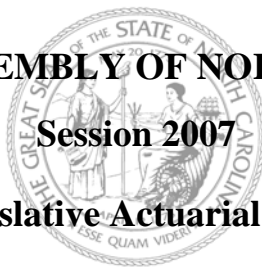


# GENERAL ASSEMBLY OF NORTH CAROLINA



Session 2007

## Legislative Actuarial Note

### HEALTH BENEFITS

**BILL NUMBER:** House Bill 1473 (Third Edition)

**SHORT TITLE:** 2007 Appropriations Act.

**SPONSOR(S):**

**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, and certain authorized local governments.

**BILL SUMMARY:** According to available information from the Executive Administrator of the Teachers' and State Employees' Comprehensive Major Medical Plan, the Plan's self-insured indemnity program needs over \$597 million in additional financial support to remain solvent and maintain minimum claim stabilization reserves for the 2007-2009 biennium.

	<u>2007-2008</u>	<u>2008-2009</u>	<u>Biennium</u>
<u>Additional Financial Support Required (\$Million)</u>	\$255.894	\$341.192	\$597.086

From these requirements can be deducted the additional funding provided by this Act in the way of premiums paid on behalf of teachers, state employees, and retired employees by employing agencies and the State's various Retirement Systems:

<u>Employer Financing (\$Million)</u>	<u>2007-2008</u>	<u>2008-2009</u>	<u>Biennium</u>
General Fund	\$133.978	\$178.637	\$312.615
Highway Fund	6.252	8.336	14.588
<u>Other Employer Funds</u>	<u>27.640</u>	<u>36.853</u>	<u>64.493</u>
Total	\$167.870	\$223.826	\$391.696

This additional premium financing is equivalent to a 14.9 % across-the-board premium rate increase for the Indemnity plan, and a 12.8% premium increase for the Preferred Provider Option (PPO) programs effective October 1, 2007. The Plan's Executive Administrator has the statutory authority to set the premium rates for the spouses and dependent children of teachers, state employees, and retired employees who elect to pay for parent and child and family coverage. If the Executive Administrator were to increase the premium amounts paid by employees and retired employees for their family members by 14.9% for the Indemnity plan and 12.8% for the PPO

programs across-the-board effective October 1, 2007, he says that the additional premium income to the program will be:

	<u>2007-2008</u>	<u>2008-2009</u>	<u>Biennium</u>
<u>Employee Financing</u> (\$Million)	\$36.865	\$49.154	\$86.019

After realizing the additional premium income provided by this Act and the anticipated premium income to be authorized by the Plan’s Executive Administrator, the program’s financial condition would still be in a deficit position.

Therefore, the required changes necessary to address the remaining deficit is accomplished through benefit reductions to the Plan. Based on estimated savings provided by the Plan’s consulting actuary for selected benefit changes, the net amount of these recommended benefit reductions for the 2007-2009 biennium is:

	<u>2007-2008</u>	<u>2008-2009</u>	<u>Biennium</u>
<u>Recommended Net Benefit Reductions</u> (\$Million)	\$51.929	\$69.392	\$121.321

The special provision in Section 28.22 of the Act reflects the amount of the benefit reductions recommended by the Plan’s Executive Administrator.

1. Subsection (d) increases the outpatient prescription drug co-payment for plan members enrolled in the Indemnity plan and the PPO programs for each preferred brand outpatient prescription drug from \$25 to \$30 for each 34-day supply;
2. Subsection (b,c,e) increases the Indemnity plan’s maximum plan member out-of-pocket annual from \$350 to \$450 with an annual limit of \$1,350 per employee and child(ren) or employee and family contract; and
3. Subsection (f) increases under the Indemnity plan out-of-pocket expenditures for plan members by increasing the office visit co-payment from \$15 to \$25 per visit.

**EFFECTIVE DATE:** July 1, 2007

**ESTIMATED IMPACT ON STATE:** Based upon information provided by the Plan, Aon Consulting, consulting actuary for the Plan, estimates that proposed benefit reductions in the bill will result in a net cost reduction of \$51.9 million in fiscal year 2007-2008 and \$69.3 million in fiscal year 2008-2009 for a total net cost reduction for the 2007-2009 biennium of \$121.2 million.

Based upon information available from the Plan, the consulting actuary for the General Assembly’s Fiscal Research Division, Hartman and Associates, estimates the referenced provisions of the bill will result in a net cost reduction to the Plano of \$41.837 million in fiscal year 2007-2008 and \$47.683 million in fiscal year 2008-2009 for a total net cost reduction of \$89.520 million for the 2005-2007 biennium.

The differences in the cost reduction estimates between Aon Consulting and Hartman and Associates are reflected below:

	2007-2008		2008-2009		Biennium	
	<u>Aon Consulting</u>	<u>Hartman &amp; Associates</u>	<u>Aon Consulting</u>	<u>Hartman &amp; Associates</u>	<u>Aon Consulting</u>	<u>Hartman &amp; Associates</u>
<b><u>Indemnity Plan Only</u></b>						
Increase Annual Deductible by \$100	\$20.10	\$14.95	\$23.00	\$18.17	\$43.10	\$33.12
Increase Office Visit Co-pay by \$10 per visit	\$6.00	\$12.49	\$22.70	\$15.43	\$28.70	\$27.92
<b><u>Indemnity Plan &amp; PPO Program</u></b>						
Increase Preferred Brand Drug Co-pay by \$5 per script	\$16.20	\$14.40	\$23.60	\$14.08	\$39.80	\$28.48
<b>Total Reductions</b>	<b>\$42.30</b>	<b>\$41.84</b>	<b>\$69.30</b>	<b>\$47.68</b>	<b>\$111.60</b>	<b>\$89.52</b>

For the purposes of funding the Plan for the 2007-2009 biennium under the funding scenario and benefit reductions included in the House Appropriations Act, the benefit reduction amounts and projection of financial need provided by the consulting actuary for the Plan were used as the baseline assumptions for funding the Plan.

**ASSUMPTIONS AND METHODOLOGY:**

**Aon Consulting:** The information below reflects the verbatim comments and assumptions of the Plan’s consulting actuary with respect to the projection of funding need and estimate of cost reduction:

- Based on total projected expenses of \$2,237,156,870 and \$2,428,499,941 for the 2008 and 2009 fiscal years respectively.
- Pharmacy claims data is received monthly from the plan’s Pharmacy Benefit Manager (PBM). Aon utilized data received for Fiscal Year 2006 as the baseline. The information was summarized by copayment category, detailing the number of scripts, total cost, member copayments and net employer cost. The data showed 10.5 million scripts with \$452 million of paid claims.
- Invoice data through February 2007 was also received from the PBM and validated with the SHP. This allowed a more accurate projection of the claims for Fiscal Year 2007. The claims were projected separately for the PPO and Indemnity plans.
- The pharmacy claims were then trended for Fiscal Year 2008 & 2009 separately for utilization and per script cost. Annual utilization was assumed to increase at 7% per year with cost per scripts increasing at a slightly lower rate of 5%.

- Aon used EInfoNow reports to collect claims distributions for members in the Indemnity Plan. Aon also collected summary reports showing the amount of deductible being paid and the timing of these payments. From these reports we were able to compile the impact of changes to the plan year deductible.
- Various monthly reports are developed by the Claims Processing Contractor (CPC) that identifies the number of office visits as well as the associated costs. The information was also compared to the EInfoNow reports.
- Aon also maintains a detailed claims database for calendar years 2001 to 2005 and is in the process of updating for 2006. This data was used to supplement the various reports.
- From the information above, Aon was able to determine utilization rates, cost per services, employee payments, etc.
- A 3-month run-in was assumed for Fiscal Year 2008, showing only 9-months of impact for the pharmacy and office visit copay changes. Due to front-end distribution of the annual deductible, 95% was assumed to be paid in Fiscal Year 2008.”

**Hartman and Associates:** : The information below reflects the verbatim assumptions of the General Assembly’s consulting actuary with respect to the estimate of cost reduction:

Data Sources: SHP Distribution of Claims Reports FY 2003-06  
 SHP Pharmacy Utilization Reports FY 2004-06  
 SHP Utilization Study FY 2002-2006

Data Summary:

Prescription Drug Summary Fiscal Year 2006			
Drug Type	Number Rx	Avg. Plan Paid	Avg. Member Co-pay
Generic	4,747,865	\$13.79	\$10.54
Single-Source Brand	4,237,539	\$83.87	\$30.11
Multi-Source Brand	1,401,056	\$36.57	\$22.83
Rx’s not on formulary: 20% (2004 reports)			

Indemnity Plan Distribution of Claims FY2006	
Annual Elig. Charges	Percent of Plan Members
<\$350	19.2%
350-450	2.3%

450-10,000	58.5%
>10,000	20.0%

Indemnity Plan Office Visit Rates FY2006		
Employee Group	Number of Office Visits	Per Member Per Year
Active	2,867,163	6.63
Medicare Retiree	1,095,133	11.66
Non-Medicare Retiree	612,199	10.48
Total	4,574,495	7.83

Plan Members: Indemnity 255,211  
PPO 363,477

Actuarial Assumptions:

Annual Claims Trend 10.0% on total claims  
-6.0% brand Rx utilization  
3.0% office visit utilization

Membership Growth 0.0%

Effective Date of change July 1, 2007

Claim Payment Lag medical claims 2 months  
prescription drugs 2 weeks

Office Visit Co-pay 25% offset by deductible/coinsurance

**General Plan Assumptions**

The Plan currently operates on a self-insured basis funded through premium contributions, investment earnings and other receipts. As of October 1, 2006, the Plan operates an Indemnity plan and an optional Preferred Provider Option (PPO) program. Claim cost trends are expected to increase at a rate of 9% annually according to the Plan’s consulting actuary. Investment earnings are based upon a 4.5% return on available cash balances.

Combined Financial Components of the Plan: For the fiscal year beginning July 1, 2006, the Plan started its operations with a beginning cash balance of \$246 million. Receipts for the year are estimated to be \$1.946 billion from premium collections, \$34 million from Medicare Part D subsidies and \$11 million from investment earnings for a total of \$1.991 billion in receipts for the year. Disbursements from the Plan are expected to be \$1.977 billion in claim payments and \$105 million in administration and claims processing expenses for a total of \$2.082 billion. For the fiscal year beginning July 1, 2006, the self-insured indemnity program is expected to have a net operating loss of approximately \$91 million for the year. The Plan is expected to have an available beginning cash balance of \$155 million for the fiscal year beginning July 1, 2007. The Plan 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.

**Indemnity Plan Component:** For the fiscal year beginning July 1, 2006, the Indemnity plan started its operations with a beginning cash balance of \$246 million. Receipts for the year are estimated to be \$1.113 billion from premium collections, \$34 million from Medicare Part D subsidies and \$9.5 million from investment earnings for a total of \$1.156 billion in receipts for the year. Disbursements from the Indemnity plan are expected to be \$1.213 billion in claim payments and \$66 million in administration and claims processing expenses for a total of \$1.279 billion. For the fiscal year beginning July 1, 2006, the self-insured indemnity program is expected to have a net operating loss of approximately \$123 million for the year. The Indemnity plan is expected to have an available beginning cash balance of \$123 million for the fiscal year beginning July 1, 2007.

**PPO Program Component:** For the fiscal year beginning July 1, 2006, the PPO program started its operations with a beginning cash balance of \$0 million. Receipts for the year are estimated to be \$833 million from premium collections, \$0 million from Medicare Part D subsidies and \$1.5 million from investment earnings for a total of \$835 million in receipts for the year. Disbursements from the Indemnity plan are expected to be \$763 million in claim payments and \$39 million in administration and claims processing expenses for a total of \$803 million. For the fiscal year beginning July 1, 2006, the self-insured indemnity program is expected to have net operating income of approximately \$32 million for the year. The Plan is expected to have an available beginning cash balance of \$32 million for the fiscal year beginning July 1, 2007. The Plan 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.

The Plan is consequently assumed to not be able to carry out its operations for the 2007-2009 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.

**Enrollment Data**

<u>Percent Enrollment by Age</u>	<u>Indemnity Plan</u>	<u>PPO Options</u>	<u>Total</u>
29 & Under	16.6%	33.6%	26.6%
30 to 44	14.2%	24.7%	20.4%
45 to 54	16.0%	21.3%	19.1%
55 to 64	21.9%	16.4%	18.7%
65 & Over	31.3%	4.1%	15.3%

<u>Percent Enrollment by Sex</u>	<u>Indemnity Plan</u>	<u>PPO Options</u>	<u>Total</u>	<u>Percent of Total</u>
Female	62.4%	162,497	223,760	386,257
Male	37.6%	92,714	139,717	232,431
Total	100.0%	255,211	363,477	618,688

**Plan Enrollment as of December 31, 2006**

<u>No. of Participants</u>	<u>Indemnity Plan</u>	<u>PPO Options</u>	<u>Total</u>	<u>Percent of Total</u>
<u>Actives</u>				
Employees	100,405	211,349	311,754	50.4%
Dependents	<u>32,776</u>	<u>112,785</u>	<u>145,561</u>	<u>23.5%</u>
Sub-total	133,181	324,134	457,315	73.9%
<u>Retired</u>				
Employees	108,263	29,764	138,027	22.3%
Dependents	<u>11,876</u>	<u>7,700</u>	<u>19,576</u>	<u>3.2%</u>
Sub-total	120,139	37,464	157,603	25.5%
<u>Former Employees with Continuation Coverage</u>				
Employees	1,391	297	1,688	0.3%
Dependents	<u>478</u>	<u>154</u>	<u>632</u>	<u>0.1%</u>
Sub-total	1,869	451	2,320	0.4%
<u>Firefighters, Rescue Squad &amp; National Guard</u>				
Employees	5	2	7	0.0%
Dependents	<u>-</u>	<u>2</u>	<u>2</u>	<u>0.0%</u>
Sub-total	5	4	9	0.0%
<u>Local Governments</u>				
Employees	16	1,045	1,061	0.1%
Dependents	<u>1</u>	<u>379</u>	<u>380</u>	<u>0.1%</u>
Sub-total	17	1,424	1,441	0.2%
<u>Total</u>	<u>255,211</u>	<u>363,477</u>	<u>618,688</u>	
Percent of Total	41.3%	58.7%	100.0%	100.0%

**SOURCES OF DATA:**

-Actuarial Note, Hartman & Associates, House Draft Special Provision: State Health Plan Benefit Changes, May 4, 2007, original of which is on file in the General Assembly's Fiscal Research Division.

-Actuarial Note, Aon Consulting, 2007-EMP-H6, May 1, 2007, 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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**DATE:** May 10, 2007



**Signed Copy Located in the NCGA Principal Clerk's Offices**