Response to Questions on the FY 2009 Advertised Budget Plan

Request By: Supervisors Gross/Herrity/McKay/Hyland

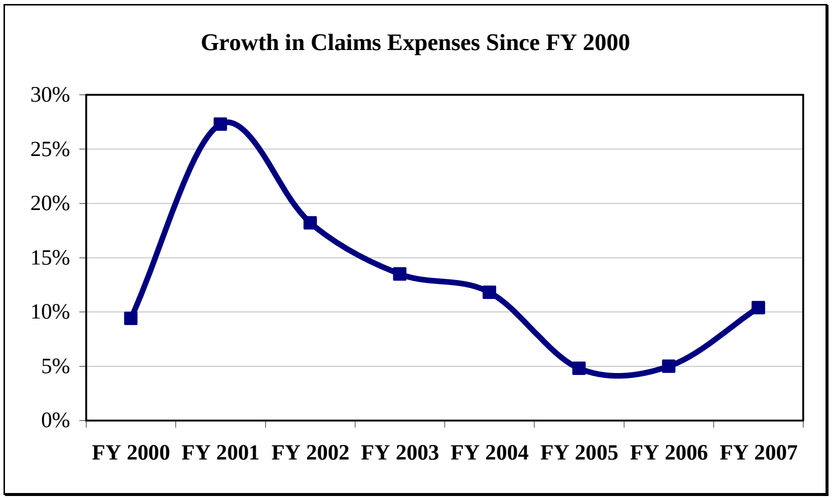
Question: How is the Health Insurance Trust Fund funded and what are the criteria for using the fund? What has been the balance in the health insurance fund over the last several years? What are the projected inflows and outflows and the basis of these estimates? What are the restrictions on the use of these funds? What is the recommended balance for this fund? What is the cost of preventing increases in health care benefit premiums for County employees?

Response: The Health Benefits Trust Fund is the mechanism through which the County pays claims expenses for its self-insured insurance plans, including the CareFirst BlueCross/BlueShield health plans, the CIGNA health plan, and the Davis Vision plan. It is primarily funded through premium contributions from the County, as well as contributions from employees and retirees, and interest income. The self-insured fund was created in order to allow the County to more fully manage all aspects of the included plans. While the fund allows the County to set premiums for these plans, it also means that adequate reserves must be maintained as the County is responsible for all claims expenses. The County still has one fully-insured plan, Kaiser, and has no control over those premium increases.

The use of the fund is discussed with the County Executive as part of budget deliberations, taking into account anticipated claims expenses, participant growth, maintenance of appropriate reserves, and the impact on the County's GASB liability. There are no restrictions related to the use of the fund.

Premium Increases

For budget purposes, a planning factor is used for premium increases based on anticipated cost growth. The FY 2009 Advertised Budget Plan includes a 5 percent premium increase to provide flexibility and give the County the option of increasing premiums up to 5 percent, if necessary, to fund anticipated claims. If current cost growth trends continue, it is not anticipated that premium increases will reach 5 percent in January 2009, as balances should be sufficient within the fund. However, cost growth can fluctuate tremendously from year-to-year, as demonstrated in the following chart:



The County experienced a significant increase in claims expenses in FY 2001, following a period of moderate growth. Therefore, cost growth trends are examined carefully in order to determine the appropriate premium level. Premium increases for January 2009 will not be set until mid-calendar year 2008; at that time, claims experience will be analyzed to determine the necessary premium adjustments.

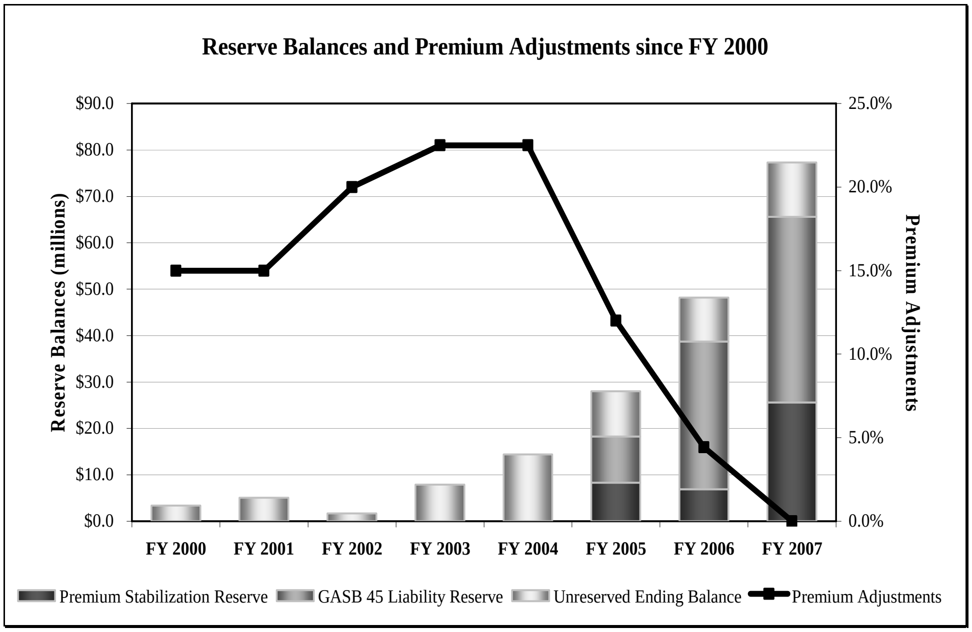
However, premiums are now set also keeping in mind the potential impact on the County's GASB 45 liability. GASB 45 requires that the County disclose the liability related to other post-employment benefits (OPEBs), excluding pensions. The OPEBs currently included in the County liability are the retiree health benefit subsidy and an "implicit" subsidy offered to retirees. Because premiums are set using the combined experience of actives and retirees, retiree premiums are much less than what they would otherwise be if they were set using only the experience of the retirees. GASB requires that the County calculate and include the liability associated with this "implicit" subsidy benefit. In January 2007, premiums were held flat, as it was anticipated that the trust fund had balances able to cover claims growth. However, this served to almost double the County's GASB liability. Thus, a holistic approach has to be taken to set premiums since, if retiree claims grow faster than premiums, GASB 45 essentially treats this as a benefit enhancement – meaning that the County's liability, as well as the annual required contribution to pay down the liability, is increased.

Premium adjustments are set in order to minimize the impact on County employees while maintaining appropriate reserves and being mindful of the GASB liability. A 5 percent premium increase would result in an annual impact of $34 to $229 for approximately 8,200 employees. If no premium increase was approved for January 2009, it would save the County an estimated $1.8 million in FY 2009 since the County pays approximately 77 percent of employee premiums. However, as the GASB impact may be considerable, holding premiums flat may cost the County millions more in the long-term. In addition, it should be noted that, as the County has no control over premium increases for the Kaiser plan, the over 2,000 employees in Kaiser may experience increases in January 2009.

Balances and Reserves

In the early part of the decade, balances in the trust fund were low as significant increases in claims expenses utilized all available resources in the fund. In fact, additional General

Fund support was required in order to maintain sufficient balances. For example, at the *FY 2003 Third Quarter Review*, the General Fund contributed an additional $4.5 million to replenish the balance which had been depleted through escalating medical and prescription claims costs. More recently, balances in the fund have grown as County claims have increased less than has been anticipated and have remained lower than national trends. As a result, several reserves have been established in order to prepare for unanticipated spikes in claims expenses as well as the implementation of GASB 45. As the following chart displays, the impact of these reserves has allowed the County to keep premium increases at manageable levels as compared to earlier in the decade:



Consistent with industry standards, the County maintains funding in an unreserved ending balance to ensure that the balance is adequate to support any unanticipated high cost claims. The targeted industry standard is 10 to 15 percent of claims paid, while the County maintains two months worth of claims paid, or approximately 16.7 percent. In addition, following six straight years of double-digit premium increases ranging from 12 to 22.5 percent, the County created a Premium Stabilization Reserve in FY 2005 in order to maintain premium increases at manageable levels and smooth out the employer and employee impact of dramatic cost growth swings.

Beginning in FY 2005, a reserve was also created in anticipation of the implementation of GASB 45. Rather than reducing benefits to retirees in order to address the GASB 45 liability, excess employer contributions were set aside in the GASB 45 Liability Reserve with the expectation that they would be transferred to a new fund for GASB, contingent upon adequate reserves remaining in the Health Benefits Trust Fund. As cost growth trends remained favorable and the Premium Stabilization Reserve retained a healthy balance, these funds were transferred to the new Fund 603, OPEB Trust Fund, at the *FY 2007 Carryover Review*.

In FY 2009, there is an anticipated balance in the fund of approximately $25.7 million, excluding the unreserved ending balance of two months of claims. It was recommended to use $22 million in excess FY 2009 revenues to meet other County requirements in

FY 2009. This $22 million consists of $10.9 million for the County’s contribution towards the annual required contribution for GASB 45 (including $6.8 million previously funded by the General Fund and an additional $4.1 million to address the unfunded liability), $7 million to begin the implementation of the replacement of the County’s legacy systems, beginning with the replacement of the system that controls personnel and benefit payments, and $4.1 million to help balance the General Fund. The remaining $3.7 million in excess revenues will stay in the fund in the Premium Stabilization Reserve. At the *FY 2008 Carryover Review*, the Premium Stabilization Reserve will be replenished based on projected FY 2008 savings in order to address any unanticipated increases in claims expenses during FY 2009.