MEMORANDUM

TO: CLAY J. PEARSON, CITY MANAGER

FROM: TIA GRONLUND-FOX, DIRECTOR OF HUMAN RESOURCES

SUBJECT: SELF FUNDED ANALYSIS

DATE: APRIL 28, 2010

Attached please find a copy of the final Self Funding Analysis report prepared by Mercer Consulting Services. Aaron Loiselle, lead consultant analyst on this project met with the Committee this morning to share his findings and recommendation.

The Committee felt the report was well prepared and contained adequate information from which to provide their analysis and recommendation.

The recommendation out of this report is to remain status quo with regard to the present funding arrangements with Blue Cross Blue Shield and Health Alliance Plan.

Mr. Loiselle will be present at Monday evening's City Council meeting to present his Analysis and recommendations as well as to respond to any questions the Council may have.

Attachment

c: Maryanne Cornelius, City Clerk
David Molloy, Director of Public Safety/Police Chief

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April 28, 2010

City of Novi
Self Funding Analysis

Tim Lindow
Aaron Loiselle
Detroit

Agenda

- Analysis Objective, Data Used, and Assumptions
- Review of Funding Arrangements
- Demographic Analysis
- Projected Cost Estimates
- Considerations and Recommendations
- Factors Not Included in this Analysis

Analysis Objective, Data Used, and Assumptions

Analysis Objective, Data Used, and Assumptions

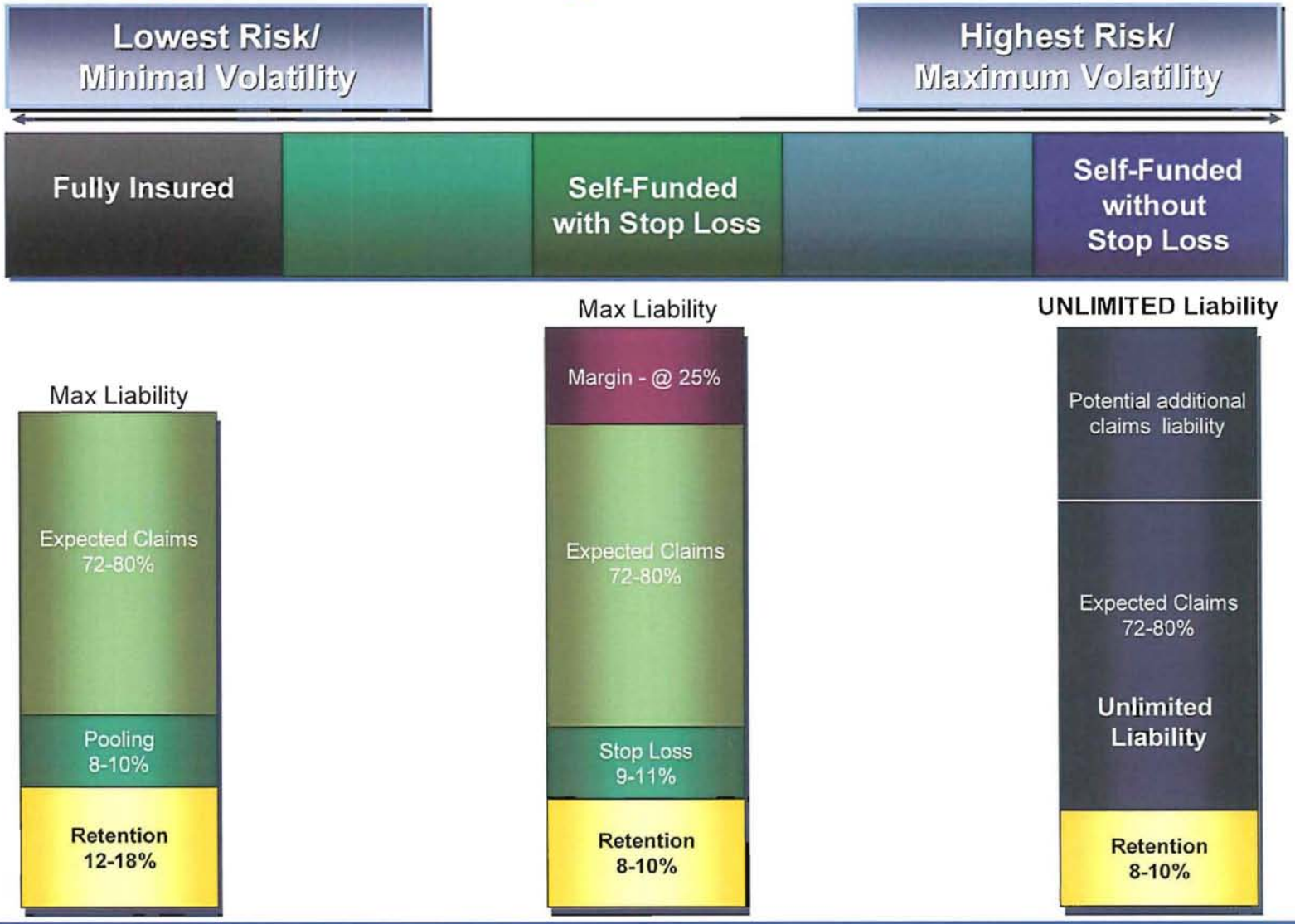
- The City of Novi engaged Mercer to develop a recommendation as to whether the group medical/Rx plans should be fully insured or self-funded
- The data provided by the City of Novi and it's two medical carriers, Blue Cross Blue Shield of Michigan (BC or BCBSM) and Health Alliance Plan (HAP) included
  - Most recent and previous carrier renewal packages
    - Including rates and limited underwriting back-up
  - Current census
    - Including member level data on birthdates and gender, as well medical coverage information
  - Prior self-funding analysis as performed by Gallagher-Raines in 2009
  - HAP's PA 106 report to the City, for the period ending 12/31/2009
- Any assumptions made in preparing the exhibits in this presentation are duly noted on the relevant slides

Review of Funding Arrangements

Funding Arrangements

- A funding arrangement is a way of managing *and/or* sharing risk
- Employers have several options to choose from when managing risk
- Each arrangement has varying levels of variable vs. fixed costs
  - Which leads to more or less variable monthly cash flow
  - Fully insured arrangements have the least variability
  - Self-insured arrangements with stop loss coverage have more variability, but with a level of certainty in terms of a maximum monthly payment

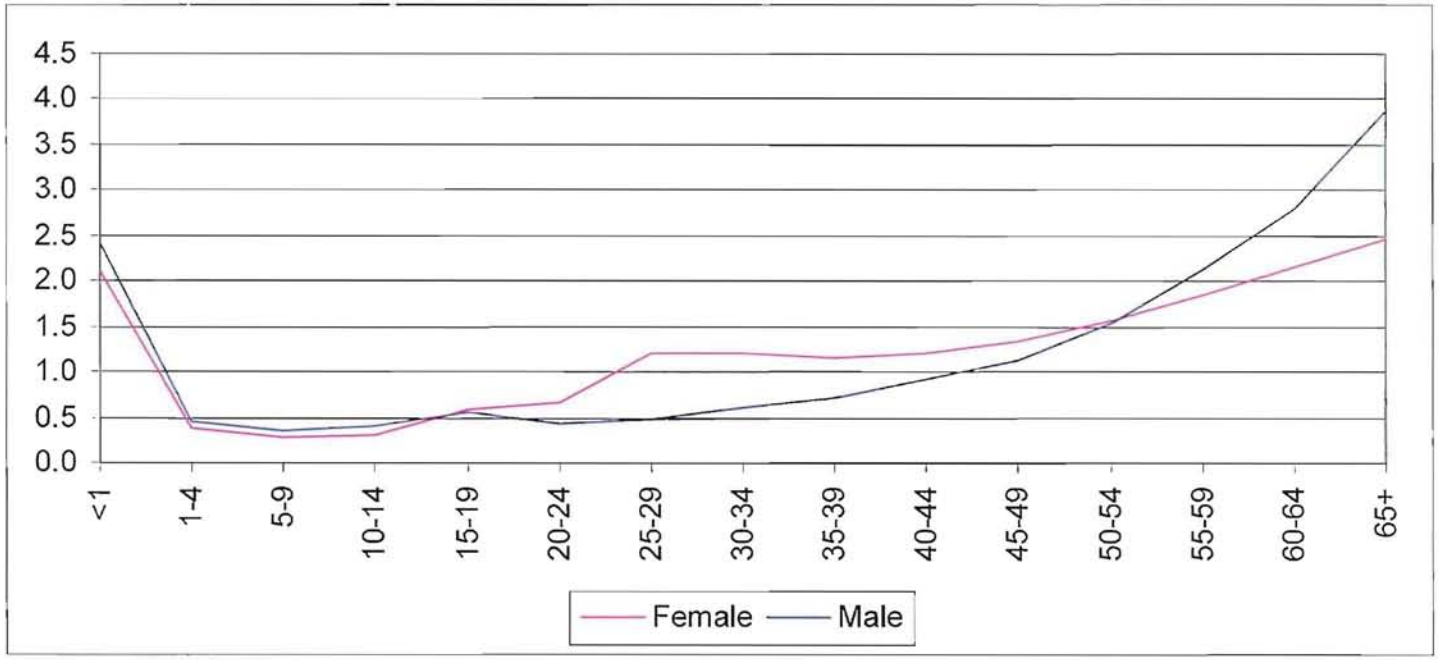
Review of Premium Components and Associated Payment Volatility Risk for Typical Funding Arrangements



Demographic Analysis

Age-Gender Factors

Age-Banded and Gender Based Healthcare Utilization Rates		
Age	Male	Female
<1	2.43	2.12
1-4	0.47	0.39
5-9	0.37	0.29
10-14	0.4	0.32
15-19	0.57	0.58
20-24	0.44	0.68
25-29	0.49	1.2
30-34	0.61	1.22
35-39	0.72	1.15
40-44	0.93	1.2
45-49	1.12	1.34
50-54	1.55	1.56
55-59	2.14	1.86
60-64	2.8	2.16
65+	3.88	2.46



- Each member is assigned a "morbidity factor" based on age and gender
- 1.00 represents the average (not necessarily healthy) member
- These factors are developed based on data for millions of members nationally and represent estimated healthcare utilization rates
- These factors can be used in conjunction with, or as a proxy to, actual group claims utilization

City of Novi Employees/Retirees

Snapshot as of April 2010

EMPLOYEE/RETIREE COUNTS

	Active			Retiree - pre-65			Retiree - post-65			Total		
	M	F	Total	M	F	Total	M	F	Total	M	F	Total
BCBSM	29	19	48	14	6	20	11	11	22	54	36	90
HAP	109	62	171	6	2	8	1	0	1	116	64	180
Total	138	81	219	20	8	28	12	11	23	170	100	270

AVERAGE AGE - EMPLOYEES/RETIREES

	Active			Retiree - pre-65			Retiree - post-65			Total		
	M	F	Total	M	F	Total	M	F	Total	M	F	Total
BCBSM	44.0	54.2	48.0	61.7	57.5	60.5	70.5	71.7	71.1	54.0	60.1	56.4
HAP	41.6	43.0	42.1	62.2	63.0	62.4	65.0	0.0	65.0	42.9	43.6	43.1
Total	42.1	45.6	43.4	61.9	58.9	61.0	70.1	71.7	70.9	46.4	49.5	47.6

AGE-GENDER FACTORS - EMPLOYEES/RETIREES

	Active			Retiree - pre-65			Retiree - post-65			Total		
	M	F	Total	M	F	Total	M	F	Total	M	F	Total
BCBSM	1.23	1.72	1.43	2.84	1.75	2.52	n/a	n/a	0.00	1.76	1.73	1.75
HAP	0.99	1.44	1.16	2.87	2.31	2.73	n/a	n/a	0.00	1.60	1.65	1.62
Total	1.04	1.51	1.22	2.85	1.89	2.58	0.00	0.00	0.00	1.65	1.68	1.66

- Enrollment is split 1/3 BC and 2/3 HAP
  - The active employees enrolled in HAP are about 6 years younger on average
  - The actives and retirees together in HAP are about 7 years younger on average
  - Based on the average age-gender factors shown
    - Active employees in HAP should utilize healthcare about 19% less than BCBSM
    - Actives and retirees combined in HAP should utilize healthcare about 7% less than BCBSM

Employees/Retirees and Dependents = Members

Snapshot as of April 2010

EMPLOYEE/RETIREE & DEPENDENT COUNTS

	Active			Retiree - pre-65			Retiree - post-65			Total		
	M	F	Total	M	F	Total	M	F	Total	M	F	Total
BCBSM	62	59	121	18	15	33	13	15	28	93	89	182
HAP	231	263	494	6	6	12	1	0	1	238	269	507
Total	293	322	615	24	21	45	14	15	29	331	358	689

AVERAGE CONTRACT SIZE

	Active			Retiree - pre-65			Retiree - post-65			Total		
	M	F	Total	M	F	Total	M	F	Total	M	F	Total
BCBSM	2.14	3.11	2.52	1.29	2.50	1.65	1.18	1.36	1.27	1.72	2.47	2.02
HAP	2.12	4.24	2.89	1.00	3.00	1.50	1.00	0.00	1.00	2.05	4.20	2.82
Total	2.12	3.98	2.81	1.20	2.63	1.61	1.17	1.36	1.26	1.95	3.58	2.55

AVERAGE AGE - EMPLOYEES/RETIREES & DEPENDENTS

	Active			Retiree - pre-65			Retiree - post-65			Total		
	M	F	Total	M	F	Total	M	F	Total	M	F	Total
BCBSM	34.1	38.8	36.4	56.7	58.8	57.6	71.2	70.7	70.9	43.7	47.6	45.6
HAP	30.9	28.4	29.6	62.2	61.5	61.8	65.0	0.0	65.0	31.8	29.2	30.4
Total	31.5	30.3	31.1	58.0	59.6	58.5	70.8	70.7	70.7	35.1	33.7	34.6

AGE-GENDER FACTORS - EMPLOYEES/RETIREES & DEPENDENTS

	Active			Retiree - pre-65			Retiree - post-65			Total		
	M	F	Total	M	F	Total	M	F	Total	M	F	Total
BCBSM	1.13	1.27	1.20	2.51	2.00	2.28	3.75	2.46	3.06	1.76	1.59	1.68
HAP	0.86	0.97	0.92	2.87	2.16	2.52	3.88	0.00	3.88	0.92	1.00	0.96
Total	0.92	1.03	0.96	2.60	2.05	2.44	3.76	2.46	3.14	1.16	1.15	1.15

- Please see the notes/observations on the next slide

Employees/Retirees and Dependents = Members

Snapshot as of April 2010

Based on the data from the previous slide

- HAP's membership associated with active employees is about 7 years younger on average
- HAP's total membership is about 5 years younger on average
- HAP's average contract size is significantly higher than BC due to larger numbers of families enrolled, 2.8 members/contract vs. 2.0
- Based on the average age-gender factors shown
  - HAP's total membership should utilize about 43% less healthcare than the BC membership

Conclusion

- On average, those members enrolled in HAP are younger and likely healthier than those enrolled in BC
- Actual HAP claims experience would be needed to help verify the average "health" status of the HAP members

Projected Cost Estimates

Projected Cost Estimates

Estimated 2010 Medical/Rx Premium Payments

Based on snapshot enrollment as of April, 2010

	BCBSM	HAP	Total
Enrollment	90	180	270
Annual Premium	$1,035,000	$2,074,000	$3,109,000
PEPY	*11,500*	*11,520*	*11,510*
Est. Claims Cost	$705,000	$1,825,000	$2,530,000
PEPY	*7,830*	*10,130*	*9,370*
Est. Retention Costs	$330,000	$249,000	$579,000
PEPY	*3,670*	*1,380*	*2,140*

Notes

PEPY = Per Employee/Retiree Per Year

Premium costs calculated using April 2010 enrollment applied to premium rates as provided by the City and the carriers.

Estimated retention costs (administration and pooling/stop loss costs, as well as margin) based on the percentages from the 1/1/2010 renewal packages provided by the carriers.

Projected Cost Estimates

Based on the estimates from the previous slide

- HAP's and BC's average per employee per year costs (PEPY) are roughly the same, around $11,500
- Based on the renewal packages
  - BC's target retention (administrative and stop loss costs) is approximately 30% of the premium, or $3,700 PEPY
  - HAP's target retention is approximately 12% of premium, or $1,400 PEPY
- Average estimated claims costs for HAP are about 35% higher, presumably due to more families enrolled

Considerations and Recommendations

Considerations

- **The City's risk philosophy**
  - Biggest factor in determining the funding method
  - Can be controlled to some extent with purchase of stop loss insurance
  - Can the City of Novi handle periodic claim payment volatility (10% - 25%, or higher, or about $30K - $50K per month, or higher)?
- **Administration**
  - Additional accounting functions including
    - Funding of claims and reconciliation of claims paid
    - Monitoring large claims relative to specific stop loss reimbursements
    - Rx rebates
    - Reserve requirements
  - Potential carve outs of stop loss, Rx, disease management
- **Employer size**
  - Size of group is directly attributable to the predictability of claims
    - "Law of large numbers" – the larger the population, claims become more predictable
    - The City of Novi, with a total enrolled population of 270, is considered a small population and therefore will have more difficulty predicting costs (i.e., claims less "credible" when projecting costs)
- **Plan experience and demographics**
  - Groups with a history of claims that represent less than 75%-80% of fully-insured premiums may have more favorable conditions to self insure
  - Generally want consistent experience over a long period of time

Considerations

- **Plan Specific Considerations**
  - BC has a small, older population
    - ⇨ Difficult to predict claims and has potential for higher utilization
  - BC's population has had 5 claims exceed $25,000 the last two years each
    - ⇨ May indicate chronic conditions and warrant the purchase of stop loss with a lower deductible and therefore higher cost
  - HAP has a somewhat larger (although still small), younger population with more families
    - ⇨ Slightly more predictable population, may have lower utilization but also may have more maternity events
  - HAP's medical loss ratio from the recent renewal is 88%, HAP's "average" or "target"
    - ⇨ Indicates that this group is a "fairly good risk" and that HAP's premiums are in line with actual costs
  - Under HAP, pooling/stop loss amounts built in to the base rate
    - ⇨ Stop loss premium/pooling charges much lower than what the City would get if coverage purchased from an outside vendor due to HAP spreading the risk over its entire book of business

Considerations

- **Other Considerations**
  - Are there union/bargaining agreements that may hamper the switch to self-funding?
  - Must both carriers, BC and HAP, be offered to employees/retirees?
    - Note that HAP's self-funded HMO arrangement does not allow enrollment of members residing outside of the state of Michigan
  - What is the City's goal in switching to self-funding?
    - Cost savings?
    - Plan design flexibility?
  - Currently with HAP's community rating, increases in overall costs are subject to state approval which may help moderate future increases
- **Financial Considerations**
  - Recommended specific stop loss (SL) deductible levels between $25K and $75K
    - Typical SL premiums range from $250 PEPM @ $25K to $70 PEPM @ $75K
    - Aggregate SL coverage may be desired and is typically $7 - $15 PEPM
  - "Fully-loaded" administrative fee, i.e., all provider discounts are passed through to the City, for BCBSM is typically $65 PEPM and for HAP is typically $33 PEPM

Considerations

- Based on the approximate mid-range of the assumptions on the previous slide and the claims costs from slide 13, 2010 costs might look like

	BCBSM	HAP	Total
Enrollment	90	180	270
Average Annual Claims	$705,000	$1,825,000	$2,530,000
Approx. Annual Administration Fee	$71,000	$72,000	$143,000
Approx. Annual Stop Loss Premium	$168,000	$335,000	$503,000
Annual Est. Self-funded Total	$944,000	$2,232,000	$3,176,000
Annual Est. Insured Premium Total	$1,035,000	$2,074,000	$3,109,000
% Difference	***-9%***	***8%***	***2%***

Notes

Average administration and stop loss estimated based on Mercer's book of business. Estimated fees used are $65 PEPM BC and $33 PEPM HAP admin, $155 PEPM stop loss. *Actual fees will vary*

- The financial exhibit above is an estimate only and the results could vary widely (approximately +/- 5%-10%, or more) depending on
  - Actual claims experience
  - Stop loss coverage chosen and actual terms received
  - Actual administrative contract terms

Recommendations

Assuming the City must offer both HAP and BC as options

- Given the very small size and relative older age of the Blue Cross enrollment
  - Sizeable periodic claims fluctuation is likely
  - If more predictable periodic payments is desired, self-funding is only recommended with a relatively low stop loss deductible, but will likely have high premium
  - If the City were a new group to BC with only 90 enrollees to offer, BC would most likely not allow the group to choose self-funding as a funding arrangement

  Recommendation: Keep it insured

- The HAP enrollment is twice as large as the BC enrollment and has a younger population with more families
  - Slightly more predictable, but claims fluctuations still likely
  - Additional stop loss vendor relationship required
  - Stop loss coverage is required, and will add a large amount to the cost of self-insuring, essentially eroding any savings from elimination of insured margin

  Recommendation: Keep it insured

Recommendations

Current Annual Premium Payments

- The exhibit below represents annual 2010 costs based on current premium payments and April 2010 enrollment
- Claims, administration, and stop loss/pooling costs are estimated based on 2010 renewal packages as provided by BC and HAP

	BCBSM	HAP	Total
Enrollment	90	180	270
Average Annual Claims	$705,000	$1,825,000	$2,530,000
Approx. Annual Administration Fee	$135,000	$249,000	$384,000
Approx. Annual Stop Loss Premium	$195,000	$0	$195,000
Annual Premium Total	$1,035,000	$2,074,000	$3,109,000

Recommendations

If the City is able to eliminate a carrier (HAP)

- Self-funding is not recommended – see financials below
- If the City were to self-fund and assuming claims fluctuation is not the main concern
  - Self-fund with BC since HAP can't cover enrollees outside of Michigan
  - Select a moderate stop loss deductible level - $35K-$50K

NOTE: THE EXHIBIT BELOW ASSUMES BC COVERS ALL CURRENT ENROLLEES

	Total
Enrollment	270
Average Annual Claims	$2,530,000
Approx. Annual Administration Fee	$212,000
Approx. Annual Stop Loss Premium	$503,000
Annual Est. Self-funded Total	$3,245,000
Annual Est. Insured Premium Total	$3,109,000
% Difference	***4%***

Notes

Average administration and stop loss estimated based on Mercer's book of business. Estimated fees used are $65 PEPM admin and $155 PEPM stop loss. *Actual fees will vary*

Factors Not Considered in This Analysis

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Factors Not Considered in this Analysis

- Long term impact of wellness and disease/case management programs
- Behavior change of enrollees if a carrier is eliminated
- HAP vs BC network discounts (discounts presumed similar in all financial exhibits)
- Impacts of healthcare reform
  - More information on the next 2 slides

Health Reform Overview

- Effective January 1, 2011 you must cover dependents to the end of the year that they turn 26 as long as they do not have access to other employer coverage. This is regardless of whether they are an IRS dependent, married, full time students, etc
- Effective January 1, 2011 your plan can not have any lifetime maximum coverage limits. The current lifetime limit in your BCBSM and HAP plans will have to be eliminated. This will increase the premium cost as well because it allows employees more coverage
- Effective January 1, 2011 employees can no longer use FSA/HSA/HRA funds for over the counter prescription items. The penalties for noncompliant use of an HSA as an employee will also increase from 10% to 20%. In 2013 the maximum FSA contribution will be $2,500
- Accounting impact of eliminating 2013 tax deduction for retiree medical Part D subsidy
- In 2011 you must start reporting health care cost on W-2s. This is not yet defined but could be similar to determining COBRA cost and reporting it on the W2. In 2013 there will also be a Medicare tax increase for employees making more than $200k individual ($250k family)
- Longer term in 2014 is when some of the penalties start to kick in for offering a plan that is not rich enough (as defined by being 60% of the value of a 'target' plan design the government will establish) and/or requiring employees to pay too much (more than 9.8% of the employees household income). The penalties are stiff and best avoided. Once the regulations are finalized we can model out where your plan design stands
- In 2018 the "Cadillac" plan excise tax kicks in. The government will determine what annual per employee per year costs should be and if your plan costs more than that predefined amount there will be a 40% tax

Health Reform Timeline

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- Change in tax treatment for over-age dependent coverage
- Accounting impact of change in Medicare retiree drug subsidy tax treatment
- Early retiree medical reinsurance
- Medicare prescription drug "donut hole" beneficiary rebate
- Auto-enrollment of FT employees (effective TBD)
- Break time/private room nursing moms

- Employers must distribute uniform benefit summaries to participants
- Employers must provide 60 day advance notice of material modifications (TBD)
- Form W-2 reporting for 2011 health coverage

- Health insurance exchanges
- Individual coverage mandate
- Individual affordability tax credits for low income individuals
- Medicaid expansion
- New health plan regulations
- HIPAA wellness limit increases
- Shared responsibility penalties
- Free choice vouchers
- Additional reporting and disclosure

- Dependent coverage to age 26 for any covered employee's child**
- No annual dollar limits**
- No pre-existing condition limits**
- No waiting period over 90 days**
- Additional new standards for new or "non-grandfathered" health plans, including limited cost-sharing
- Insurance industry fees begins

- *Dependent coverage to 26 (no other employer coverage available)**
- *No lifetime dollar limits**
- *Restricted annual dollar limits**
- *No pre-existing condition limitations for children up to age 19 **
- *No rescissions**
- Additional standards for new or "non-grandfathered" health plans including non-discrimination provisions for insured plans and mandatory preventive care with no cost-sharing
- No health FSA/HRA/HSA reimbursement for non-prescribed OTC medications
- Increased penalties for non-qualified HSA distributions
- Voluntary LTC "CLASS" program slated to start
- Pharmaceuticals manufacturers' fee
- Medicare, Medicare Advantage benefit and payment reform
- Insurers subject to medical loss ratio rules*

- $2,500 health FSA contribution cap (indexed)
- Medical device manufacturers' fees start
- Higher Medicare payroll tax on wages exceeding $200,000/individual; $250,000/couples
- New Medicare tax on net investment income for taxpayers with incomes exceeding $200,000/individual; $250,000/couples
- Research fees begin
- Change in Medicare retiree drug subsidy tax treatment takes effect

- Excise tax on "high cost" or Cadillac plans

** Applies to all plans including "grandfathered" plans effective for plan years beginning on or after Sept.23, 2010 (Jan. 1, 2011 for calendar year plans). Collectively bargained plans may have a delayed effective date.*

*** Applies to all plans including grandfathered plans effective for plan years beginning on or after Jan. 1, 2014*

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