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DEPT. COMM. NO. 13

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December 2, 2009

The Honorable Colleen Hanabusa
President of the Senate
State Capitol, Room 409
Honolulu, Hawai'i 96813

Dear Madam President:

Re: Act 5, Special Session Laws of Hawai'i 2008

This letter responds to Act 5, Special Session Laws of Hawai'i (SSLH) 2008, which requests the Auditor to determine the effects of the Hawai'i State Teacher's Association (HSTA) voluntary employees' beneficiary association (VEBA) trust pilot program on the Hawai'i Employer-Union Health Benefits Trust Fund (EUTF).

Summary of Findings and Recommendations
After completion of our preliminary research and extensive discussion with representatives from the EUTF, HSTA, and the Department of Budget and Finance, we have determined that the analysis requested in Act 5 cannot be performed for the following reasons:

- We are unable to analyze the benefit costs for the teacher retirees and their beneficiaries who remained EUTF participants because the EUTF cannot segregate this data accurately. Unlike active teachers, teacher retirees enrolled in the EUTF are not sorted or identified as teachers. Because of this, the information about healthcare benefits and costs for retirees is reported in the aggregate in EUTF's Financial Statements and Report of Independent Certified Public Accountants.

- We confirmed with the department and the HSTA that the HSTA VEBA trust financial and utilization reports are not available. Without these reports, we cannot perform an impact analysis of insurance rates to determine the difference in EUTF's annual costs with and without teacher members/retirees and their beneficiaries.

In the alternative and using information and data that are available, we conducted analyses of premium costs and administrative costs and assessed the transparency and accountability of the VEBA trust. We found that the VEBA trust pilot program: 1) promotes adverse selection and increases premium costs for EUTF enrollees; 2) duplicates administrative costs borne by the State employer; and 3) cannot ensure transparency and accountability in providing health benefits for teachers and teacher retirees. Overall, the HSTA VEBA trust breaks up the EUTF health plan and negatively impacts the EUTF.

Moreover, we assert the HSTA, not the Legislature or the Auditor, must prove the VEBA trust results in actual savings to the State. In light of administrative costs totaling over $2.4 million paid to the HSTA VEBA trust instead of the EUTF, we recommend that the VEBA trust pilot program established by Act 245, SLH 2005, as amended, be allowed to sunset on July 1, 2010, pursuant to Act 5, SSLH 2008.

The following is a brief summary of information supporting our findings and recommendations.

Background and Analysis of the Effects of the HSTA VEBA Trust on the EUTF

Hawai'i Employer-Union Health Benefits Trust Fund

In our Report No. 99-20, *Actuarial Study and Operational Audit of the Hawaii Public Employees Health Fund*, we found the benefits of consolidating the public employee health fund and the union plans included eliminating the negative effects of *adverse selection*[1], increasing the overall negotiating leverage with health plans and creating economies of scale, and centralizing the administrative functions and costs into a single health fund program. Based on our report, the 2001 Legislature established a single health trust fund—the Hawai'i Employer-Union Health Benefits Trust Fund—which combined the public employee health fund program and all the union health plans into one health benefit program. Effective July 1, 2003, the EUTF replaced the Hawaii Public Employees Health Fund (PEHF).

Table 1 shows the number of active public employees and retirees enrolled in the EUTF.

Table 1. EUTF Enrollment for Fiscal Years 2007 and 2008

Enrollment:	FY 2007	FY 2008
Active employees	53,100	55,100
Retirees	36,900	37,600

Source: Office of the Auditor

Voluntary Employees' Beneficiary Association Trust

In 1985, the HSTA established a VEBA trust to provide health benefits for its members. With the implementation of the EUTF in 2003, however, the union-sponsored VEBA trust was discontinued and HSTA members were included in the EUTF. In FY2006, when the EUTF included teachers, the EUTF board of trustees reportedly achieved major cost savings for medical and prescription drug plans through negotiations with the Hawai'i Medical Services Association that resulted in a total savings for retirees estimated at more than $5.2 million, and for active employees and employers estimated at about $20.5 million.

[1] *Adverse selection* occurred as younger active employees with smaller families attracted by lower contributions for insurance premiums opted to enroll in the union health plans at the expense of inadvertently increasing the employers' costs and the employees' share for insurance premiums under the public employee health fund.

In 2005 the Legislature allowed via Act 245 (SLH 2005) the temporary establishment of a union sponsored VEBA trust to provide health benefits for its members separate from the EUTF. The three-year VEBA trust pilot was intended as a cost containment measure to allow time for a thorough cost and benefits analysis to be evaluated against the EUTF "to determine what actual savings could be realized by the State."

Subsequently, the HSTA VEBA trust was formed and on March 1, 2006, all active HSTA employees were transferred from the EUTF to the trust. According to EUTF's financial statement reports, approximately 1,400 teacher retirees exercised a one-time option to transfer over to the HSTA VEBA trust and nearly 5,500 teacher retirees elected to remain with the EUTF. Currently, teachers retiring on or after March 1, 2006 are enrolled in the HSTA VEBA trust as retirees and do not have an option to enroll with the EUTF.

The HSTA VEBA trust administrative fees are paid by the State as the employer based on the same administrative rate structure implemented by the EUTF. Since March 1, 2006, the Department of Budget and Finance has paid the HSTA VEBA trust a total of $2.4 million in administrative fees billed to the State.

Table 2 shows the number of active teachers and retirees enrolled in the HSTA VEBA trust.

Table 2. HSTA VEBA Trust Enrollment for Fiscal Years 2007 and 2008

Enrollment:	FY 2007	FY 2008
Active teachers	N/A	13,132
Teacher retirees	N/A	1,682

Source: Office of the Auditor

The Analysis Requested by Act 5 (SSLH 2008) Cannot Be Performed

Based on our preliminary research and discussions with representatives from the EUTF, HSTA, and the Department of Budget and Finance, the analysis requested by Act 5 (SSLH 2008) cannot be performed because: 1) the EUTF does not segregate teacher retirees from other retirees; and 2) the HSTA VEBA trust utilization rates necessary to generate an impact analysis are not available.

First, we are unable to analyze costs and benefits that cover the EUTF teacher retirees and their beneficiaries because EUTF does not segregate this data. Although the EUTF's Financial Statements and Report of Independent Certified Public Accountants for the years ended June 30, 2007 and 2008 conducted by Grant Thornton, LLC, and actuarial certifications as of July 1, 2006 and July 1, 2007 are available, the audit was conducted of the entire EUTF. Accordingly, information about healthcare benefits and costs for retirees is reported in the aggregate. Teacher retirees cannot be segregated from other retirees in the EUTF because they are not sorted or identified as teachers.

The EUTF cautioned that although it can identify retired teacher members by bargaining unit ID codes, the numbers may not be accurate due to discrepancies stemming from the transfer of enrollee data from the PEHF to the EUTF and the non-reporting of bargaining unit codes for deferred retirees.[2] There are some retirees participating in the EUTF who should be, but are not, designated as teachers.

Second, we confirmed with the department and the HSTA that not all the HSTA VEBA trust financial and utilization reports are available. Without these reports, we cannot perform an impact analysis of insurance rates to determine the difference in EUTF's annual costs with and without teacher members/retirees and their beneficiaries.

Thus, absent information in the EUTF financial audits and actuarial study that specifically covers the approximately 5,500 teacher retirees who are EUTF participants, or in the alternative, the HSTA VEBA trust financial and utilization reports, the analysis requested by Act 5 (SSLH 2008) cannot be performed.

The VEBA Trust Negatively Impacts the EUTF and Should Be Allowed to Sunset
In lieu of the analysis requested in Act 5 (SSLH 2008), we provide the following information and analysis on the negative effects of the VEBA trust pilot program on the EUTF. We conclude that the VEBA trust pilot program: 1) promotes adverse selection and increases premium costs for EUTF enrollees; 2) duplicates administrative costs borne by the State employer; and 3) cannot ensure transparency and accountability in providing health benefits for teachers and teacher retirees. Overall, because the HSTA VEBA trust breaks up the EUTF health plan and negatively impacts the EUTF, Act 245 (SLH 2005), as amended, should be allowed to sunset.

The VEBA Trust Promotes Adverse Selection and Increases Premium Costs for EUTF Enrollees
In 2005, the Department of Budget and Finance voiced strong opposition to a VEBA trust pilot program, stating it would reinstate the adverse selection spiral and associated higher premium costs for both active employees and retirees remaining in the EUTF. The department explained that the costs of retirees would increase if older retirees remain with the EUTF and younger retirees become part of the HSTA VEBA because older retirees are more costly. This scenario applies to the reported 5,500 teacher retirees who elected to remain in the EUTF health plans.

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[2] A deferred retiree is a vested former public employee who enrolls with the EUTF to receive health benefits upon retirement after a break in service with the State or county. The bargaining unit codes for deferred retirees are not available as codes are not required to be reported upon enrollment with the EUTF. Furthermore, it is not known how many HSTA retirees are within the group of deferred retirees.

Based on the EUTF enrollment data as of January 2007, Garner Consulting determined that the EUTF budget for the HMSA PPO plan would have been lower by 4.3 percent if HSTA members were included in the EUTF. This amounts to an overall premium reduction of $8.6 million. Thus, if the VEBA trust pilot program is allowed to sunset and VEBA enrollees return to the EUTF, the negative effects of adverse selection experienced by EUTF participants would be eliminated, resulting in lower premium costs for all EUTF enrollees.

The VEBA Trust Duplicates Administrative Costs Borne by the State Employer
In 2005, the Department of Budget and Finance raised concerns that a VEBA trust pilot program duplicates the administrative costs needed to support the administrative expenses and services of the EUTF. All administrative fees for the EUTF plan are paid by the state and county employers and added to the employers' premium contributions for every active and retiree enrollee per plan per month as negotiated under collective bargaining agreements. Any fees not needed by the EUTF for administrative costs are deposited in its reserve fund to offset or pay future benefit claims or used for other purposes. The EUTF has never sought supplemental appropriations for administrative costs from the Legislature.

All administrative fees for the HSTA VEBA trust plan are paid by the State and added to the employer's premium contributions. According to the department, from March 1, 2006 to June 30, 2009, over $2.4 million in administrative fees was paid by the State to the HSTA VEBA trust. In contrast with the EUTF, the HSTA VEBA trust has incurred administrative expenses in excess of the administrative fees paid by the State—an excess of nearly $1 million in its total of $3.4 million incurred in administrative expenses. The majority of the HSTA VEBA trust's administrative expenses were comprised of the costs of its third party administrator, consultant, and attorneys, as well as other expenses such as bank fees, office supplies, postage and printing. The HSTA VEBA trust also reportedly owes unpaid taxes.

In effect, administrative fees are being paid by the State to operate two separate administrative offices—one for EUTF and another for the HSTA VEBA trust. We find this is unnecessary, costly, and duplicative.

The VEBA Trust Cannot Ensure Transparency and Accountability in Providing Health Benefits for Teachers and Teacher Retirees
The EUTF is a state agency administratively attached to the Department of Budget and Finance. It ensures transparency and accountability through public meetings; accessible government records; and legislative, administrative rulemaking, and state budgeting processes that monitor budgeting and administrative expenses. Unlike the EUTF, the VEBA trust's governing board is not a state agency and hence not subject to state requirements and processes. Lacking the transparency and accountability of a state agency, the VEBA trust pilot program and the State's

monthly contributions for health premium shares and administrative costs are vulnerable to abuse and waste.

Coincidentally, in 2005, the Department of the Attorney General raised concerns regarding the lack of access to information, transparency, and accountability in the operations of the VEBA trust. Although the Attorney General is charged with enforcement of violations of the VEBA trust, the Attorney General will not know of violations because it does not monitor the activities of the VEBA trust. For example, the Attorney General was not aware that the former administrators of the HSTA VEBA trust filed for bankruptcy until news reports appeared in March 2009. A bankruptcy or similar event could not happen to the EUTF. Thus, unlike the EUTF, the VEBA trust pilot program does not ensure transparency and accountability.

Conclusion and Recommendations

Lack of necessary data precluded us from performing the requested analyses. However, in the alternative and utilizing data that is available, we found that the VEBA trust pilot program: 1) promotes adverse selection and increases premium costs for EUTF enrollees; 2) duplicates administrative costs borne by the State employer; and 3) cannot ensure transparency and accountability in providing health benefits for teachers and teacher retirees. Further, we stand on our findings in Report No. 99-20 supporting a consolidated public employee health fund.

These findings are compelling. In light of administrative costs totaling over $2.4 million paid to the HSTA VEBA trust instead of the EUTF, we assert that the HSTA has not proven that implementation of its VEBA would result in actual savings to the State. Accordingly, we recommend that the VEBA trust pilot program established by Act 245 (SLH 2005), as amended, be allowed to sunset on July 1, 2010, pursuant to Act 5 (SSLH 2008).

Please do not hesitate to contact me should you have any questions.

Sincerely,

Marion M. Higa

Marion M. Higa
State Auditor

c: ✓ Carol Taniguchi, Senate Clerk