



AB 256 Executive Summary

3/19/08

AB256: Potential Advantages and Drawbacks of a Mandatory Purchasing Pool

Potential Advantages: (pp. 9-11)

Short-Term Advantages

1. Increased quality and service. A single purchasing pool would be large enough to drive market change and to demand better quality and better service, and create more partnership.
2. Reduced direct expense. Insurance contracts include a number of direct expenses that are generally related to the size of the group. These include retention, premium tax, commission or broker fees, and stop loss coverage. These expenses could be reduced or eliminated in a self-funded, mandatory pool.
3. Reduced and streamlined administration. Currently, each district must make its own arrangements for administration internally or on an outsourced basis. A single pool would allow for reduced and streamlined administration through economies of scale, by eliminating redundant and overlapping systems and administrative practices.
4. Improved prescription drug costs. Large purchasers can demand the biggest reductions in wholesale price, increased rebates, and the best plan management. A single pool would have significant leverage in this area. In the current system, only districts covered by CalPERS enjoy this degree of size-based purchasing leverage.
5. Improved network discounts. Not all districts currently benefit from the best available discounts for medical coverage. Some do not contract with networks that offer the deepest discounts.

Upper-Bound Estimate of Near-Term Cost Savings for Implementing a Mandatory School Pool (p. 10)

<u>Savings Opportunity</u>	<u>Dollars in Millions</u>	<u>Percentage of Premium</u>
Reduced Direct Expense	\$165	2.45%
Reduced/Streamlined Operation	\$ 34	0.50%
Improved Prescription Drug Costs	\$101	1.50%
Improved Network Discounts	\$101	1.50%
Total	\$401	5.95%

Long-Term Advantages

6. Implement best practices for health, wellness and disease management. These programs are intended to improve health and thus lower costs. If implemented successfully and effectively communicated to the membership, we would expect to see ongoing, long-term savings in the form of reduced trend. We estimate a potential trend reduction of 1% per year.
7. Consider the impact of selection against the current plans in developing rate and tier structure. If the dependent ratio in the pool more closely approximated norms in the market place, annual savings of approximately 1% to 3% of premium – or from \$67 to \$203 million – could be achieved by reducing the impact of dependent coverage selection against the plans.
8. Implement best practices for plan administration. In developing systems to support the districts, utilize and maintain uniform best practices for plan administration, including tracking terminations and additions, effective eligibility management, and monitoring Medicare enrollment. Effective eligibility management alone has been shown to save 2% to 3% of premium, or \$134 to \$203 million.
9. Review plan design alternatives. If plan designs in the pool more closely approximated PEMHCA plans, rather than those currently favored by the districts, savings of about 3% of premium, or \$203 million, could be realized.

Potential Drawbacks: (p. 56)

1. No matter how the pool is set up, there are likely to be winners and losers in the process. Some districts may find that they subsidize the cost of others; some may find that the pool is non-responsive to their specific needs or preferences.
2. A pool would limit local control and input into major coverage decisions, such as the level and structure of coverage, contributions, extent of coverage, and health management techniques. The pool would need to be structured so that it provided an opportunity for ongoing input from stakeholders, and sufficient flexibility in plan designs and coverage rules so that it met a broad range of district needs and preferences.
3. If there are constraints in joining or leaving the pool, the districts could find these to be too costly or restrictive.
4. It is not possible for a mandatory pool to offer all of the various choices that are currently available to the districts. A finite array of choices would be offered.
5. A mandatory pool, with mandated benefits for school districts, would be difficult to achieve. While there is a potential for significant consolidation, it also implies that there would be a limited number of carriers providing benefits.
6. If the pool is not efficient or well-run, it will be less effective than the current system which includes several large pools competing for district business.
7. A budget shortfall currently impacts only the affected group. In a pool arrangement, some mechanism would need to be in place to limit the impact on the entire group of a budget shortfall within the pool.

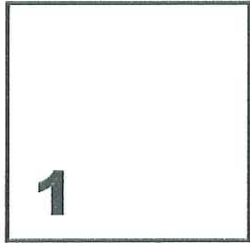
December 17, 2007

**Feasibility of Offering Health Care
Coverage to School Employees as
Outlined in AB 256**
CalPERS and CalSTRS

MERCER



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Executive Summary

Background

Assembly Bill 256 requires the Board of Administration of the Public Employees' Retirement System to conduct a study to examine the feasibility and cost-effectiveness of:

- Creating a single statewide health care pool that would cover all public school employees, either on a mandatory or a voluntary basis; or
- Including all school employees in the Public Employees' Medical and Hospital Care Act (PEMHCA) and covering them within the programs offered by CalPERS.

On January 4, 2007, representatives from the California Public Employees' Retirement System (CalPERS), the California State Teachers' Retirement System (CalSTRS), the California School Employees Association (CSEA), and the California Teachers Association (CTA) met with the team from Mercer to discuss the study and the data needed to conduct it. The purpose of this report is to document Mercer's analysis, findings and conclusions related to the study, as well as the data sources used.

Mercer would like to thank CalPERS, CalSTRS, CSEA, CTA and the contributing constituent groups for their cooperation and assistance in preparing this report.

Populations Included in the Study

The populations to be included in the study include:

- Active employees of the public school system¹.
- Retired employees of the public school system.
- The dependents of those active employees and retirees.

The following were considered outside the scope of this study:

- Public school employees not actively-at-work because of they are on leave, they are not able to find work, or for other reasons.
- Employees and retirees of private schools (about 9% of California students attend private schools²).

Project Objectives and Scope

AB 256 outlined specific objectives in evaluating the feasibility and cost-effectiveness of creating a single statewide coverage pool for all public school employees. These objectives included improving access to health care coverage for the school district employees who do not currently have coverage because they are not eligible (those who do not work enough hours to qualify) or the coverage is unaffordable (the lowest wage earners).

This study was intended to develop a realistic representation of the financial structure of healthcare coverage for school district employees and retirees in California, so that the current situation would be better understood and high-level recommendations could be made. Stated areas of interest included the following:

¹ AB 256 contemplated inclusion of community colleges as a part of the potential health care pool. Many of our primary data sources did not include community college information, but we believe our broad recommendations would not change if the community colleges were included. If they are included, then the dollar amounts of the estimated savings shown would increase.

² Web site: California Department of Education, General Information for Fiscal Year 2006-07.

- A review and analysis of the costs, potential savings, benefits and drawbacks of creating a health care pool for all public school employees in California, including retirees.
- A discussion of the health care pool rating approach, both on a statewide basis and including regional rating structures.
- A high level cost impact analysis of the single health care pool approach compared to the current market process which includes many different pools and plans.
- A high level examination of appropriate plan design options for a statewide health care pool.
- An examination of the feasibility and cost savings of including all school employees under a health care pool.
- A review and analysis of the costs, potential savings, benefits and drawbacks of expanding coverage of school employees within the current programs offered by CalPERS.

It was beyond the scope of this project to take an in-depth look at the census, plan, and cost data of each and every district individually. Rather, we used readily available information supplemented by a few focused surveys and by our knowledge of the California healthcare industry.

Key Data Findings and Observations

Data sources on certificated employees were extensive enough for us to develop a reasonably good picture of how health care coverage is provided to them, and what the actual cost is to the districts³ and to certificated employees themselves. Data on classified employees was not as extensive within the data sources used. Therefore, we identified possible similarities and differences between certificated and classified employees, and developed assumptions based upon them.

Observations Related to the Potential Market or Structural Inefficiencies in the Current System

Key observations related to potential market or structural inefficiencies in the current system include:

- Most school districts (almost 80%) already provide coverage under various arrangements that include some elements of pooling (JPA, Trust, or CalPERS). They currently gain some level of administrative efficiency, effective program management, and negotiation leverage, but results are not consistent.
- Compared to other large California employers⁴, school districts pay more for medical coverage on a per employee basis and charge their employees less for that coverage. The higher cost is likely tied to a combination of factors, including:
 - School districts cover more dependents than most California employers.
 - School districts generally provide richer benefits than other large California employers, including benefits offered through CalPERS.
- Based on a regression analysis of the cost of coverage for school districts, employee group size does not appear to be a significant factor in current plan cost. This may be, in part, because smaller districts are more likely to be participating in one of the existing pooling arrangements. Smaller districts, on average, also charge their employees more for the cost of coverage.

³ We use “district” in this report broadly. Coverage within a district can vary based on a number of factors, including whether employees are certificated or classified. Some organizations which provide coverage to the districts use the term “unit” instead to demonstrate that there may be multiple units within a district.

⁴ Based on the Mercer Survey of Employer-Sponsored Health Plans, large employers have 500 or more employees.

- Health plan enrollment is predominantly in Kaiser, Blue Cross and Blue Shield, but districts make arrangements for coverage with the same carriers through many different plans and approaches. The approach to the market is highly fragmented.

Observations Related to Access and Affordability

Key observations related to reviewing medical coverage access and affordability include:

- Certificated employees who work full-time generally have good access to affordable medical coverage. While classified employees are, on average, paid less than certificated, a large percentage does have access to the same benefit levels as the certificated – at the same or similar contribution levels.
- Medical coverage for part-time employees is generally accessible for those who work at least half-time – though it is often much less affordable when analyzed on the basis of individual income.
- Compared to other large California employers, school districts do a good job of providing comprehensive medical coverage to early retirees to bridge the transition to coverage under Medicare, as long as the retiree has sufficient service to qualify. Once retirees reach Medicare age, they are much less likely to have district-provided coverage. However, while some district retirees are not eligible for Medicare coverage, many do get it from other sources (e.g., spouse's coverage or coverage from other employment).

Conclusions

Properly structured, there is a viable opportunity for districts to benefit from being placed in a statewide health care coverage pool. We believe that such a pool should be mandatory because:

- A single purchasing pool would be large enough to drive market change and to demand better quality and better service, and create more partnership.
- A mandatory pool would have considerable mass and leverage, and would be able to implement many best practices in a consistent manner.
- A voluntary pool would be an addition to an existing state which already includes many pooled options. Districts would be free to shop coverage against it and would only join the pool if it were best for them financially. Unless the pool could protect itself against some of this selection, it could find itself in a selection spiral – and ultimately fail. These selection issues would not be a factor for a mandatory pool.
- Savings estimates represented in this report assume a mandatory pool. While there could be some economies of scale sufficient to make a well-run voluntary pool competitive in the market place, the savings shown would be considerably reduced.

While there are several drawbacks to creating a pool, they are not insurmountable and we believe that the added benefits of a mandatory pool make the effort needed to address or overcome them well worth it. If a purchasing pool is developed, those drawbacks should be taken into consideration as the basic structure is put in place. A well-conceived, timed and executed transition strategy could alleviate many of the issues associated with implementing a pool, including those specific to a mandatory pool.

Size-Based Immediate or Near-Term Savings Opportunities

There are opportunities to obtain immediate or near-term savings by creating a health care pool for all public school employees in California, including retirees. Total potential savings depend upon how efficiently and effectively the pool operates compared to the current system, but some savings opportunities are scale based and thus can be realized by consolidating into a single pool. These include:

- **Reduced Direct Expense.** Insurance contracts include a number of direct expenses that are generally related to the size of the group. These include retention, premium tax, commission or broker fees, and stop loss coverage. These expenses could be reduced or eliminated in a self-funded, mandatory pool.
- **Reduced and Streamlined Administration.** Currently, each district must make its own arrangements for administration internally or on an outsourced basis. A single pool would allow for reduced and streamlined administration through economies of scale, by eliminating redundant and overlapping systems and administrative practices.
- **Improved Prescription Drug Costs.** Large purchasers can demand the biggest reductions in wholesale price, increased rebates, and the best plan management. A single pool would have significant leverage in this area; in the current system, only districts covered by CalPERS enjoy this degree of size-based purchasing leverage.
- **Improved Network Discounts.** Not all districts currently benefit from the best available discounts for medical coverage. Some do not contract with networks that offer the deepest discounts.

A summary of the range of estimated immediate or near-term cost savings that are solely based on pool size is shown in Table 1. The savings estimates are based on estimated total premium for 2007/2008 for the active and retiree population.

Table 1 – Range of Estimated Immediate or Near-term Size-Based Cost Savings for Implementing a Mandatory Pool

Savings Opportunity	Upper Bound		Lower Bound	
	Dollars in Millions	Percentage of Premium	Dollars in Millions	Percentage of Premium
Reduced Direct Expense	\$165	2.45%	\$ 98	1.45%
Reduced and Streamlined Administration	\$ 34	0.50%	\$ 34	0.50%
Improved Prescription Drug Costs	\$101	1.50%	\$ 51	0.75%
Improved Network Discounts	\$101	1.50%	\$ 34	0.50%
Total	\$401	5.95%	\$217	3.20%

Additional and Longer Term Savings Opportunities

In our review of the current situation, we discovered additional opportunities for savings. Since these opportunities are not just scale-based, actions in these areas may be more difficult to take but the savings potential is real. For some of these opportunities, results may only emerge over time, but these longer-term strategies – if rigorously implemented and supported – could allow the districts to improve the overall health of the population and to impact cost trend. Therefore, any implementation of a mandatory purchasing pool should include further analysis and discussion of these potential areas of savings. They include:

- Implement best practices for health, wellness and disease management. These programs are intended to improve health and thus lower costs. If implemented successfully and effectively communicated to the membership, we would expect to see ongoing, long-term savings in the form of reduced trend. We estimate a potential trend reduction of 1% per year.
- Consider the impact of selection against the current plans in developing rate and tier structure. If the dependent ratio in the pool more closely approximated norms in the market place, annual savings of approximately 1% to 3% of premium – or from \$67 to \$203 million – could be achieved by reducing the impact of dependent coverage selection against the plans.
- Implement best practices for plan administration. In developing systems to support the districts, utilize and maintain uniform best practices for plan administration, including tracking terminations and additions, effective eligibility management, and monitoring Medicare enrollment. Effective eligibility management alone has been shown to save 2% to 3% of premium, or \$134 to \$203 million.
- Review plan design alternatives. If plan designs in the pool more closely approximated PEMHCA plans, rather than those currently favored by the districts, savings of about 3% of premium, or \$203 million, could be realized.

The size-based immediate or near-term savings opportunities are significant on their own, but the additional and longer-term savings opportunities deserve thoughtful consideration. They represent the greater opportunity to successfully implement a viable, long-term strategy for providing comprehensive, affordable health care coverage to the districts. If they are not implemented and supported, the long-term value of a mandatory pool could be diminished.

Issues Associated with Using PEMHCA

There are several issues associated with using PEMHCA to provide the vehicle for the health care pool for the districts.

Barriers to Using PEMHCA

There are barriers to using the PEMHCA plans. These include:

- The districts favor a composite approach to premium payment and contributions. CalPERS offers a three-tier rate structure for both actives and retirees. While this does not preclude districts from using the composite approach for employee contributions, it does – by implication – discourage it. And premium payment must be made on the three-tier basis.
- There are currently many plan design alternatives available to school district employees, but most employees are covered by plans that are relatively rich compared to the CalPERS benefit plans.
- CalPERS does not currently offer all of the services that some of the other large purchasing pools offer. Districts that offer coverage through CalPERS must make additional arrangements for COBRA administration, eligibility and termination monitoring, and communications preparation.
- Employers are required to contribute towards the cost of employee and retiree premiums in order to be covered. Districts that do not currently offer or pay for retiree coverage would need to do so, resulting in significant increased current costs. The school districts would also incur an increase to their GASB obligations. A further discussion of this issue follows.

Retiree Medical Cost and GASB Implications

A major issue in using PEMHCA as the vehicle for a mandatory pool for school districts is the PEMHCA requirement for retiree coverage for those who are under age 65 and for those who are Medicare eligible; only about 15% of the districts currently offer coverage to retirees this way.

For the remaining districts, this requirement would introduce a significant additional cost for new retiree benefits:

- About one third of districts provide coverage to active employees only.
- Almost all of the remaining districts currently provide benefits to active employees and to non-Medicare eligible retirees who qualify for benefits. They do not provide coverage to Medicare-eligible retirees.

In addition, there would be a new or increased GASB obligation to account for the increased cost of the expanded coverage requirement.

However, GASB accounting rules allow PEMHCA to base the valuation on the blended active and non-Medicare rates, while other similarly-situated plans must base the valuation on the actual cost. For the majority of districts – those that provide benefits to active employees and non-Medicare eligible retirees – moving to the PEMHCA model would reduce GASB costs for non-Medicare benefits. This change would mitigate the added GASB obligation for the added benefits somewhat, but does not mitigate the actual additional costs.

Conclusions Related to Using PEMHCA

The disadvantages outlined above make it impossible for us to recommend using PEMHCA as the vehicle for a mandatory pool for the districts. If, however, modifications to current PEMHCA rules were made such that these disadvantages could be resolved – especially as relates to the significant additional cost associated with providing benefits to retirees – then PEMHCA could be a realistic option. It may, for example, be possible to set up a district-only pool using PEMHCA's existing systems, management and expertise.