LATE TESTIMONY

TESTIMONY BY KALBERT K. YOUNG
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEES ON LABOR & PUBLIC EMPLOYMENT AND
CONSUMER PROTECTION & COMMERCE
ON
HOUSE BILL NO. 1459

February 6, 2013

RELATING TO INSURANCE

House Bill No. 1459 establishes a captive insurance company to manage the administration and financing of the current and potential future public employee health benefit obligation of the State and county governments. The bill establishes the Hawaii Employer-Union Health Benefits Trust Fund Captive Insurance Company Fund (the Fund) within the Department of Budget and Finance (B&F) for administrative purposes. The Fund is to consist of contributions, interest, income, dividends, refunds, rate credits, legislative initiatives and other returns, and is held in trust for the exclusive use and benefit of employee-beneficiaries and dependent-beneficiaries.

The bill also establishes a Hawaii Employer-Union Health Benefits Trust Fund Captive Insurance Company Reserve Account (the Account) to be placed within the B&F for administrative purposes. The Account's balance is initially set at $1.5 billion and is to be used as a reserve against the Fund's future cost of providing health and other benefits for retired public employees and their beneficiaries. Each public employer is responsible for a proportionate share of the initial balance and has five years to make its required contributions. If the Account's balance falls below $1.5 billion, public employers are required to make additional proportionate share contributions until the Account's balance meets or exceeds $1.5 billion.

The provisions under House Bill No. 1459 relating to definitions and types of plans and benefits appear to generally follow existing provisions under Chapter 87A, HRS. The major differences (aside from provisions to adapt the Employer-Union Trust Fund (EUTF) to a captive insurance concept) are in the makeup and voting of the governing Board of Trustees, and the power and duties of the Administrator. This bill adds a county representative to the captive insurance company Board and gives the county representative a separate vote - currently, the EUTF trustees vote in blocs with the five public employer EUTF trustees having one vote and the five public union EUTF trustees having one vote. This bill also gives the captive insurance company's Administrator broad authority over certain operational aspects of the company - currently, these powers rest with the EUTF Board.

B&F is open to exploring various avenues to improve the cost effectiveness of delivering public employee and retiree health benefits and to address the State's unfunded other post-employment benefits (OPEB) liabilities. However, questions remain as to how House Bill No. 1459 will accomplish reducing the State's unfunded liability under the requirements of Government Accounting Standards Board (GASB) 43 and 45.

It is unclear if the captive insurance company will reduce current benefits costs. Being the largest employer group in the State, the EUTF has significant bargaining power in negotiating with Hawaii's health insurance carriers. All of the EUTF plans are group rated and very favorable interest and return of excess reserves provisions are in place in the EUTF contracts. There is always room for improvement, but it isn't readily apparent how a captive insurance company could be more cost effective. Additional information and data will need to be collected in order to appropriately analyze the State's employee risk pool. The business question of whether to establish a captive insurance program versus a more common and traditional model of paying for third-party insurance is a business decision where organizations must weigh how much risk they are willing to assume, the likelihood of increase costs or savings, and quality of insurance. While this bill does not ensure that financial objectives can be achieved, we do recognize that it does advance the discussion of the future viability of the EUTF.

House Bill No. 1459 is also unclear as to how a captive insurance company would directly impact the State's unfunded OPEB liability. The introduction of the bill (page 4, lines 9-11) states "[e]stablishing a reserve account to accumulate ten percent of the unfunded liabilities . . . will have the effect of fully funding the liabilities." The total State and county unfunded OPEB liability (as of July 1, 2012) is $16.3 billion of which the State's liability is $13.6 billion. The bill does not address how a $1.5 billion reserve would satisfy a $16.3 billion obligation. Regardless of the model of insurance structures, the State will still need to comply with the GASB provisions in order to meet the growing liability in the State's financial statements. As of June 30, 2012, the State's position of net assets is $1.3 billion, down from $5.0 billion since implementation of GASB 43 and 45. This is of serious concern as the State's financial statements are one of the key financial material bond investors and rating agencies use to gauge the fiscal health of the State. The EUTF actuaries and the State's auditors would have to agree that partially funding a reserve or captive insurance fund in the near-term would satisfy a larger long-term financial liability.

Regarding public employer contributions towards the captive insurance company's initial reserve account amount of $1.5 billion, it should be noted that the State will bear the lion's share of the funding responsibility. The State has 70,114 active and retiree plan subscribers out of the EUTF's total plan subscribers of 92,906, or a little over 75% of the total. Hence, the State's share of the $1.5 billion based on "proportional share" would be approximately $1.125 billion ($1.5 billion times 75%). This amount would have to be paid over to the captive insurance company by July 1, 2019 (initial balance requirement is to be met within five years from the effective date of the bill which is July 1, 2014). Again, the State would want to ensure that such a contribution could be attributed towards reducing its long-term OPEB liabilities and that such reduction would be reflected on its financial statements and audits in accordance with GASB requirements.

Finally, B&F has concerns with the bill's two changes to the current governance structure of the EUTF. One concern is that the addition of a third county vote on the captive insurance company's Board gives the appointed county representative the swing vote. This would give the counties disproportionate representation when their active and retiree subscribers amount to less than 25% of the total EUTF subscribers (and costs and OPEB liabilities). The other concern is the authority being granted to the captive insurance company Administrator. The captive insurance company Board is the body with fiduciary responsibility for the captive insurance company and the Board should have the appropriate powers and authority (and can delegate certain powers to the Administrator as deemed appropriate) to operate and manage the captive insurance company.

The Department is open to continued discussion on ways to reduce the overall cost trends of providing health insurance coverage for its 70,000+ active and retired employees, and we look forward to working with the Legislature on this issue.