

SB

90

<TARGET><BILL>SB 90</BILL><SUBJECT>SB
90</SUBJECT><COMM>SEDC28</COMM></TARGET>

Alaska State Legislature

Senate Education Committee

Senator Gary Stevens, Chair

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MEMBERS:

Senator Charlie Huggins
Senator Mike Dunleavy
Senator Berta Gardner
Senator Bert Stedman

WAIVE COMMITTEE REFERRAL


DATE: April 5, 2013

RE: Senate Bill 90, "An Act relating to group insurance coverage and self-insurance coverage for school district employees; and providing for an effective date."


Members of the Senate Education Committee agree to waive Senate Bill 90 from the Education Committee and on to its next committee of referral.




Senator Gary Stevens, Chair



Senator Mike Dunleavy, Vice-Chair



Senator Charlie Huggins



Senator Bert Stedman



Senator Berta Gardner

FROM NEA

SB 90

- Bill requires that ALL eligible school district employees be covered by this policy. Several districts only provide one policy per family if spouses are also employed, employees who have coverage outside of the district also waive, and most employees eligible for Indian Health Service do not take employer sponsored plans. **This bill will drive up the costs to cover all eligible employees even if the employee does not need the coverage.**
- Bill requires dismantling of bundled borough/city and school district plans. Driving up the costs for the borough/cities. Given the short time line of this bill, due consideration for the impact upon those boroughs has not been afforded. Has communication occurred with those entities regarding this impact? Are they prepared? Ketchikan is a prime example.
- Local 71 provides a less expensive plan than the mandated economy plan they have identified additional cost of \$400,000 due to this bill, **how many more situations like this are out there?**
- The economy plan as proposed in this bill has a financial note of \$1,330 per employee, on a benefit level vs. premium; the Trusts' plan is less expensive and provides important benefits. The Trust also offers plan designs with a lower premium and less.
- State already sponsors a health insurance plan for public education employees. On Saturday Rob Thomason Superintendent with Petersburg reported a nearly 40% increase to their plan with the state sponsored plan design. This was the basis for a decision to leave the state sponsored plan, saving over per his testimony \$400,000. Other districts have or are abandoning the state sponsored plan as well. (AETNA Poly Sub)
- Commissioner of Department of Administration testified 10% for admin (10 cents of every premium dollar goes to non claims related expenses, only 90 cents actually are spent on health care). National trend is 6%, other Trusts are at 3% **INEFFICIENT**
- The State does not have a wellness program. There is no health care management program to manage costs and quality at the state level.
- All self-insured organizations are vested in the health of employees. Their claims cost hit them every day. To say only the state is concerned is false.
- This becomes a **MANDATE** and gives no options for employees. Don't legislators typically oppose mandates? Provide an "opt in" program for districts that want the state's plan. Provide direction to the school districts on allowable insurance benefits rates.
- Per their report, Buck Consultants will **artificially** rate the economy plan. Keeping funding flat for five years. Costs will be there, but they will not increase the premium. They are passing the costs to other plans. \$1,389 in FY 15 and \$1,389 in FY 19. **Not transparent.**

Ray Gillespie
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Lobbying and Governmental Affairs



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March 4, 2013

HAND DELIVERED

Dear Tim ~~Lamkin~~,

As we promised, attached is an executive summary and actuarial review of certain aspects of the Hay Group report concerning a proposed (SB 90 and HB 196) state managed group health insurance program for public school employees. Please share with Senator Stevens.

Sincerely,

A handwritten signature in black ink, appearing to be 'Ray Gillespie', written over a large, sweeping flourish that extends to the left.

Ray Gillespie

February 25, 2014

The Wilson Agency, LLC engaged Optum consultants to review actuarial aspects of the report produced by the Hay Group (Hay) titled "State Managed Group Health Insurance Program for Alaska Public School Employees (December 2013)." Optum was chosen because they are an international firm with 15 offices across the United States performing actuarial services for over 300 insurance companies. Specifically, Optum actuaries were asked to review the assumptions used by Hay to determine their projected savings of a statewide plan for the following two factors: stop loss fees and fully insured overhead. Optum found:

- A. The Hay calculation does not consider the claims that stop loss carriers pay. The savings would only be \$330,000 to \$385,000, not \$1,100,000.
- B. The Hay report estimated overhead savings at 8%. Optum estimate the savings from overhead to be 4.9% to 5%. Optum's estimate reduces the overhead savings to \$550,000, a reduction of \$350,000 from the savings in the Hay report.
- C. Hay states, "We would anticipate that a new State-wide health plan would be self-sustaining, and not require State funding." Optum wholeheartedly concurs. However, the impact of underfunding a health plan of this size would be a significant hit to the finances of participating school districts and to the state itself. Optum' estimate that in 18% of plan years (nearly 1 in 5) actual claims may exceed the budget by over 105%. In another 32% of plan years claims may exceed the budget by up to 5%.
- D. Hay should have included a rate stabilization reserve to smooth out the impact of underfunding an additional annual cost of \$2 million.

Based on their analysis, Optum conclude the savings in the Hay report are overstated. In fact, Optum projected there would be **added cost** to the school districts if Hay had included the necessary funding of a claims stabilization reserve.

This paper was commissioned to address only a small part of the Hay report. There are other more subjective discussions in the Hay report that address savings to the district's budget but are not a savings in total spend through plan design and premium sharing changes that we did not cover in our report.



**ACTUARIAL REVIEW OF THE REPORT BY THE HAY GROUP ON A
STATE MANAGED GROUP HEALTH INSURANCE PROGRAM FOR
ALASKA PUBLIC SCHOOL EMPLOYEES**

FEBRUARY 14, 2014

INTRODUCTION

The Wilson Agency, LLC engaged Optum consultants to review actuarial aspects of the report produced by the Hay Group (Hay) titled "State Managed Group Health Insurance Program for Alaska Public School Employees (December 2013)." Specifically, Optum actuaries were asked to review the assumptions used by Hay to determine their projected savings of a statewide plan for the following two items in their report: stop loss fees and fully insured overhead.

The purpose of this Optum report is to respond to the Hay report with regard to these two items. This report is not intended for any other use.

The Alaska Senate Finance Committee engaged the Hay Group to perform a review of the current system of providing health benefits to Alaska public school employees. As part of this review, Hay consultants compared the present cost of the health plans used by school districts to the projected cost of a statewide, mandated participation health plan for all districts, under four scenarios of plan choice and employee contribution levels. The savings that Hay projected for the two items that Optum analyzed are the same for all four scenarios and are as follows ¹:

- Stop loss fees: \$1,100,000
- Fully insured overhead: \$1,200,000

Based on our study described below, we believe that these savings are overstated. This report will demonstrate why we take this position and will estimate the amount by which we differ from Hay's estimated savings.

STOP LOSS FEES

From our reading of the report, it appears that Hay considered the entire amount of stop loss fees now paid by the self-insured and "partially insured" groups as savings that would result from moving to a statewide plan. Hay believes that a statewide plan would not need any stop loss coverage, due to its large size, although later they say that such a plan could consider buying stop loss at a high attachment point. We have two issues with this savings item:

- A. If Hay is taking the entire stop loss premium as savings, then their calculation does not consider the claims that stop loss carriers pay. We do not have data on actual stop loss claims for the Alaska school districts, but based on our experience, stop loss coverage is generally priced under the assumption that 65% to 70% of the premiums will be paid as claims. This implies that, on average over the years, approximately \$715,000 to \$770,000 of the \$1,100,000 stop loss fees (premiums) will be paid back to the self-funded school districts as claims. These stop loss claims would offset claims that these districts would otherwise have to bear themselves.

For example, if a self-funded district purchases stop loss at a \$250,000 attachment point and one member has a \$1,000,000 claim, then the stop loss carrier pays \$750,000 of that member's claims and the district has no liability for the amount paid by the stop loss coverage.

Thus, even assuming that a statewide plan doesn't need stop loss coverage, the savings would only be **\$330,000 to \$385,000**, not \$1,100,000.

- B. While we agree with Hay that a large statewide plan does not require as great a level of stop loss protection as an individual school district, we do not agree that a statewide plan can do without any stop loss coverage. Alaska is a unique market, and the geographical size and relatively small population in the state imply a greater challenge to control the cost of large claims than in other states. The ACA-mandated unlimited benefit further complicates this task and then adds a significant catastrophic claim risk.

A reasonable stop loss level for a statewide plan would be a \$1,000,000 attachment point. Based on Optum's claims continuance (probability) table for 2013 and the stop loss premiums for the Public Education Health Trust for the 2012-13 school year shown in the Hay report ², we estimate an equivalent stop loss premium for a \$1,000,000 attachment point of \$1.20 per member per month (PMPM). Assuming an average of 2.06 members per employee, the stop loss premium for a statewide plan at a \$1,000,000 attachment point would be approximately \$475,000. As with (A) above, we would expect that 65% to 70% of this premium would be paid back as claims, so a statewide plan would have a "true" reinsurance cost of **\$140,000 to \$165,000**.

Bottom line: Rather than a \$1,100,000 savings from stop loss fees as projected by Hay, we believe the real savings will only be **\$190,000** (\$330,000 in A less \$140,000 in B) to **\$220,000** (\$385,000 in A less \$165,000 in B), a reduction of approximately \$900,000 from the savings in the Hay report.

FULLY INSURED OVERHEAD

Comments on Hay's Estimate

Hay considers the following parts of an insured plan's retention as fully insured overhead ³:

1. Pooling charges*:	2% of premium
2. Risk charges:	4% of premium
3. <u>Company profit:</u>	<u>2% of premium</u>
4. Total of 1, 2 and 3:	8% of premium

* "Pooling charges" typically mean amounts to cover very large, catastrophic claims, similar to stop loss. Later on the same page of the report, Hay refers to this item as "Reserves to cover the possibility of benefit costs exceeding their projections." We're not sure then why this item would be different from risk charges.

Hay then calculated the overhead expense as 8% of the fully insured premium for the 2012-13 plan year (\$10,974,000) to get \$877,837 of insurer overhead, which, when added to premium tax savings, totaled \$1.2 million (rounded) in total overhead savings.

The Hay report does not say how these overhead expense loads were derived, only that they are "typically" these percentages. Based on our long experience of developing and filing large and small group rates, we consider 8% to be high for these items. The table below, based on Appendix VII of the Hay report, shows the distribution of fully insured school districts by size.

DISTRIBUTION OF ALASKA SCHOOL DISTRICTS				
Size Category (cov'd employees)	Number of Groups	Number of Employees	Total Spend 2012-13	% of All Insured Spend
Under 10	3	14	\$ 231,904	2.1%
10 to 24	4	62	1,038,144	9.5%
25 to 50	6	227	4,326,818	39.3%
51 to 100	1	76	1,212,079	11.0%
101 to 150	1	137	1,274,969	11.6%
151 to 200	0	0	0	0.0%
201 and over	1	236	2,919,045	26.5%
Totals	16	752	\$ 11,002,959	100.0%

Two districts, each with over 100 covered employees, account for 38% of all the insured spend (premiums). Another district is in the 51 to 100 covered employee category and accounts for 11% of the spend. These three districts with nearly half of the insured spend are considered large groups under Alaska law, with an ACA minimum medical loss ratio (MLR) of 85%, and we would normally expect the sum of the priced-for risk margin and insurer profit on these groups to be about 3%. For the groups with 50 or fewer employees, we would normally expect the sum of the priced-for risk margin and insurer profit to be in the 4% to 6% range. Based on the distribution of fully insured districts by size, our expectation for the sum of the risk margin and insurer profit is more like **4.1% of premium**. As shown above, Hay assumes 4% for the risk charges and 2% for company profit, for a total of 6%. In dollar terms, we expect the sum of risk margin and insurer profit to be \$450,000, not the \$670,000 that Hay assumes.

Carriers add pooling charges to the rate development of large, experience rated groups. We generally concur with Hay's estimate that these gross charges, averaged over all of the fully insured groups (including those not experience rated), is approximately 2% of premium. We developed our estimate by averaging higher percentage charges for the larger experience rated districts (51 or more employees) and zero charges for the non-experience rated small districts of 50 or fewer employees, assuming common large claim pooling levels.

Carriers are permitted to experience rate large groups (51 or more eligible employees). Part of the experience rating process includes the pooling of very large, individual member claims. Under pooling, the carrier subtracts large claims in excess of the pooling attachment point from the group's experience claims and then adds back a pooling charge. In this way, large individual catastrophic claims won't cause a group's rates to fluctuate wildly. If a group has high individual claims that exceed the pooling charge, the pooling process can significantly reduce the claims used for rate setting and, in turn, reduce the group's rate. In effect, across a carrier's book of insured business, most of the pooling charge substitutes for a portion of the incurred claims in the rate bases of the carrier's insured groups.

Therefore, the large claim pooling process in an experience rated, fully insured plan functions analogously to stop loss in a self-insured plan. And just like stop loss, the carrier sets its pooling charge on the assumption that the pooled claims it removes from the group's experience for rate setting purposes will average about 65% to 70% of the pooling charge. Thus, the true net added cost of pooling to a block of experience rated groups is approximately 30% to 35% of the pooling charge. Using Hay's assumption of a 2% average gross pooling charge⁴ across all insured school districts, the real impact net of pool claims is only 0.6% to

0.7% of premium, or \$66,000 to \$77,000. Even if we use a slightly higher overall average pooling charge estimate, the real impact net of pooled claims is in the range of only **0.8% to 0.9% of premium**, not 2% as Hay assumes. In dollar terms, we expect the net pooling charge impact to be approximately \$100,000, not the \$220,000 to \$230,000 that Hay assumes.

Bottom line: We therefore estimate the savings from insurer overhead (pooling and risk charges and insurer profit) to be 4.9% to 5% of premium, not 8% as Hay assumes. Our estimate reduces the overhead savings to **\$550,000**, a reduction of \$350,000 from the savings in the Hay report.

Stabilization Reserve for a Statewide Plan

In its report, Hay states, "We would anticipate that a new State-wide health plan would be self-sustaining, and not require State funding."⁵ We wholeheartedly concur with this statement. The impact of underfunding a proposed statewide plan of this size would be a significant hit to the finances of participating school districts and to the state itself. For this reason, many if not most actuaries who work with large, self-funded plans strongly recommend that the plan hold a stabilization reserve in addition to the usual "incurred by not reported" (IBNR) claim reserve. Health insurers are *required* to hold a minimum amount of risk-based capital, which serves the same function as a stabilization reserve.

The purpose of the stabilization reserve is to provide a fund that the statewide plan can use to cover losses in a year or series of years. It is a smoothing mechanism to reduce the adverse impact on the school districts of a bad claims year. Without such a fund, the plan would have to cover its losses by either retroactively assessing the school districts for additional premium or by requesting money from the State. Either way causes significantly budgetary disruption to some government entities.

Even with a pool of the size proposed in the Hay report (15,768 covered employees and Optum's estimate of a total of 32,500 members), there is a significant likelihood that actual claims will exceed 105% of expected claims in a given year. To test the incidence, we performed a Monte Carlo simulation of the performance of a pool with approximately the total member count of all of the Alaska school districts combined. We used Optum's standard national claims distribution and assumed that predicted pricing trends would equally likely be too high or too low. We did not assume any other random factors. The results are as follows:

Claims as % of Expected	% of Years Occurring
85% or Less	0.2%
85%-90%	2.8%
90%-95%	14.2%
95%-97.5%	14.7%
97.5%-100%	18.0%
100%-102.5%	17.6%
102.5%-105%	14.3%
105%-110%	14.6%
110%-115%	3.3%
115% or more	0.3%

In this simulation, 18% of plan years—nearly 1 in 5—showed actual claims exceeding 105% of expected claims. Another 32% of plan years showed small losses under 5%.

Besides missing a trend forecast, the other risks to a large self-funded pool are:

- Not accounting for renegotiated changes in provider contracts and for additions and terminations of providers to and from the network.
- Extra uncertainty in the early years of operation. The plan will have to set an expected claim rate for the first two years using the past experience of many different existing plans, schedules of benefits, and funding mechanisms. There will be a significant time lag between the experience period and the projected plan year. The rate setting process for a new statewide school plan will be even more complicated if, as suggested in the Hay report⁶, school district participation could be phased in over several years, as collective bargaining agreements expire. There would be even more complications if Options 2, 3 and 4, all involving immediate plan changes, are adopted.
- Multiple consecutive years of unfavorable experience. The time lag between experience years and plan years for which rates are developed increases the likelihood that not just one but the next two plan years may be underrated. This is particularly a risk in the first two years of a new multi-district pool, for which the second year's rate will be based on an incomplete first year.

In summary, while over the long run, it's true a large statewide pool may increase credibility of experience for forecasting, in the short run there is considerably more uncertainty regarding the experience on which to base the early years' rates.

There are no published actuarial guidelines of which we're aware for determining the stabilization reserve for a self-funded plan. The best guides are the Risk Based Capital requirements for health insurers and the general practice of insurers and other public employee plans. These suggest a stabilization reserve ranging from 7% to 15% of annual premium (total spend) would be appropriate. In dollar terms, based on the 2012-13 school year total spend of \$295 million⁷, this range implies a stabilization reserve for a statewide plan ranging from \$20.6 million to \$44.2 million. The riskier early years of operation require a higher stabilization reserve, but for this analysis, we considered a longer 10 year time horizon, and so assumed that a statewide plan should hold, at a minimum, a 7% of premium (total spend) stabilization reserve.

Obviously, some entity or entities would have to fund this stabilization reserve, either the State of Alaska or the school districts. We assume that a likely scenario would be the State's providing initial funding for the stabilization reserve, with the districts repaying the State over a period of years. A ten year timeframe implies that districts' contribution to the stabilization reserve would be at least 0.7% of premium per year. We note that this contribution by the districts is entirely analogous to the risk charges that fully insured groups pay to carriers.

The annual contribution would be even more had we considered a shorter time frame and a larger stabilization reserve level. Furthermore, if the plan experiences a loss in any one of the years in the timeframe, the districts may need to make additional contributions to offset the loss.

Therefore, rather than the assertion in the Hay report that fully insured risk charges and stop loss fees would be eliminated in a statewide plan, there would indeed be some stop loss premiums, albeit at a higher attachment point, plus an estimated \$2.1 million per year in assessments to school districts to fund the plan's stabilization reserve (based on 2012-13 school year spend: \$295 million * 0.7%).

CONCLUSION

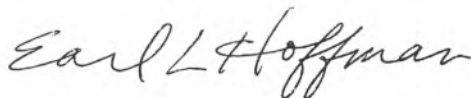
Based on our analysis, we conclude that the savings in the Hay report from the two items, fully insured overhead and stop loss fees, are overstated. In fact, we project that there would be *added* cost to the school districts if we include the necessary funding of a stabilization reserve for a statewide plan. The table below summarizes our findings:

Comparison of the Cost Difference from Moving to a Statewide Plan (costs are based on 2012-13 school year outlays)			
Item	Savings (Added Cost) Based On		Difference
	Hay Report *	Optum Analysis	
Stop loss fees	\$ 1,100,000	\$ 205,000 **	\$ (895,000)
Fully insured overhead			
Carrier risk charge & profit	670,000	450,000	(220,000)
Carrier pooling charge	230,000	100,000	(130,000)
State of Alaska premium tax	300,000	300,000	0
Statewide plan stabilization reserve--annual contribution ***	0	(2,065,000)	(2,065,000)
Total savings (added cost)	\$ 2,300,000	\$ (1,010,000)	\$ (3,310,000)

* Based on Hay report "Potential Savings" tables on pages 36, 39, 44, and 47 and on "Overhead by District Size on page 23.

** Stop loss fees net of expected stop loss claims. This is the average of the range of \$190,000 to \$220,000 stated above.

*** Average contribution over ten years.



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Footnotes

All citations below refer to the Hay Group report of December 6, 2013

1. Pages 36, 39, 44, 47.
2. Page 26.
3. Page 22, bar graphic for Fully Insured groups.
4. Page 22, bar graphic for Fully Insured groups.
5. Page 61.
6. Page 63.
7. Appendix VII