NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE ACTUARIAL NOTE

BILL NUMBER: House Bill 1580

SHORT TITLE: State Health Plan Changes

SPONSOR(S): Representative Thomas Wright (By Request)

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, and premium payments for coverages selected by eligible former teachers and State employees.

BILL SUMMARY: The bill changes the Plan's fiscal year from July through June to January through December, beginning January 1, 2003. In making this change, the cost sharing requirements for program members and certain maximum benefits will change as follows for the 2002-03 year under the Plan's self-insured indemnity program:

	Currently Authorized July, 2002 – June, 2003	Authorized by House Bill 1580		
		July-December, 2002	January-June, 2003	Total July, 2002 - June, 2003
Annual Deductible				
Individual	$350	$200	$375	$575
Family	$1,050	$600	$1,125	$1,725
Annual Coinsurance Out-of-Pocket Maximum				
Individual	$1,500	$800	$1,600	$2,400
Family	$4,500	$2,400	$4,800	$7,200
Maximum Annual Outpatient Prescription Drug Copayment	$2,500	$1,350	$2,500	$3,850
Maximum Annual Chiropractic Benefit	$2,000	$1,050	$2,000	$3,050
Maximum Annual Routine Examination Benefit without Deductibles & Coinsurance	$150	$80	$150	$230
Maximum Annual Diabetes Self-Care Benefit	$300	$160	$300	$460
Annual Visits for Mental Health & Chemical Dependency without Case Management	26	14	26	40

The same deductibles, coinsurance, and maximum benefits as shown for January-June, 2003, would continue through December 2003.

The bill also provides an optional benefit under the Plan's self-insured indemnity program, beginning January 1, 2003. This optional benefit will allow an employee or retired employee to choose for himself or herself and his or her enrolled spouse and dependent children to pay a $25 copayment for physicians' office visits, consultations, and surgeries, and for visits to chiropractors and inhalation, occupational, physical, and speech therapists. This copayment is an increase from the program's currently authorized copayment of $15 for the same services. However, unlike the program's current benefit, the optional $25 copayment's services will not be subjected to the program's annual individual and family deductibles or to the coinsurance to be paid by members of the program. In addition, the optional benefit places an annual individual deductible of $425 and an annual family deductible of $1,275 on all of the program's services assessed annual deductibles and coinsurance except for the services for which the $25 copayment is applied. The program's currently authorized annual deductibles and coinsurance maximum out-of-pocket expenses are described above.

EFFECTIVE DATE: July 1, 2002.

ESTIMATED IMPACT ON STATE: Based upon information provided by the Plan, the Plan's consulting actuary, Aon Consulting, estimates that the bill will have a net cost reduction of $6.3 million for the 2003-03 fiscal year and a net cost increase of $2.7 million for the 2003-04 fiscal year for the Plan's self-insured indemnity program. The bill will also have a net cost reduction of $27.1 million for the 2004-05 fiscal year for the program. The components of these costs for the next two fiscal years are:

	Cost Increases (Decreases)	
	2002-03	2003-04
$200 Deductible & $800 Coinsurance Out-of-Pocket Maximum for July – December, 2002	$ (4,200,000)	$ 7,400,000
$375 Deductible & $1,600 Coinsurance Out-of-Pocket Maximum for January – December, 2003	$ (5,800,000)	$(10,200,000)
Benefit Alternative - $25 Outpatient Copayment without Deductible or Coinsurance	$ 3,700,000	$ 5,500,000
Total Net	$(6,300,000)	$ 2,700,000

Aon Consulting assumes that 44% of the program's deductible and 48% of the program's coinsurance are incurred in the first six months of a plan year. Aon Consulting further assumes that 50% of the program's participants will choose the alternative $25 copayment benefit.

Also based upon data supplied by the Plan, the consulting actuary for the General Assembly's Fiscal Research Division, Hartman & Associates, estimates that the bill will cost the Plan's self-insured indemnity program an additional $15.8 million for the 2002-03 fiscal year and will result in a cost reduction of $17.2 million for the program for the 2003-04 fiscal year. The components of these costs for the next two fiscal years are:

Cost Increases (Decreases)

	2002-03	2003-04
$200 Deductible & $800 Coinsurance Out-of-Pocket Maximum for July – December, 2002	$ 23,757,000	$ (1,000,000)
$375 Deductible & $1,600 Coinsurance Out-of-Pocket Maximum for January – December, 2003	$ (8,872,000)	$(19,121,000)
Benefit Alternative - $25 Outpatient Copayment without Deductible or Coinsurance	$ 761,000	$ 2,828,000
Total Net	$15,646,000	$(17,293,000)

Hartman & Associates assumes that 60-70% of the program's deductible and 40% of the program's coinsurance are assessed against members of the program during the first six months of a plan year. Hartman & Associates further assumes that only 5% of the program's employees, including retired employees, and their families will choose the alternative $25 copayment benefit.

The Plan's Executive Administrator estimates that the program will incur additional administrative expenses of some $300,000, including the cost of new identification cards and benefit booklets, during the 2003-02 plan year which would be in addition to the foregoing cost estimates.

ASSUMPTIONS AND METHODOLOGY: The Comprehensive Major Medical Plan for Teachers and State Employees is divided into two programs. From October 1982, through June 1986, the Plan only had a self-funded indemnity type of program which covered all 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. A prepaid program of coverage by health maintenance organizations (HMOs) was offered in July 1986, as an alternative to the Plan's self-insured indemnity program. 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 $1,500 annually, etc. paid by the program's members). HMOs are required to offer benefits that are comparable to those provided by the self-insured indemnity program. 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. Employer-paid non-contributory premiums are only authorized for the indemnity program's coverage for employees and retired employees. All other types of premium in the indemnity program are fully contributory. 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 employees, retired employees, and their families. Premiums paid by employers to HMOs are limited to like amounts paid to the indemnity program with employees and retired employees paying any HMO amounts above the indemnity program's non-contributory rates. Both types of coverage continue to be available in the Plan; however none of the HMOs with certificates of authority to transact business in North Carolina have offered to participate in the Plan since September 30, 2001. The Plan's employees and retired employees select the type of program that they wish for themselves and their dependents during the months of August and September of each year for coverage beginning in October. The demographics of the Plan as of December 31, 2001, include:

	Self-Insured Indemnity Program	Alternative HMOs	Plan Total
Number of Participants			
Active Employees	279,398	-0-	279,398
Active Employee Dependents	142,856	-0-	142,856
Retired Employees	112,042	-0-	112,042
Retired Employee Dependents	18,744	-0-	18,7440
Former Employees & Dependents with Continued Coverage	2,859	-0-	2,859
Firefighters, Rescue Squad Workers, National Guard Members & Dependents	4	-0-	4
Total Enrollments	555,903	-0-	555,903
Number of Contracts			
Employee Only	304,906	-0-	304,906
Employee & Child(ren)	42,354	-0-	42,354
Employee & Family	46,246	-0-	46,246
Total Contracts	393,506	-0-	393,506
Percentage of Enrollment by Age			
29 & Under	27.8%	-0-%	27.8%
30-44	21.2	-0-	21.2
45-54	21.2	-0-	21.2
55-64	15.1	-0-	15.1
65 & Over	14.7	-0-	14.7
Percentage of Enrollment by Sex			
Male	38.6%	-0-%	38.6%
Female	61.4	-0-	61.4

Assumptions for the Self-Insured Indemnity Program: For the fiscal year beginning July 1, 2001, the self-insured program started its operations with a beginning cash balance of $51.2 million. Receipts for the year are estimated to be $1.233 billion from premium collections, $4 million from investment earnings, $1 million in risk adjustment and administrative fees from HMOs, and a $36 million transfer from State's General Fund from the Governor's Budget Office for a total of $1.274 billion in receipts for the year. Disbursements from the self-insured program are expected to be $1.215 billion in claim payments and $36 million in administration and claims processing expenses for a total of $1.251 billion for the year beginning July 1, 2001. For the fiscal year beginning July 1, 2002, the self-insured indemnity program is expected to have a beginning cash balance of $74 million with a net operating loss of approximately $29 million for the year. For the fiscal year beginning July 1, 2003, the self-insured indemnity program is expected to have a beginning cash balance of only $45 million. The self-insured indemnity program is consequently assumed to be unable to carry out its operations for the 2003-2005 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 $186.04 monthly for employees whose primary payer of health benefits is Medicare and $244.38 per month for employees whose primary payer of health benefits is not Medicare. Fully contributory premium amounts for employee and child(ren) contracts are $115.78 monthly for children whose primary payer of health benefits is Medicare and $152.32 monthly for other covered children, and $277.68 per month for family contracts whose dependents have Medicare as the primary payer of health benefits and $365.36 per month for other family contract dependents. Claim cost trends are expected to increase 12% annually. Total enrollment in the program is expected to increase about 3% annually over the next two years. The number of enrolled active employees is expected to show a 3% increase annually over the next two years, whereas the growth in the number of retired employees is assumed to be 7% per year. The program is expected to have an increase in the number of active employee dependents and retiree dependents of 2% per year. Investment earnings are based upon a 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 on the Plan's Change in Fiscal Year: When the Plan was first established in June, 1982, by Chapter 1398 of the 1981 Session Laws, the self-insured indemnity program had its annual deductibles and coinsurance out-of-pocket maximum amount established on a calendar year basis, January through December. The program's annual individual deductible was $100 at the time, with an annual family deductible of $300 and 5% coinsurance paid by members of the program up to a maximum annual amount of $100. No change was made in the program's annual deductibles and coinsurance provisions until the 1985 Session of the General Assembly. Upon the convening of the 1985 Session, the General Assembly was faced with having to provide additional financial support for the Plan equivalent to an increase of over 47% in employer-provided funds and a 16% increase in employee-provided funds just for the 1985-86 plan year. The Session adopted various benefit changes to the Plan's self-insured indemnity program and provided additional funding for the Plan. By changing the application of annual deductibles and coinsurance annual out-of-pocket maximum amounts from a calendar year to a fiscal year basis to correspond with the State budget's July through December fiscal year, the 1985 Session kept increases in annual deductibles and annual coinsurance maximums paid by members of the program to a minimum. In other words, an increase in the program's individual deductible on a calendar year basis would be expected to generate claim cost reductions for only one-third of a budget year during the year of implementation, assuming a 60-day lag between the time a claim is incurred and the time that it is paid. On a fiscal year basis, the claim cost reduction for the same amount of increase in the individual deductible would be available for over 83% of a budget year in the year of implementation under the same assumption. Consequently, an individual deductible does not have to be increased as much in the year of implementation on a fiscal year basis to generate the same amount of claim cost reductions during a budget year. The same holds true for maximum annual out-of-pocket expenses for coinsurance paid by members of the program. The same also holds true for premium increases paid to the Plan by employing state agencies, universities, public schools, and community colleges, the State Retirement Systems, and by employees and retired employees as well for their enrolled spouses and dependent children. Premium rates do have to be raised as much during a budget year when additional premium income can be generated over longer periods during the year. Obviously, premium rate increases are greater when they generate the same amount of income for only six months of a year rather than a full year during the year of implementation. By using a fiscal year basis, the 1985 Session of the General Assembly only increased the program's annual individual deductible from $100 to $150, effective July 1, 1986, and increased the maximum annual out-of-pocket coinsurance expense from $100 to $300, effective July 1, 1985, along with an increase in the coinsurance rate paid by program members from 5% to 10% on the same date. Premium rates paid by

employees and retired employees for their enrolled spouses and dependent children were only increased 12% during the same time. The Plan has maintained a July through June fiscal year definition since July 1, 1985.

As separate but related matters, officials in the Office of the State Controller have expressed concern about a change in the Plan's fiscal year. This concern is related to full disclosure of the most recent financial information under the State's Comprehensive Annual Financial Report (CAFR) requirements. In addition, the Internal Revenue Service, U. S. Department of Treasury, has stated that "cafeteria" or flexible benefit plans operating under Section 125 of the Internal Revenue Code do not have to be based on calendar years. An IRC 125 plan can adopt a plan year of any twelve-month period. Some public school units have IRC 125 plans with years that correspond to the State's and the Plan's current fiscal year basis according to the North Carolina Association of Educators.

Assumptions on the Plan's Office Visits and Other Professional Outpatient Services: The most recently available information on the number of physicians' office visits, consultations, and surgeries, and other professional outpatient services under the Plan's self-insured indemnity program is:

	Number of Visits and Services				
Services	1997-98	1998-99	1999-2000	2000-01	July, 2001-April, 2002
Office Visits	1,306,002	1,425,961	1,522,885	2,151,227	2,095,531
Office Consultations	44,273	47,401	54,592	72,027	68,090
Office Surgery	85,342	90,798	94,899	107,445	90,995
Professional Ambulatory Surgery			44	76	107
Preventive Health	55,777	70,787	88,528	122,031	121,888
Inhalation Therapy	203	248	567	808	651
Occupational Therapy	163	382	763	1,012	864
Chiropractic Therapy	236,467	256,263	292,518	356,037	287,726
Physical Therapy	80,879	88,516	98,482	129,238	118,019
Speech Therapy	2,085	2,408	3,066	4,412	3,340
Total	1,811,191	1,982,764	2,156,344	2,944,313	2,787,211
Average Monthly Enrollment	390,783	406,053	425,658	490,668	543,308
Average Number of Visits & Services Per Year	4.6	4.9	5.1	6.0	5.1
Annualized					6.2

SOURCES OF DATA:

-Actuarial Note, Hartman & Associates, House Bill 1580, July 2, 2002, original of which is on file in the General Assembly's Fiscal Research Division.

-Actuarial Note, Aon Consulting, House Bill 1580, June 26, 2002, 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: Section 2(b) of the bill should be amended to add a new item to subsection (a1) proposed for G.S. 135-40.4 to read:

"(5) An employee may choose the alternative benefit for himself or herself and his or her enrolled spouse and dependent children only once per fiscal year with the choice lasting twelve months or for as long as the employee and his or her spouse and dependent children remain covered by the Plan during the twelve month period."

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DATE: July 2, 2002

Signed Copy Located in the NCGA Principal Clerk's Offices