LATE

TESTIMONY BY KALBERT K. YOUNG
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON FINANCE
ON
SENATE BILL NO. 946, S.D. 1, H.D. 1

April 2, 2013

RELATING TO RESOLVING THE UNFUNDED LIABILITIES OF THE STATE AND THE COUNTIES

Senate Bill No. 946, S.D. 1, H.D. 1, does the following:

- Part I establishes a Hawaii Employer-Union Health Benefits Trust Task Force within the Department of Budget and Finance (B&F), for administrative purposes, that will examine the unfunded liability of the Hawaii Employer-Union Trust Fund (EUTF); and
- Part II 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.

Part I - Hawaii Employer-Union Health Benefits Trust Task Force

The task force established in Part I consists of: two members from the House appointed by the Speaker; two members from the Senate appointed by the President; four members representing the State's unions; the Director of Finance (or designee); one member appointed by the Governor; one member from the Hawaii Council of Mayors; and one member from the Hawaii State Association of Counties. The task force examines:

1. The current and projected unfunded actuarial accrued liability of the EUTF;
2. The availability of medical benefits plans other than plans that pay or reimburse medical services providers under a fee-for-service model, including alternative medical benefits plans;
3. The costs and benefits of alternative medical benefits plans in relation to the medical benefits plans currently offered by the EUTF;
4. An evaluation of the costs and process of transitioning from the current medical benefits plans to an alternative medical benefits plans, including proposed legislation; and
5. Any other matters that are relevant to gaining a full and meaningful understanding of the circumstance of the EUTF.

The Director of Finance, in consultation with the task force, is to submit a report to the Legislature 20 days prior to convening of the 2014 Regular Session. An unspecified appropriation of general funds is included for travel expenses and consultant services to support the work of the task force.

B&F supports the intent of Part I of this bill that will establish the task force; provided that the Legislature also supports the Governor's proposed FB 2013-15 budget that includes approximately $100 million in each of the next two fiscal years to begin the process of pre-funding the State employer contributions for Other Post Employment Benefits (OPEB).

It is imperative for the State to take its first step with regard to the $100 million in OPEB pre-funding for FY 2014 and FY 2015 and to become accustomed in terms of contributing the full annual required contributions of $500 million in future fiscal years. It is further suggested that the task force should consider a wider range of issues, in addition to the possible alternative medical benefit plans which are provided in this bill. For example, the task force should explore mechanisms that would best enable the State to meet its annual pre-funding requirements, consider best approaches to ensure a consistent, balanced, and prudent investment return which would increase the corpus of the OPEB funds and possibly lower future contribution requirements and the liability, consider appropriate and feasible new strategies and approaches in the EUTF benefits design, and possible employee and retiree involvement in wellness and other programs which may result in immediate and longer term benefits for employees, retirees, and employers.

Finally, while we support having county representation on this task force, appointing a member from the Hawaii Council on Mayors and appointing another member from the Hawaii Association of Counties is not reflective of the EUTF's membership. Currently, State employees make up approximately 76% of EUTF's participants. We respectfully ask that the Governor to have the discretion in considering the making of appointments that would represent the interests of the counties.

<u>Part II - Captive Insurance Company for Public Employee & Retiree Health Benefits</u>

Part II of the bill establishes the Hawaii Employer-Union Health Benefits Trust Fund Captive Insurance Company Fund (the Fund) within the 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 bill further establishes a Hawaii Employer-Union Health Benefits Trust Fund Captive Insurance Company Minimum Capital and Surplus Account (the Surplus Account) to be placed within the B&F for administrative purposes. The Surplus Account is to be used to hold the minimum capital and surplus amounts established by the Insurance Commissioner for captive insurance companies. Each public employer is to make a contribution to the Surplus Account as determined by the captive insurance company Board.

The provisions under Part II of this bill, 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 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 OPEB liabilities. However, questions remain as to how Part II of this bill 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 experience 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 with all the additional insurance regulatory requirements 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 increased 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.

Part II of this bill 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 7, lines 11-13) 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.

It should be pointed out that one of the premises of this bill, as stated in the introduction (page 6, lines 10-14), is that ". . . a captive insurance company will address the necessary premium contributions for public employee health benefits because there would be a commitment from the board of directors, composed of members from the public employers and employees, to fund the employees' health benefits going forward." This is not accurate because the creation of a captive insurance company in and of itself does not assure any funding for health benefits going forward. Funding of active and retiree health benefits, as well as other types of appropriations, are the sole purview of the Legislature and the respective county councils.

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.

FINTestimony

LATE

From: mailinglist@capitol.hawaii.gov
Sent: Monday, April 01, 2013 2:25 PM
To: FINTestimony
Cc: tony@rmasalesco.com
Subject: Submitted testimony for SB946 on Apr 2, 2013 14:00PM

SB946
Submitted on: 4/1/2013
Testimony for FIN on Apr 2, 2013 14:00PM in Conference Room 308

Submitted By	Organization	Testifier Position	Present at Hearing
Anthony Borge	RMA Sales	Support	No

Comments: We support the intent of S.B.646 SD1, HD1 as it proposes to address the unfunded liabilities of the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) which is a looming crisis that unless addressed will jeopardize future bond ratings for the State of Hawaii. Respectfully Submitted by Anthony Borge

Please note that testimony submitted less than 24 hours prior to the hearing , improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

FINTestimony

LATE

From: mailinglist@capitol.hawaii.gov
Sent: Tuesday, April 02, 2013 7:55 AM
To: FINTestimony
Cc: tabraham08@gmail.com
Subject: Submitted testimony for SB946 on Apr 2, 2013 14:00PM

SB946
Submitted on: 4/2/2013
Testimony for FIN on Apr 2, 2013 14:00PM in Conference Room 308

Submitted By	Organization	Testifier Position	Present at Hearing
Troy Abraham	Individual	Support	No

Comments: I support passage of this bill

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

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