+	1,444	$5,789	($4,920)	85%	$868
Scenario total		**113,669**	**$750,900,000**	**($367,500,000)**	**49%**	**$383,400,000**
Current state		**113,669**	**$750,900,000**	**($70,300,000)**	**9%**	**$680,600,000**
Difference		**0**	**$0**	**($297,200,000)**	**40%**	**($297,200,000)**

Mercer believes that Scenario 4 or Scenario 5 are the optimal scenarios to meet the State's objectives since each of these scenarios blend three important dimensions together (years of service, date at which retiree healthcare benefit coverage begins and ability-to-pay). While the above table appears complex, it would, in Mercer's opinion, provide a balance between logic, cost, service and equity.

In Scenario 4, it is assumed that an individual with over $125,000 in pension income has the ability to contribute 100% of the cost of retiree medical coverage; however, individuals with enough points would qualify for a reduction in contributions.

Scenario 5 – Benefit points and ability-to-pay (estimated household income)

Scenario 5 is identical in concept to Scenario 4 but uses estimated household income to determine ability-to-pay rather than Pension Income.

Points	Estimated Household Income	Projected enrollees	Average per enrollee per year spend (FY2012)			
			Gross plan cost	Enrollee contribution	%	Net State cost
0 - 78	$0-$30,000	14,884	$5,774	($2,887)	50%	$2,887
	$30,000-$60,000	5,060	$7,233	($4,340)	60%	$2,893
	$60,000-$100,000	4,304	$8,283	($5,798)	70%	$2,485
	$100,000-$200,000	3,146	$8,238	($6,590)	80%	$1,648
	$200,000-$250,000	440	$7,965	($7,169)	90%	$797
	$250,000+	258	$7,949	($7,949)	100%	$0
79 - 85	$0-$30,000	6,405	$5,204	($1,821)	35%	$3,383
	$30,000-$60,000	9,541	$6,675	($3,004)	45%	$3,671
	$60,000-$100,000	9,563	$8,058	($4,432)	55%	$3,626
	$100,000-$200,000	8,126	$7,970	($5,181)	65%	$2,790
	$200,000-$250,000	817	$7,609	($5,706)	75%	$1,902
	$250,000+	1,168	$7,581	($7,581)	100%	$0
86 - 92	$0-$30,000	2,867	$4,840	($968)	20%	$3,872
	$30,000-$60,000	7,061	$5,782	($1,734)	30%	$4,047
	$60,000-$100,000	8,859	$7,120	($2,848)	40%	$4,272
	$100,000-$200,000	7,946	$6,979	($3,489)	50%	$3,489
	$200,000-$250,000	1,001	$7,121	($4,272)	60%	$2,848
	$250,000+	1,292	$6,815	($6,815)	100%	$0
93+	$0-$30,000	2,509	$4,642	($232)	5%	$4,410
	$30,000-$60,000	3,600	$5,175	($776)	15%	$4,399
	$60,000-$100,000	5,165	$5,899	($1,475)	25%	$4,424
	$100,000-$200,000	6,730	$5,997	($2,099)	35%	$3,898
	$200,000-$250,000	1,270	$5,917	($1,775)	30%	$4,142
	$250,000+	1,657	$5,777	($4,911)	85%	$867
Scenario total		**113,669**	**$750,900,000**	**($370,700,000)**	**49%**	**$380,200,000**
Current state		**113,669**	**$750,900,000**	**($70,300,000)**	**9%**	**$680,600,000**
Difference		**0**	**$0**	**($300,400,000)**	**40%**	**($300,400,000)**

In Scenario 5, it is assumed that an individual with over $250,000 in household income has the ability to contribute 100% of the cost of retiree medical coverage; however, individuals with enough points would qualify for a reduction in contributions.

4

Administrative considerations and issues

As noted in the Executive Summary, implementation issues are an important consideration in deciding between the proposed scenarios in this report (or modified versions of these scenarios). The survey benchmarking information reveals that the most common dimension for determining retiree healthcare contributions is years of service, which is how the State has historically determined a retiree's contributions (though not dependent contributions). However, compared to the marketplace, the current contribution schedule has become dated and fallen behind market trends as the vast majority of State retirees make no contributions for retiree healthcare coverage for themselves. Additionally, the current program does not consider the retiree's ability-to-pay or the age at which the individual begins receiving benefits. The benchmarking information shows that the cost of pre-Medicare coverage is more than twice the cost of coverage for participants eligible for Medicare. In the proposed scenarios, Mercer has attempted to show how increasing the number of dimensions to the retiree contribution calculation can make the program more equitable and more cost effective. However, this additional complexity will create administrative challenges.

Ability-to-pay

In the determination of a retiree's ability-to-pay, an important question is whether this dimension needs to be evaluated each and every year or whether a reasonable proxy for a retiree's ability-to-pay can be established at the age and date that healthcare benefits begin. Mercer's analysis of adjusted gross income (AGI) and pension income reveals that for State retirees, there is a very strong correlation between these two variables with a correlational coefficient of +0.988 (a coefficient of positive 1.000 is a perfect relative relationship while a coefficient of negative 1.000 is a perfect inverse relationship). In other words, a retiree's State of Illinois pension(s) is very predictive of a person's household income in retirement. This analysis is based upon a subset of Illinois tax filers (e-filers) representing over 50% of all filers. Note: Mercer has had to make the assumption that this 50% subset has the same pension income to household income relationship as the non e-filers. Given the very high correlational coefficient noted above for the e-filers Mercer believes that this is a reasonable assumption.

Generally, pension income represents approximately 50% of household income on average. Social Security income, investments, and other income make up the balance. Social Security income is correlated to pension income for most State retirees. Mercer projects that the most variable items in household income over time will be investment income, income from a spouse or secondary employment and "windfall" income.

The annual verification approach has the best assurance of catching year-to-year variations in household income and, hence, ability-to-pay. However, this approach also comes with a number of administrative complexities. The annual verification approach will be costly. This approach would likely require submission of Federal AGI documentation due to non-Illinois income tax filers (out-of-state retirees or filers with only Illinois pension income). There would also be a time lag in this approach since the prior year's tax information could be four to eight months in arrears and might not be available for the start of the upcoming fiscal year. Additionally, this process would need to be manual, meaning that over 80,000 paper files would need to be maintained, annually updated with the information communicated to a "billing" unit, all the while maintaining strict confidentiality and security of the information. ***This will be a considerable challenge.*** In addition, it is likely that an appeals process would need to be established to address situations where income "spikes" in a year and a subsequent increase in retiree healthcare contributions would be viewed as a hardship. An example would be a low household income family that was required to liquidate a substantial portion of their retirement savings to pay for a family emergency, such as a son or daughter's own medical crisis.

A primary drawback with a one-time determination of ability-to-pay using pension income is the exclusion of a spouse's income (until the spouse retirees) and other sources of income such as investments, lottery winnings, etc. While evaluating a retiree's ability-to-pay in setting retiree healthcare contributions is an important consideration, this approach ignores the retiree's length of service and the retiree's contribution to the State. Adding a points factor (years of service and age when benefits begin) is more in line with the market and more equitable. The points system requires those retiring early and receiving more expensive pre-Medicare healthcare coverage to pay more than similarly situated retirees deferring the age at which they begin benefit coverage (closer to Medicare eligibility). Therefore, the points dimension of Scenarios 4 and 5 serve somewhat as a partial barrier to the early retirement / spousal income issue. The primary advantage to making the determination at the age and date when retiree healthcare coverage begins is that it needs to be done only once, greatly reducing the administrative issues noted above. Additionally, using Illinois retiree pension income as a proxy for household income would be even more automated and much less difficult to administer. If household income were required to be determined just once, it is likely that some retirees with large spousal incomes would defer their benefit start date until their household income dropped.

Overall, Mercer advises that careful consideration be given to the value, cost and feasibility of each approach in evaluating ability-to-pay each year vs. making this determination once at the date benefits begin.

Potential to phase-in changes

As noted previously, Mercer believes that, due to the current level of generosity, any scenario chosen may require a phase-in of the changes over two or three years. The proposed scenarios would be the ultimate design at year two or year three. In a phase-in approach, the percentages would ramp up towards the ultimate percentages and be fully disclosed to all participants to provide adequate advance notice for personal financial and retirement planning purposes.

Other cost considerations

Currently, the State has an opt-out credit plan available to certain retirees who waive coverage. To minimize actual cost savings variability, Mercer would recommend that the current opt-out credit program be discontinued or modified as part of any of the scenarios recommended in this report. Under the current program, the opt-out credits make good financial sense (though they are rarely taken due to the generosity of the current plan). Under the proposed scenarios, the opt-out credits may not make financial sense for the State in their current form and could reduce the projected savings.

Enrollees who waive coverage may be another source of savings. As enrollee contributions increase, it becomes more likely that an enrollee will waive coverage. Enrollees who waive would provide additional savings to the State (beyond those shown in each scenario) as the State would no longer have to pay for their medical coverage; as noted earlier, these savings have not been incorporated into this analysis.

5

Study methodology

To perform its analysis, Mercer obtained de-identified census data from the State, which included information on each enrollee's retirement system (GARS, SERS, SURS, TRS or JARS) years of service (YOS), benefit start date and pension income.

Data overview

Like most datasets, the State's census information was incomplete in certain cases. When presented with missing information, an assumption was made regarding that data element as described below:

- About 5% of the retirees/survivors had either no YOS, or a way to calculate YOS (subtracting date of hire from date of retirement). The assumed YOS assigned to these records consisted of the average YOS based on the distribution of the known YOS population by current age and retirement system.

- For the records which had no date of hire, date of annuitant, or YOS, date of annuitant was assumed by assigning the average annuitant age by retirement system and adding this to the member's birthdates.

- Specific dependent data was not available. It was assumed that the "Mem + 2" coverage tier consisted of exactly two dependents, both of whom were non-Medicare eligible.

- The census contained some duplicative records, likely due to multiple pension benefits being collected by same member. These records were combined and their pension incomes were totaled.

Data summary

After the underlying data was cleaned, the three key amounts that drive each contribution scenario had to be derived: YOS, age at retirement (benefit start date) and annual income.

Where provided in the census, YOS was used. In cases where YOS was unavailable, date of hire was subtracted from date of retirement.

Age at retirement was calculated by subtracting date of birth from annuitant date, (as opposed to date of retirement to account for individuals who did not take their retiree medical benefit immediately).

Pension income, as reported by HFS, was used in Scenarios 3 and 4. Scenario 5 was based on estimated household income. Individuals with no income reported were assumed to have no income. Household income was estimated by multiplying pension income by the ratio of the average total income to average pension income, calculated separately for pre-65 and post-65 retirees, as outlined in the table below:

	Average Total Income (a)	Average Pension Income (b)	Ratio (a / b)
Pre-65 Retiree	$90,265	$45,070	2.003
Post-65 Retiree	$73,018	$34,036	2.145

The table shows that Pre-65 retirees tend to have more total income and pension income indicating they either have another source of income or they were able to retire sooner because of their higher salary. A further refinement of this methodology might assume individuals with fewer than 30 years have their pension income grossed up until they reach the equivalent of 30 years.

Projected retiree medical spend

FY2011 funding rates were provided by the Department of Health and Family Services to estimate new gross cost per enrollee. An enrollee's current contribution rates were calculated based on the FY2011. Contributions were assigned to each record based on the following rules:

- Survivor assumes retiree's benefit rules
- If retired before January 1, 1998, then the retiree received benefits with no contribution
- If retiree belongs to the TRS or SURS pool, retiree starts receiving contribution from the state at 5% per year of service starting with the fifth year of service.
- If retiree belongs to the SERS State pool, retiree starts receiving contribution from the state at 5% per year of service starting at the eight year of service.

- If retiree belongs to the GARS state pool, retiree starts receiving a 100% contribution from the state after four years of service.
- If retiree belongs to the JRS state pool, retiree starts receiving a 100% contribution from the state after six years of service.
- Dependents pay the contribution rate based on the coverage level and plan elected.

Other Assumptions

For the proposed scenarios, the individual costs were aggregated to determine the total cost to the State. No increase in covered lives was assumed and Fiscal Year 2011 budget and contribution rates were trended to Fiscal Year 2012 at 8%. No change in vendor or migration between current plans was assumed.

The aggregate costs were first calculated for the baseline 2012 scenario, then individuals were apportioned between the various pools within the five scenarios based on their YOS, benefit points and/or income to determine what level of cost share, by pool, would be needed to approach the 50% benchmark contribution level resulting in approximately $260 to $300 million in cash savings for FY2012.

Appendix A

Retiree medical strawman comparison

Appendix A

Strawman comparison - Medicare primary retirees											
						Monthly QCHP contribution					
Strawman	Years of service	Age at benefit start date	Benefit points	Pension income	Household income	Current[1]	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
1	10	65	75	$10,000	$30,000	$202	$287	$233	$36	$179	$215
2	10	65	75	$20,000	$40,000	$202	$287	$233	$108	$215	$215
3	20	55	75	$20,000	$20,000	$0	$179	$233	$108	$215	$179
4	20	65	85	$40,000	$120,000	$0	$179	$179	$179	$197	$233
5	20	55	75	$80,000	$160,000	$0	$179	$233	$251	$287	$287
6	20	65	85	$120,000	$120,000	$0	$179	$179	$251	$269	$233
7	30	55	85	$20,000	$60,000	$0	$108	$179	$108	$162	$197
8	30	65	95	$40,000	$80,000	$0	$108	$72	$179	$90	$90
9	30	55	85	$80,000	$80,000	$0	$108	$179	$251	$233	$197
10	30	65	95	$120,000	$240,000	$0	$108	$72	$251	$162	$108
11	30	65	95	$160,000	$350,000	$0	$108	$72	$251	$305	$305

Strawman comparison - Non-Medicare retirees											
						Monthly QCHP contribution					
Strawman	Years of service	Age at benefit start date	Benefit points	Pension income	Household income	Current[1]	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
1	10	65	75	$10,000	$30,000	$481	$784	$637	$98	$490	$588
2	10	65	75	$20,000	$40,000	$481	$784	$637	$294	$588	$588
3	20	55	75	$20,000	$20,000	$0	$490	$637	$294	$588	$490
4	20	65	85	$40,000	$120,000	$0	$490	$490	$490	$539	$637
5	20	55	75	$80,000	$160,000	$0	$490	$637	$686	$784	$784
6	20	65	85	$120,000	$120,000	$0	$490	$490	$686	$735	$637
7	30	55	85	$20,000	$60,000	$0	$294	$490	$294	$441	$539
8	30	65	95	$40,000	$80,000	$0	$294	$196	$490	$245	$245
9	30	55	85	$80,000	$80,000	$0	$294	$490	$686	$637	$539
10	30	65	95	$120,000	$240,000	$0	$294	$196	$686	$441	$294
11	30	65	95	$160,000	$350,000	$0	$294	$196	$686	$833	$833

[1] Represents typical State contribution rules of a 5% State contribution for each year of service

Appendix A
Page 2 of 2

Strawman comparison - Medicare primary dependents											
						Monthly QCHP contribution					
Strawman	Years of service	Age at benefit start date	Benefit points	Pension income	Household income	Current[1]	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
1	10	65	75	$10,000	$30,000	$153	$288	$234	$36	$180	$216
2	10	65	75	$20,000	$40,000	$153	$288	$234	$108	$216	$216
3	20	55	75	$20,000	$20,000	$153	$180	$234	$108	$216	$180
4	20	65	85	$40,000	$120,000	$153	$180	$180	$180	$198	$234
5	20	55	75	$80,000	$160,000	$153	$180	$234	$252	$288	$288
6	20	65	85	$120,000	$120,000	$153	$180	$180	$252	$270	$234
7	30	55	85	$20,000	$60,000	$153	$108	$180	$108	$162	$198
8	30	65	95	$40,000	$80,000	$153	$108	$72	$180	$90	$90
9	30	55	85	$80,000	$80,000	$153	$108	$180	$252	$234	$198
10	30	65	95	$120,000	$240,000	$153	$108	$72	$252	$162	$108
11	30	65	95	$160,000	$350,000	$153	$108	$72	$252	$306	$306

Strawman comparison - Non-Medicare primary dependents											
						Monthly QCHP contribution					
Strawman	Years of service	Age at benefit start date	Benefit points	Pension income	Household income	Current[1]	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
1	10	65	75	$10,000	$30,000	$214	$685	$557	$86	$428	$514
2	10	65	75	$20,000	$40,000	$214	$685	$557	$257	$514	$514
3	20	55	75	$20,000	$20,000	$214	$428	$557	$257	$514	$428
4	20	65	85	$40,000	$120,000	$214	$428	$428	$428	$471	$557
5	20	55	75	$80,000	$160,000	$214	$428	$557	$600	$685	$685
6	20	65	85	$120,000	$120,000	$214	$428	$428	$600	$642	$557
7	30	55	85	$20,000	$60,000	$214	$257	$428	$257	$385	$471
8	30	65	95	$40,000	$80,000	$214	$257	$171	$428	$214	$214
9	30	55	85	$80,000	$80,000	$214	$257	$428	$600	$557	$471
10	30	65	95	$120,000	$240,000	$214	$257	$171	$600	$385	$257
11	30	65	95	$160,000	$350,000	$214	$257	$171	$600	$728	$728

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