Unfunded Actuarial Liability for Retiree Health is Large, but State Could Save Up to $64 Million Annually by Shifting Costs to Medicare Advantage Plans

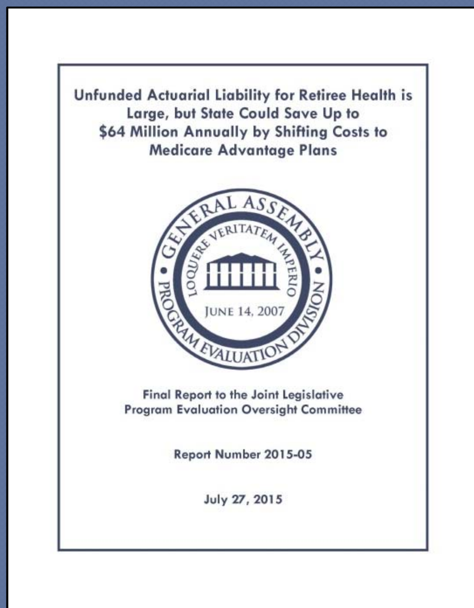
A presentation to the
Joint Legislative Program Evaluation Oversight Committee

July 27, 2015

Kiernan McGorty, Principal Program Evaluator

Handouts

The Full Report



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General Assembly · Loquere Veritatem Imperio · June 14, 2007 · Program Evaluation Division

Final Report to the Joint Legislative Program Evaluation Oversight Committee

Report Number 2015-05

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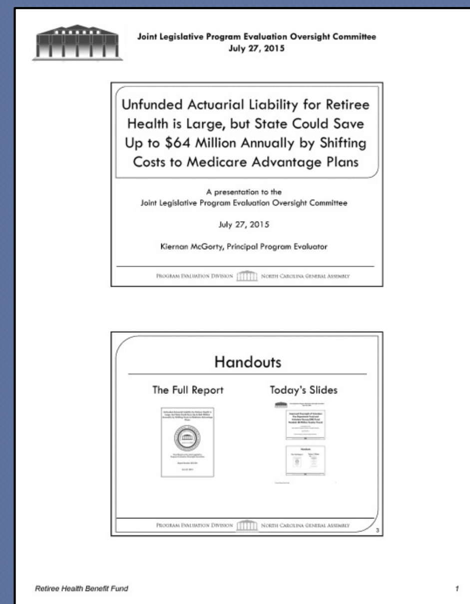
Today's Slides



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Retiree Health Benefit Fund 1

Evaluation Team

- Directive: 2013-15 Work Plan
- Agency: Department of State Treasurer
- Team
  - Kiernan McGorty, Evaluation Lead
  - Meg Kunde, Program Evaluator
  - Sara Nienow, Senior Program Evaluator
  - David Vanderweide, Fiscal Research Division

Overview

- Unfunded liability for the Retiree Health Benefit Fund is $25.5 billion
- North Carolina ranks 41st in unfunded liability per state resident
- Several options exist to reduce unfunded liability but there may be legal implications

Overview (cont.)

- General Assembly should direct State Health Plan to shift costs to Medicare Advantage plans, generating up to $64 million in annual savings
- General Assembly could appoint a joint committee to determine which other options to pursue

How the Fund Works

Retiree Health Benefit Fund

General Assembly funds public employers

Employers contribute percentage of covered salaries

Fund pays employers' share of premiums to State Health Plan

Retirees pay their share of premiums to State Health Plan

North Carolina State Health Plan
FOR TEACHERS AND STATE EMPLOYEES
A Division of the Department of State Treasurer

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Three Levels of Benefits Based on Years of Service

Level	Years of Service
Non-contributory – State pays full premium	• Hired before 10/1/2006 with 5 years of service • Hired on or after 10/1/2006 with 20 years of service
One-half contributory – State pays half of premium	Hired on or after 10/1/2006 with 10 but fewer than 20 years of service
Fully contributory – State pays none of premium	Hired on or after 10/1/2006 with fewer than 10 years of service

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Retirees Younger Than 65

Plan	Members' Monthly Premiums
Traditional 70/30 (n = 21,085)	• Non-contributory: $0 • One-half contributory: $224 • Fully contributory: $448
Enhanced 80/20 (n = 31,116)	• Non-contributory: $14 • One-half contributory: $238 • Fully contributory: $462
Consumer-Directed Health Plan (n = 847)	• Non-contributory: $0 • One-half contributory: $224 • Fully contributory: $448

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Retirees 65 and Older

Plan	Members' Monthly Premiums
Traditional 70/30 (n = 37,538)	• Non-contributory: $0 • One-half contributory: $174 • Fully contributory: $348
Medicare Advantage Base (n = 60,833)	• Non-contributory: $0 • One-half contributory: $115 • Fully contributory: $115
Medicare Advantage Enhanced (n = 37,980)	• Non-contributory: $33 • One-half contributory: $148 • Fully contributory: $148

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North Carolina's Funding Status

Funding vs. Reporting

- Benefits funded on pay-as-you-go basis
  - Pay-as-you-go basis = recognize costs when benefit is provided in retirement
- Accounting standards require states to report liability on accrual basis
  - Accrual basis = recognize costs when employee becomes eligible for benefit during employment

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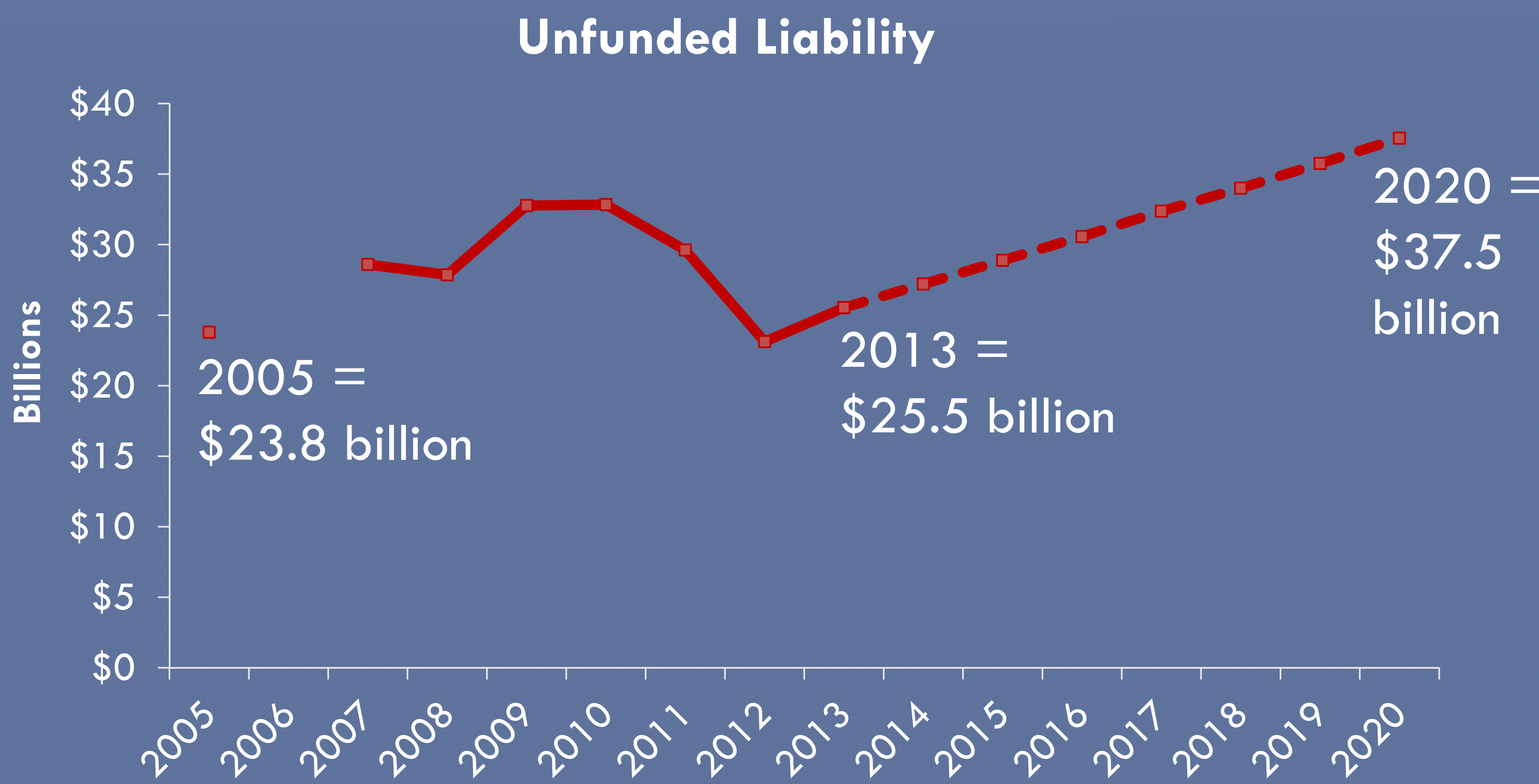
$25.5 Billion Unfunded Liability



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North Carolina Performs Poorly on Funding Status Measures (FY 12-13)

- Ranked 41st in unfunded liability per state resident
- Among 38 states with funded ratio of 10% or less
- Among 26 states that paid less than 50% of annual contribution needed to fully fund benefits in the long run

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Reasons North Carolina's Unfunded Liability is Large

- Benefits have always been funded on a pay-as-you-go basis
- Retirees eligible for non-contributory benefit
- Benefits available to essentially all retirees with requisite number of years of service

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Options for Improvement

Six Options for Improving Funding

Option	Increase Funding	Reduce Benefit
1. Increase appropriation	✓ (state)	
2. Increase costs borne by federal government	✓ (federal)	
3. Transition to defined contribution model	depends on state's contribution rate	depends on individual circumstances
4. Reduce number of individuals eligible		✓
5. Require active employees to contribute		✓
6. Increase amount retirees pay		✓

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1. Increase appropriation

- General Assembly appropriated 5.49% of payroll in FY 2014–15 ($800 million)
- Need to appropriate 15% to fully fund benefit over 30-year amortization period
- Actuary stated General Assembly needs to appropriate at least 10% to be pre-funding

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2. Increase costs borne by federal government

- Shift 35,000+ Medicare-eligible retirees from Traditional 70/30 to Medicare Advantage plans
  - Retirees pay same or lower premiums, receive benefits comparable in value to 80/20 plan
  - State saves \$44 to \$64 million annually, reduces unfunded liability by \$3 billion

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2. Increase costs borne by federal government (cont.)

- Offer financial incentives to non-Medicare eligible retirees to obtain insurance from health insurance exchange (currently in Senate version of budget bill)

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3. Transition to defined contribution model

- Defined contribution plans provide health insurance allowance through
  - Health Reimbursement Arrangements (HRAs)
  - Health Savings Accounts (HSAs)
- Defines limits of state's costs
- Shifts risks of rising healthcare costs and poor investment returns to employees

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4. Reduce the number of individuals eligible

- By increasing service time requirements
  - Currently need 20 years of service
  - Some states require 25 or 30 years
- By eliminating health benefits for certain groups

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4. Reduce the number of individuals eligible (cont.)

Group	Percentage Reduction in Unfunded Liability in 2026
Eligible employees and retirees	78%
Employees not yet eligible	22%
New hires	10% (currently in Senate version of budget bill)

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5. Require active employees to make contributions

- Employees contribute 0% of salary for retiree health benefits
  - In contrast, employees contribute 6% of salary to pension
- Four states require employees to contribute up to 3% of salary for retiree health
- Offer employees choice between contributing and giving up retiree health benefit

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6. Increase the amount retirees pay

- Increase premiums
- Increase out-of-pocket costs
  - Deductibles
  - Coinsurance
  - Copayments

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Legal Considerations

Lack of Legal Precedent

- No legal precedent exists regarding the State's obligation to maintain certain levels of retiree health benefits

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Pending Lawsuit: Lake v. State Health Plan (2012)

- Group of retirees (with at least five years of service by 2011) alleged breach of contract based on
  - Elimination of non-contributory 80/20 plan
  - Forced election of 70/30 plan to receive a non-contributory benefit
  - Elimination of a contributory 90/10 plan

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Pending Lawsuit (cont.)

- State's main defense is G.S. § 135-48.3: General Assembly reserves the right to alter, amend, or repeal any section of state law regarding State Health Plan
- Court case should determine whether State Health Plan can make adjustments to cost-share levels and premiums

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Threat of Future Lawsuits

- Court case won't address whether the State can exercise other options for eligible and not-yet-eligible employees
- Options discussed can be made for new hires without threat of new lawsuit

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How To Proceed

Ways to Proceed

- General Assembly should direct State Health Plan to shift costs to Medicare Advantage plans, generating up to $64 million in annual savings
- General Assembly could appoint a joint committee to determine which other options to pursue

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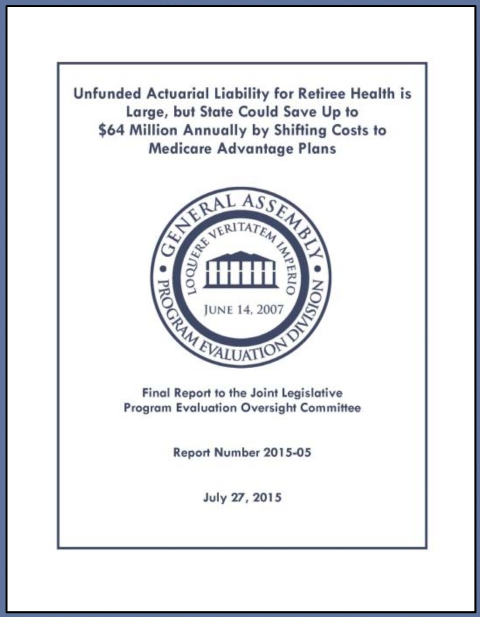
Treasurer's Response

- State Treasurer agrees with the major conclusions of the report

Legislative Options

- Accept the report
- Refer it to any appropriate committees
- Instruct staff to draft legislation based on the report

Report available online at www.ncleg.net/PED/Reports/reports.html



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JUNE 14, 2007
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