GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

Legislative Actuarial Note

HEALTH BENEFITS

BILL NUMBER: House Bill 1352 (First Edition)

SHORT TITLE: State Health Plan Vesting Changes.

SPONSOR(S): Representatives Clary and LaRoque

SYSTEM OR PROGRAM AFFECTED: Teachers' and State Employees' Comprehensive Major Medical Plan.

FUNDS AFFECTED: State General Fund, State Highway Fund, other State employer receipts, premium payments for dependents by active and retired teachers and State employees, premium payments for coverages selected by eligible former teachers and State employees, premium payments for coverages selected by firefighters, rescue squad workers, members of the National Guard, certain County local governments, and the North Carolina Symphony Society, Inc.

BILL SUMMARY: The proposed legislation changes eligibility for non-contributory health benefit coverage as a retired employee for future employees first hired on and after October 1, 2005 and members of the General Assembly first taking office on and after October 1, 2005. The bill proposes coverage for health benefits under the Plan to be provided on a partially contributory basis to future employees who become an eligible retired employee with less than 20 years of retirement service credit at the time of their retirement. These future employees will pay a percentage of the premium contribution required for their own health benefit coverage under the Plan according to the following schedule: 5 up to 10 years of retirement credit service 75%; 10 up to 15 years of credit – 50%; and 15 up to 20 years of credit – 25%. Future employees who retire with 20 or more years of retirement service credit will be eligible for non-contributory health benefit coverage.

EFFECTIVE DATE: July 1, 2005.

ESTIMATED IMPACT ON STATE: Based upon information provided by the Plan's consulting actuary, Aon Consulting, and the consulting actuary for the General Assembly, Hartman and Associates, both actuaries estimate that the proposed bill will have no financial impact on the Plan for the upcoming 2005-2007 biennium.

Eligibility for health benefit coverage under the Plan, as a retired employee requires that the employee have completed at least 5-years of contributory retirement service with an employing unit at the time of their retirement from a State-supported retirement system. The earliest that a member of the Teachers' and State Employees' Retirement System and the Legislative Retirement System can retire, is age 60 with 5 years of retirement service credit, and age 50 with 5 years of retirement service credit under the Consolidated Judicial Retirement System. Therefore, the proposed bill would not have any financial impact on the Plan earlier than October 1, 2010.

With respect to the future financial impact on the Plan 5-years and beyond, both actuaries estimate that the Plan will experience adverse selection of plan members who retire in the future with less than 20 years of retirement service credit, who under the bill, will be subject to partially contributory premiums (i.e., premium contributions cost-shared by the employee and the State) in order to participate in the Plan. Adverse selection occurs when a change in the Plan creates an incentive for plan members with favorable claims experience to exit the Plan and those with greater claims experience to remain. Current underwriting experience reflects that, on average, the Plan collects premiums in excess of claims for retired employees who retired with less than 20 years of retirement service credit. Supporting this observation is that the majority of current retired employees who retired with less than 20 years of retirement service credit have other primary health benefit coverage that serves as the first payer of a plan member's claims before the Plan is subject to a potential claim receipt. Approximately 84% of these current retired employees are Medicare eligible, which under the General Statutes requires the Plan to be the secondary payer of benefits after Medicare on a "carve-out" basis for these affected plan members. With the Plan as secondary payer of health benefits, the claims liability for these retired employees is significantly less than when the Plan is the primary payer of benefits. Thus, the requirement that future retired employees with the same amount of retirement service credit pay fully contributory premiums may cause a significant percentage of them to seek other less costly health benefit coverage. While the plan members may choose alternative health benefit coverage thereby lowering the amount of claims paid by the Plan, the loss of the premium contributions collected in excess of their claims will likely have a negative financial effect upon the Plan. The net effect is to lose the underwriting subsidy generated by healthier plan members and therefore reduce the Plan's underwriting gain to offset other poorer claims risk in the Plan. The result of this anticipated adverse selection is to cause the Plan to require additional premium dollars to compensate for the loss of underwriting gain currently experienced for this group. As an arbitrary point in time estimate, a 10th year impact was requested from each actuary. Aon Consulting's estimate indicates a slight premium increase of 0.1% would be required in 2015 as a result of the bill. Hartman and Associates indicates that the bill would require a similar minimal premium increase in 2015 at a rate equivalent to 0.2%. In current dollars the estimated required additional premium in year 10 ranges between $1 million and $4 million. The alternatives to a premium increase would be a reduction in benefits offered by the Plan in an amount equal to the required additional premium or, if sufficient, utilization of the Plan's cash reserves at that point in time.

Separately, outside of the slightly negative impact to the Plan's finances, there could be some future amount of payroll savings to the State as an employer. Currently, employing agencies are charged a percent based payroll contribution rate that generates contributions from all employing agencies. These employer-paid funds are deposited in a trust fund in the State Treasurer's office from which the proceeds are used to pay non-contributory premiums (i.e., employer-paid premiums) for all eligible retired employees. Savings to the State would occur by requiring future retired employees who retire with less than 20 years of retirement service credit, that elect to join the Plan, to pay their premiums on a partially contributory basis. Any savings anticipated would not be realized for at least 5 or more years. Based on data provided by the State Retirement System, assuming a 3-year average of 1,952 annual retirements of employees with less than 20 years of retirement service credit, it is estimated that there may be approximately $10 to $12 million in payroll contribution savings by year 10. The expected impact from the proposed bill on the employer contribution rate used to fund premium contributions for retired employees is estimated to be approximately 0.1% of total payroll. The payroll savings are limited because past experience data indicates that approximately 70% of employees retire with more than 20-years of retirement service credit and therefore on average most future retired employees would not be affected by the fully contributory premium requirements in the proposed bill. In, addition the bill requires its application to be prospective to employees first hired on or after October 1, 2005. Thus, current non-contributory premiums paid on behalf of current retirees, and future retirees who were employed before October 1, 2005, and whom retire with less than 20 years of retirement service credit, will continue to be a State obligation for some time until these retirees exit the Plan.

ASSUMPTIONS AND METHODOLOGY: The Comprehensive Major Medical Plan for Teachers and State Employees is divided into two programs: a self-insured indemnity type program and a prepaid program of coverage by health maintenance organizations. The benefits of the self-insured indemnity type of program are spelled out in Part 3 of Article 3 of Chapter 135 of the North Carolina General Statutes (i.e., $350 annual deductible, 20% coinsurance up to $1,500 annually, etc. paid by the program's members). From October, 1982, through June, 1986, the Plan only had a self-funded indemnity type of program which covered all employees, retired employees, eligible dependents of employees and retired employees, and eligible former employees and their eligible dependents authorized to continue coverage past a termination of employment other than for retirement or disability purposes. A prepaid program of coverage by health maintenance organizations (HMOs) was offered in July 1986, as an alternative to the Plan's self-insured indemnity program. HMOs are required to offer benefits that are comparable to those provided by the self-insured indemnity program. Beginning in July 2000, firefighters, rescue squad workers, and members of the National Guard and their eligible dependents were allowed to voluntarily participate in the Plan on a fully contributory basis, provided they were ineligible for any other type of group health benefits and had been without such benefits for at least six months. In July 2004, the North Carolina Symphony Society, Inc., a non-profit corporation, was included as an employing unit under the Plan for the purpose of providing health benefits to the Symphony Society's employees and employees' families. The Symphony Society provides health benefits for its employees and employee family members through a labor contract with the Professional Musicians Association, a local of the American Federation of Musicians. Coverage under the Plan will be on a partially contributory basis for Symphony Society employees and enrolled spouses and dependent children. The amount of contributions provided by the Symphony Society and by their employees is determined periodically in accordance with the labor contract. The Plan's Executive Administrator and Board of Trustees are required to set premium rates for Symphony society employees and their families separate from those charged to active and retired teachers and state employees and their dependents enrolled in the Plan. Retired employees of the Symphony Society are not eligible for health benefits under the Plan since they are not members of the State Retirement Systems. Also beginning in July 2004, the North Carolina county local governments of Bladen, Cherokee, Rutherford, Washington, and Wilkes counties were authorized to become employing units under the Plan for the purpose of providing health benefits to their respective employees, retired employees, and their employee's eligible spouses and dependent children. If these local governments elect to participate in the Plan, they must by legal resolution approved by the Plan elect such participation and agree to make any contributions required by the Plan. A local government must allow all of its eligible employees and their eligible spouses and dependent children to enroll in the Plan on a non-contributory, partially contributory, or fully contributory basis. All enrolled employees, retired employees, and their family members will be required to participate in disease management, case management, and all other cost containment measures implemented by the Plan. If a local government elects to enroll its retired employees, and their eligible spouses and dependent children, the election is irrevocable. Local government employers making this election to cover retired employees are also required to make additional contributions to the Local Governmental Employees' Retirement System for this purpose as do all other employers participating in the Plan that cover its retired employees. If a local government does not participate in the Local Governmental Employees' Retirement System, but has another formally established retirement plan, and elects to cover its retired employees, it is required to make premium contributions to the Plan as it may require. Local governments and their employees and retired employees will pay the same premium rates as those charged by the Plan for active and retired teachers and state employees and their dependents enrolled in the Plan. County local governments authorized to participate in the Plan may do so through June 30, 2006. Of the county local governments authorized to participate in the Plan, none have chosen to do so as of December 31, 2004. Employer-paid non-contributory premiums are only authorized for the self-insured indemnity program's coverage for teachers, state employees and retired employees. All other types of premium contributions in the indemnity program are fully contributory, except for job-sharing public school teachers who are authorized to pay partially contributory premiums at 50% of non-contributory rates. The Plan's Executive Administrator has set the premium rates for firefighters, rescue squad workers, and members of the National Guard and their families at 20% more than the comparable rates charged for teachers, state employees, retired employees, and their families. Similarly the Plan's Executive Administrator has set premium rates for members of the North Carolina Symphony Society, Inc. and their families at 51% more than the comparable rates charged for teachers, state employees, retired employees, and their families. Premiums paid by employers to HMOs are limited to like amounts paid to the indemnity program with employees and retired employees paying any HMO amounts above the indemnity program's non-contributory rates. Both types of program coverage continue to be available under the Plan; however none of the HMOs with certificates of authority to transact business in North Carolina have offered to participate in the Plan since September 30, 2001. The Plan's employees and retired employees select the type of program that they wish for themselves and their dependents during the months of August and September of each year for coverage beginning in October.

The demographics of the Plan as of December 31, 2004, include:

	Self-Insured Indemnity Program	Alternative HMOs	Plan Total
Number of Participants			

Active Employees	295,793	-0-	295,793
Active Employee Dependents	134,812	-0-	134,812
Retired Employees	127,074	-0-	127,074
Retired Employee Dependents	19,180	-0-	19,180
Former Employees & Dependents with Continued Coverage	2,278	-0-	2,278
Firefighters, Rescue Squad Workers, National Guard Symphony Members & Dependents	171	-0-	171
Total Enrollments	579,308	-0-	579,308
<u>Number of Contracts</u>			
Employee Only	339,047	-0-	339,047
Employee & Child(ren)	41,448	-0-	41,448
Employee & Family	42,372	-0-	42,372
Total Contracts	422,867	-0-	422,867
<u>Percentage of Enrollment by Age</u>			
29 & Under	26.2%	-0-%	26.2%
30-44	20.6	-0-	20.6
45-54	20.1	-0-	20.0
55-64	17.9	-0-	17.9
65 & Over	15.3	-0-	15.3
<u>Percentage of Enrollment by Sex</u>			
Male	37.9%	-0-%	37.9%
Female	62.1	-0-	62.1

<u>Assumptions for the Self-Insured Indemnity Program</u>: For the fiscal year beginning July 1, 2004, the self-insured program started its operations with a beginning cash balance of $224 million. Receipts for the year are estimated to be $1.687 billion from premium collections and $7 million from investment earnings for a total of $1.694 billion in receipts for the year. Disbursements from the self-insured program are expected to be $1.667 billion in claim payments and $56 million in administration and claims processing expenses for a total of $1.723 billion for the year beginning July 1, 2004. For the fiscal year beginning July 1, 2004, the self-insured indemnity program is expected to have a net operating loss of approximately $29 million for the year. The Plan’s self-insured indemnity program is expected to have an available beginning cash balance of $195 million for the fiscal year beginning July 1, 2005. The self-insured indemnity program is consequently assumed to not be able to carry out its operations for the 2005-2007 biennium without increases in its current premium rates or a reduction in existing benefits or payments to health care providers or both. This assumption is further predicated upon the fact that the program’s cost containment strategies (hospital DRG reimbursements, discounts on hospital outpatient services, pre-admission hospital testing, pre-admission hospital inpatient certification with length-of-stay approval, hospital bill audits, case and disease management for selected medical conditions, mental health case management, coordination of benefits with other payers, Medicare benefit “carve-outs”, cost reduction contracts with participating physicians and other

providers, a prescription drug benefit manager with manufacturer rebates from formularies, and fraud detection) are maintained and improved where possible. Current non-contributory premium rates are $217.66 monthly for employees whose primary payer of health benefits is Medicare and $285.92 per month for employees whose primary payer of health benefits is not Medicare. Fully contributory premium amounts for employee and child(ren) contracts are $135.46 monthly for children whose primary payer of health benefits is Medicare and $178.22 monthly for other covered children, and $324.88 per month for family contracts whose dependents have Medicare as the primary payer of health benefits and $427.48 per month for other family contract dependents. Claim cost trends are expected to increase at a rate of 12% annually. Total enrollment in the program is expected to increase less than 2% annually over the next few years. The number of enrolled active employees is expected to increase about 2.5% annually over the next few years, whereas the growth in the number of retired employees is assumed to be 5% per year. The program is expected to have a 1% decrease in the number of active employee dependents per year whereas the number of retiree dependents is expected to increase 1% per year. Investment earnings are based upon a 3.5% return on available cash balances. The self-insured indemnity program maintains a claim stabilization reserve for claim cost fluctuations equal to 7.5% of annual claim payments without reserving additional funds for incurred but unreported claims.

<u>Assumptions for estimating impact to the Plan under the proposed changes for future employees eligibility for non-contributory health benefit coverage:</u>

Data was collected from the State Retirement Systems Office on current service retirees in the Teachers' and State Employees' Retirement System by their years of service at retirement. This data was further grouped into categories of 5 up to 10 years of service, 10 up to 15 years of service, 15 up to 20 years of service, and 20 or more years of service. From this data the Claims Processing Contractor for the Plan matched data on medical claims experience, primary or secondary coverage status, and type of member contract. This data was used to estimate the underwriting impact on the Plan based on medical claims experience and premium projections for estimating future financial impact to the Plan under the proposed bill. The State Retirement Systems Office also provided additional data on service retirements by year since calendar year 2000. That data reflected that on average 90% of employees retired with 10 or more years of service. Based on the underwriting experience generated by the analysis of data from each actuary, the rate of anti-selection assumed by each actuary was approximately 60% on average. Claims data and estimated premium contributions reflect that on average the ratio of claims to premiums paid were as follows: Medicare eligible retired employees – 80%; Retired employees with other primary coverage – 20%; and Retired employees with the Plan as primary coverage – 120%.

SOURCES OF DATA:

-Actuarial Note, Hartman & Associates, House Bill 1352, June 27, 2005, original of which is on file in the General Assembly's Fiscal Research Division.

-Actuarial Note, Aon Consulting, House Bill 1352, July 8, 2005, original of which is on file with the Comprehensive Major Medical Plan for Teachers and State Employees and the General Assembly's Fiscal Research Division.

TECHNICAL CONSIDERATIONS: None

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