GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

Legislative Actuarial Note

HEALTH BENEFITS

BILL NUMBER: Senate Bill 1866 (First Edition)

SHORT TITLE: State Health Plan/Retiree Vesting.

SPONSOR(S): Senator Snow

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 modifies eligibility for non-contributory health benefit coverage as a retired employee for future employees first hired on and after October 1, 2006 and members of the General Assembly first taking office on and after October 1, 2006. The bill proposes to require future employees upon retirement to earn a minimum of 20 years of retirement service credit to be eligible for health benefit coverage on a non-contributory basis. The bill further requires future employees upon retirement who earn less than 20 years of retirement service credit to pay a premium contribution for their health benefit coverage under the Plan. Future employees upon retirement who earn 10 up to 20 years of retirement service credit would be required to pay a partially contributory premium equal to 50% of the required premium. Future employees upon retirement with 5 up to 10 years of retirement credit service would be ineligible for health benefit coverage under the Plan.

EFFECTIVE DATE: July 1, 2006

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 current 2005-2007 biennium. Because of the prospective application of the bill's changes to future employees first hired on or after October 1, 2006, the first year of financial impact is not expected until after October 1, 2011.

With respect to the future financial impact on the Plan 5-years and beyond, both actuaries estimate that the Plan will experience adverse selection from the proposed legislation. Adverse selection occurs when a benefit change 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 estimated to be 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 less than 20-years of retirement service credit to pay fully or partially contributory premiums may cause a significant percentage of them to seek lower priced alternative health benefit coverage. While 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 estimated positive 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 potentially 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 does not estimate an impact to the Plan for the 2016-2017 fiscal year and first projects a mid-point estimated impact of $3.3 million in the 2017-2018 fiscal year. Hartman and Associates indicates that the bill would require a slight premium increase in the 2016-2017 fiscal year with a midpoint estimate of $2.2 million. The difference in the projection of when an adverse impact to Plan would be first expected to occur reflects Hartman & Associates recognition of expected underwriting gains that would be estimated to be lost on retired employees with 5 up to 10 years of service being excluded from participating in the Plan. 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 actuarial analysis that reflects a 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 be assumed to 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 either a fully or partially contributory basis based on the number of years of retirement service credit earned. Any savings anticipated would not be realized for at least 5 or more years beyond October 1, 2006.

The Fiscal Research Division has made an arbitrary point-in-time 10th year impact estimate on payroll contributions. This analysis estimates in current dollars approximately $11 to $13 million in payroll contribution savings assuming all future employees retiring with between 5 to 10 years of service will be ineligible for health benefits under the Plan. The resulting expected impact on the employer contribution rate used to fund premium contributions for retired employees is estimated to be approximately 0.1% (one-tenth of one percent) of total payroll based on current projected total payroll. The payroll savings are limited because past experience data indicates that approximately 90% of employees retire with more than 10-years of retirement service credit and therefore on average most future retired employees would not be affected by the fully or partially 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, 2006. Thus, current non-contributory premiums paid on behalf of current retirees, and future retirees who were employed before October 1, 2006, 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 currently operates a self-insured indemnity type health benefit program serving covered 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. 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 $2,000 annually, etc. paid by the program's members).

The Plan also has statutory authorization under G.S. 135-39.5B(a) to operate optional prepaid programs of health benefit coverage. A prepaid program of coverage by health maintenance organizations (HMOs) was offered in July 1986 under this authority, as an alternative to the Plan's self-insured indemnity program, where HMOs were required to offer benefits that were comparable to those provided by the self-insured indemnity program at that time. Coverage under prepaid HMO plan alternatives ceased being offered after September 30, 2001 due to the lack of HMOs with certificates of authority to transact business in the state responding to solicitations by the Plan to offer them as alternatives.

The 2005 Session of the General Assembly modified the Plan's statutes by adding G.S. 135-39.5(b) to allow the Plan to adopt an arrangement for optional hospital and medical benefits programs other than an option prepaid program on a purchased or underwritten basis including a preferred provider option (PPO) or other type optional program. After consultation with the Committee on Employee Hospital and Medical benefits in early 2006, the Plan has elected to offer benefit alternatives under a PPO option beginning October 1, 2006.

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. The North Carolina Symphony, Inc. is authorized to be deemed an employing unit until June 30, 2006.

Also beginning in July 2004, the North Carolina county local governments of Bladen, Cherokee, Rutherford, and Washington counties, and beginning in July 2005 the local government municipality of the Town of Forest City, 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 a local government elects 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, only the counties of Bladen, Rutherford, and Washington have chosen to do so as of December 31, 2005.

Employer-paid non-contributory premiums are only authorized for the self-insured indemnity program and the three choices to be offered under the optional preferred provider option program's coverage for teachers, state employees and retired employees. All other types of premium contributions in the indemnity program and the preferred provider option 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 optional programs are limited to like amounts paid to the indemnity program with employees and retired employees paying any optional program premium amounts above the indemnity program's non-contributory rates.

The demographics of the Plan as of December 31, 2005, include:

	Self-Insured Indemnity Program	Optional Programs	Plan Total
Number of Participants			
Active Employees	300,899	-0-	300,899
Active Employee Dependents	132,737	-0-	132,737
Retired Employees	133,486	-0-	133,486
Retired Employee Dependents	19,676	-0-	19,676
Former Employees & Dependents with Continued Coverage	2,482	-0-	2,482
Firefighters, Rescue Squad Workers, National Guard Symphony Members & Dependents	176	-0-	176
Local Government Members & Dependents	1,308	-0-	
Total Enrollments	590,764	-0-	590,764
Number of Contracts			
Employee Only	354,033	-0-	354,033
Employee & Child(ren)	41,686	-0-	41,686
Employee & Family	42,632	-0-	42,632
Total Contracts	438,351	-0-	438,351
Percentage of Enrollment by Age			
29 & Under	25.8%	-0-%	25.8%
30-44	20.4	-0-	20.4
45-54	19.7	-0-	19.7
55-64	18.6	-0-	18.6
65 & Over	15.6	-0-	15.6
Percentage of Enrollment by Sex			
Male	37.5%	-0-%	37.9%
Female	62.5	-0-	62.1

Assumptions for the Self-Insured Indemnity Program: For the fiscal year beginning July 1, 2005, the self-insured program started its operations with a beginning cash balance of $188.1 million. Receipts for the year are estimated to be $1.879 billion from premium collections and $9.6 million from investment earnings for a total of $1.888 billion in receipts for the year. Disbursements from the self-insured program are expected to be $1.740 billion in claim payments and $77.7 million in administration and claims processing expenses for a total of $1.817 billion for the year beginning July 1, 2005. For the fiscal year beginning July 1, 2005, the self-insured indemnity program is expected to have a net operating gain of approximately $70.9 million for the year. The Plan's self-insured indemnity program is expected to have an available beginning cash balance of $259 million for the fiscal year beginning July 1, 2006. The self-insured indemnity program is assumed to 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 $244.48 monthly for employees whose primary payer of health benefits is Medicare and $321.14 per month for employees whose primary payer of health benefits is not Medicare. Fully contributory premium amounts for employee and child(ren) contracts are $152.16 monthly for children whose primary payer of health benefits is Medicare and $200.18 monthly for other covered children, and $364.92 monthly for family contracts whose dependents have Medicare as the primary payer of health benefits and $480.14 per month for other family contract dependents.

Claim cost trends are expected to increase at a rate of 11% 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 4.5% 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.

Assumptions for estimating impact to the Plan under the proposed changes for future employees' eligibility for non-contributory health benefit coverage as a retired employee:

Data was collected from the State Retirement Systems Office in 2005 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 for calendar years 2000 through 2004. That data reflected that on average 90% of employees retired with 10 or more years of service and that over 70% of employees retired with more than 20-years of service. Aon Consulting reports that 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%. Based on data provided by the State Retirement System, the payroll contribution analysis assumes a 3-year projected average of 825 annual retirements of employees with less than 10-years of retirement service credit assuming a 10% growth in the number of these retirements over 2004. It was also assumed that some percent of the annual number of retirements of employees with 7, 8, or 9 years of retirement service credit would be delayed to the future in anticipation of earning a minimum of 10-years of retirement service credit in order to be eligible to earn a 50% premium contribution for health benefit coverage. 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.

SOURCES OF DATA:

-Actuarial Note, Hartman & Associates, Senate Bill 1866, June 5, 2006, original of which is on file in the General Assembly's Fiscal Research Division.
-Actuarial Note, Aon Consulting, Senate Bill 1866, July 5, 2006, 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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Official Fiscal Research Division Publication

DATE: July 17, 2006

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