OVERVIEW

Actuarial Study and Operational Audit of the Hawaii Public Employees Health Fund

Report No. 99-20, May 1999

Summary

The Legislature requested this study and audit in House Concurrent Resolution No. 88, House Draft 1, Senate Draft 1, Conference Draft 1 of the 1998 session. The project was conducted by the Office of the Auditor and Ernst & Young LLP, which provided actuarial and related services.

Health benefits are a significant component of the total compensation package for public employees and a significant cost to public employers. The Hawaii Public Employees Health Fund (health fund) provides health and life insurance benefits to eligible active state and county employees, retirees, their dependents, and reciprocal beneficiaries. Eligible employees and retirees can enroll in a health benefit plan sponsored by a public employee organization or union in lieu of a plan provided directly by the health fund.

Each month, the health fund receives contributions from employers and employees for health benefits. From FY1995-96 to FY1997-98, employer contributions rose from approximately $235.3 million to $262.6 million and employee contributions declined from about $39.2 million to $32.2 million because of the large migration of employees from the health fund plans to the union plans. As of July 31, 1997, a total of 77,478 active employees and retirees were enrolled in medical plans. Of these, about 66 percent were enrolled in the health fund medical plans and about 34 percent in union medical plans. Each month, the health fund "ports," or transfers, to the union health plans the employer contributions for the employees enrolled in the union plans.

We found that the presence of union plans competing with the health fund for enrollees will continue to drive state and county costs higher, perhaps by several million dollars a year, because of a phenomenon called "adverse selection." Active employees enrolled in union plans tend to be younger in age and have smaller families. The least costly strategy for enrollees is the most costly for employers. The existence of union plans has also increased the premium costs for participants enrolled in health fund plans. Furthermore, the health fund's annual experience report understates certain cost increases in the public employee health benefit program because of limited information on the union plans.

We also found that the health fund's cost to provide health benefits for active employees and retirees as well as the post-retirement health benefit liability have increased dramatically over the past decade. Our "most likely" (intermediate) estimate is that as of July 1, 1998, the State and counties' accrued liability for providing future retiree health benefits, under the current plans, is $4.5 billion. Our most likely estimate of the liability for the year 2013 is $11.4 billion. Prefunding the liability—an alternative to the current pay-as-you-go method of funding—and other alternative approaches merit consideration.

We also found that two states—Oregon and Pennsylvania—use an employer-union trust governance structure to provide a single health benefit program for public employees.

Moreover, we found that the Board of Trustees of the health fund needs to attend to pressing operational issues. The board has not ensured that the health fund's reserves have been properly managed. Erratic premium rates indicate ineffective rate stabilization efforts, and excess reserves have not been returned to employees.

Finally, we found that the board has never audited the union plans' use of the funds paid to the union plans, has taken too long to replace the health fund's inadequate computer system, has yet to implement a required long-term care plan, and can improve on customer service.

Recommendations and Response

We recommend combining the health fund program and all of the union programs into one overall health benefit program.

We also recommend giving the health fund more authority and flexibility to deal with the dynamics of the health care marketplace. Furthermore, consideration should be given to restructuring the Board of Trustees to oversee a single program approach. There should be relatively equal representation on the board between unions and government employers if there is to be a joint union/employer trust or similar program. At least some members of the board should be required to have some knowledge of employee health benefit programs and their financing.

Finally, we recommend specific actions by the Board of Trustees to address problems in the areas of rate stabilization, excess reserves, porting of premiums to the union plans, computerization, long-term care, and customer service.

Commenting on our draft report, the chairman of the health fund's Board of Trustees expressed some immediate concerns related to our discussion of computerization, long-term care, and auditing of the union plans. He indicated that over the next few months, the board will work with legislative committees to review our findings, explain the rationale for the board's decisions, and implement appropriate program changes. The Department of Budget and Finance expressed general agreement with the recommendations in our draft report.

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