BF Committee

From: Mizuno, Derek M <derek.m.mizuno@hawaii.gov>
Sent: Thursday, April 20, 2017 4:37 PM
To: BF Committee
Cc: Shelly K. Espeleta
Subject: EUTF Follow Up
Attachments: Segal report on what jurisdictions are doing to address the OPEB liability.pdf; OPEB Contribution Comparison.pdf; 04.13.17 COM Budget and Finance Committee Meeting Follow Up.pdf

Budget and Finance Committee,

Please follow up responses to your questions from the 04/13/17 Budget and Finance Committee meeting. Please let me know if there are additional or further questions.

Derek Mizuno
EUTF
586-1681

DAVID Y. IGE
GOVERNOR

STATE OF HAWAII

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April 20, 2017

TO: Chair Riki Hokama and Vice Chair Mike White and Members of the Budget and Finance Committee

FROM: Derek Mizuno, Administrator

SUBJECT: EUTF Follow Up Questions

Thank you for the opportunity to provide an update on the EUTF operations. I look forward to continually these in the future. As a follow up to our meeting, please find the following responses to your questions:

1. HDS coverage of new technology

I should first clarify that the EUTF Board is responsible for the design of the benefit plans. The Board relies on the EUTF benefits consultant, Segal Consulting (Segal), and the carriers to provide recommendations regarding plan design changes on an annual basis.

Our current dental plan design covers X-rays but it does not cover cone beam imaging (CBCT). I'm assuming that this is what was being referred to at the meeting. It is my understanding that CBCT is more expensive than regular X-rays, there are very few procedures that absolutely require CBCT, and the Oral Surgery Academy does not require CBCT. Additionally, HDS' national affiliate Delta Dental does not cover CBCT and there are very few carriers that cover CBCT.

Regarding whether our plan would rather have a tooth extracted than saved, it is difficult to address without the details of the case. In general an extraction may cost $200 but a replacement bridge or implant could cost $2,000. These costs to the plan and member could possibly be higher than saving the tooth. If more information is provided, I can further follow up.

2. Provide information on other employers contributing monies in excess of the requirements under Act 268, SLH 2013

See attached for comparison of actual versus Act 268 required contributions for FY15-16 and FY16-17 (through 2/28/17). Additionally, attached is Practical Research on Public Sector Benefits Summer 2016 publication from Segal that discusses what public sector plans are doing related to the OPEB liability. As discussed, the EUTF and the legislature has done some of the items discussed such as lowering the employer contribution to retiree plans creating different benefit levels and created a Medicare Advantage Employer Group Waiver Plan. Most, if not all, of the other items cannot be considered because of the ruling of the Hawaii Supreme Court that the retirees accrued health benefits are protected under the non-impairment clause in the State Constitution.

3. Projections if and when the EUTF plans may exceed the Cadillac Tax

The Cadillac Tax applies both the employee and retiree plans. Based on projections from late 2015, our benefits consultant projected, based on an 8% trend rate, that the following EUTF plans would hit that Cadillac Tax that's effective January 1, 2020:

- HMSA HMO employee plan 2020
- HMSA 90/10 employee plan 2022
- Kaiser non-Medicare plan 2022

We will be updating the projections within the next few months. As I mentioned at the meeting, organizations including the EUTF plan to either terminate plans or reduce the benefits associated with the plans (only applicable to EUTF employee plans).

Please let me know if there any additional or further questions that I can assist with.

Segal Consulting

data

Practical Research on Public Sector Benefits

Summer 2016

Survey Finds Concerns about GASB's OPEB Accounting Changes, Yet Relatively Few Actions Taken to Mitigate the Impact

To gauge awareness of the accounting changes for public sector retiree health insurance and other postemployment benefits (OPEB) introduced by the Governmental Accounting Standards Board (GASB) and to find out what actions have been taken or are being considered to manage OPEB liabilities, the State and Local Government Benefits Association (SALGBA), the Public Sector HealthCare Roundtable and Segal Consulting recently collaborated on a *Public Sector Retiree Health Survey*.

The survey found high awareness about GASB's OPEB accounting changes. Despite that awareness, relatively few jurisdictions have taken action to mitigate the impact of the accounting changes. This report presents the results alongside observations from Segal.

About the Survey

Segal conducted the survey from April 1, 2016 through April 14, 2016. SALGBA and the Public Sector HealthCare Roundtable invited their members to participate in the survey. Public sector contacts of Segal also received an invitation to take the survey.

Of the more than 80 state and local governments that completed the survey, 70 percent offer retiree health benefits. The data in this report is from those jurisdictions. Information about the survey respondents is on page 9.

About the New GASB OPEB Standards

The first of two new Governmental Accounting Standards Board (GASB) standards for accounting and financial reporting by state and local governments for retiree health insurance and other postemployment benefits (OPEB) is now in effect for fiscal years beginning after June 15, 2016: Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statement No. 43, applies to OPEB **plans** that administer government employee benefits.

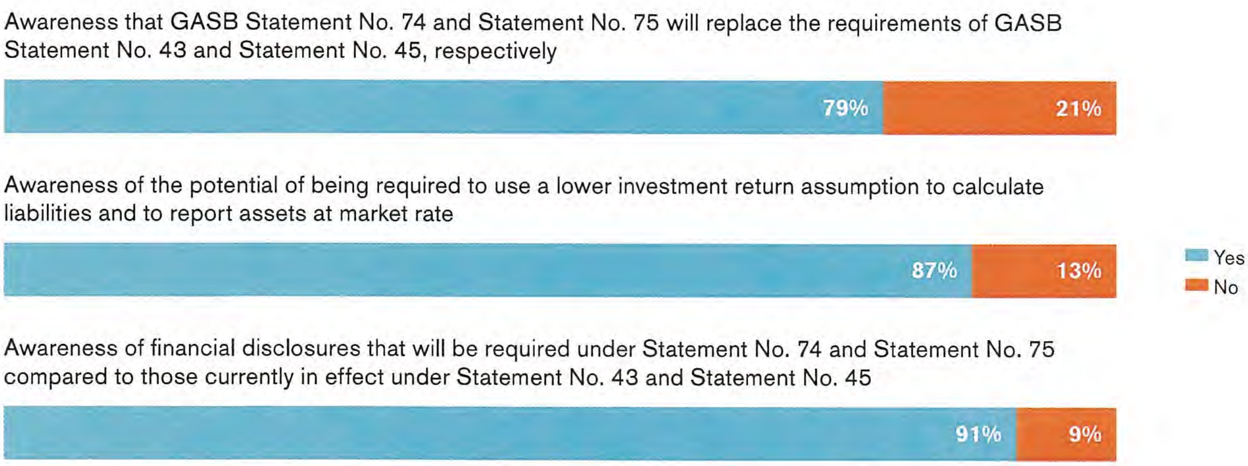
The other updated OPEB standard, Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which addresses reporting by **governments** that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. It replaces Statement No. 45 and takes effect one year later (for fiscal years beginning after June 15, 2017).

According to GASB, Statement No. 74 is designed to improve the usefulness of information about postemployment benefits other than pensions provided and Statement No. 75 is intended to improve accounting and financial reporting by state and local governments for OPEB. The net OPEB liability that must now be recognized in the footnotes of the financial statements for plans soon will have to be recognized on governments' balance sheets.*

* For a summary of the new standards, see Segal Consulting's April 15, 2016 *Update*.

Awareness of and Concern about Changes in Accounting Methodology Is High

A large majority of jurisdictions are aware of the new GASB OPEB standards (described in the box above) and changes in accounting methodology.



Source: SALGBA, Public Sector HealthCare Roundtable and Segal Consulting *Public Sector Retiree Health Survey*, 2016

About 25 percent of the survey respondents indicate additional education is necessary.

Segal Observations Concern about the new OPEB accounting requirements is warranted. Financing large and likely growing liabilities will have implications for the budgeting of most jurisdictions. Once an entity reflects these values in a more direct manner on its financial reports, it will be faced eventually with tough choices between financing those benefits and financing other essential government services. There is likely to be a reaction to the impact on financial statements from bond-rating agencies, investors in municipal bonds, retirees, employees and other taxpayers.

How Retiree Health Liabilities Are Financed

Pay-as-you-go financing is much more common than prefunding.

Most of the jurisdictions that prefund have established a trust for the amount prefunded.

More than half of the jurisdictions have a specific funding policy with respect to retiree health liabilities.

Source: SALGBA, Public Sector HealthCare Roundtable and Segal Consulting *Public Sector Retiree Health Survey*, 2016

Respondents that have a funding policy for their retiree health liabilities were asked to describe it. Jurisdictions noted a wide variety of funding and prefunding approaches and requirements. The most commonly stated policies included:

- Contributions toward retiree health benefits are specified in statute. One respondent wrote, "It is set in State statute that a percentage of employer contributions goes to the health care trust fund to pay for future health care premium subsidies."
- A percentage of the budget is earmarked for retiree health prefunding.
- Contribute the annual required contribution as determined by the actuary. One respondent wrote, "Fund according to the Actuarial Required Contribution (ARC) analysis performed by actuaries."
- The administration has full discretion to fund the required premiums or more based on the availability of revenues.

A few respondents indicated that they have prioritized retiree funding where prefunding for retiree health is contingent on the adequacy of funding for the retirement pension benefits. Other approaches are:

- "Fund as much of annual cost as possible but not less than 50% of each year's annual cost."
- "Target policy of 7.5% of annual payroll, which is used to finance the ARC."

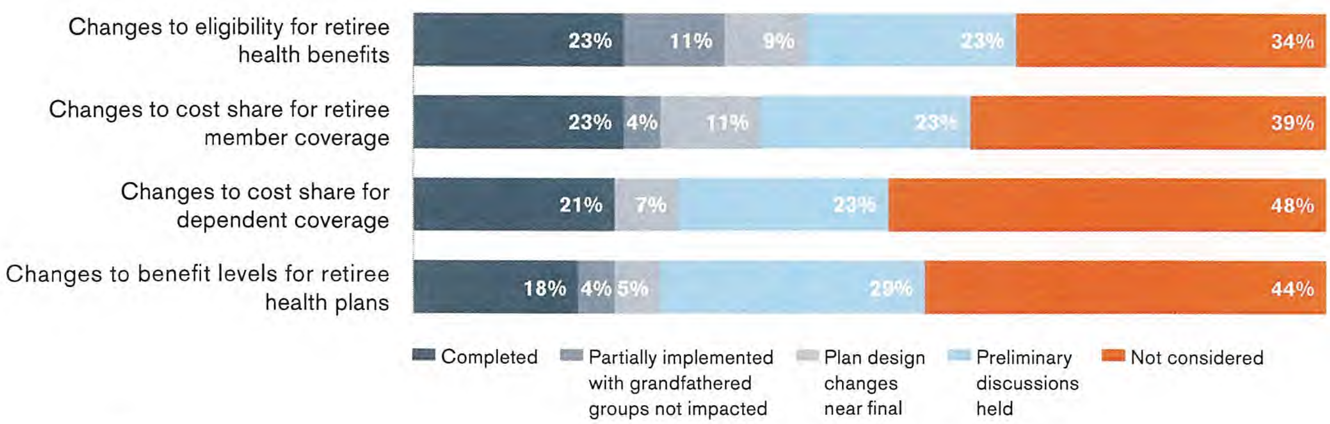
Segal Observations A policy for funding retiree health benefits is a concise statement of how a jurisdiction intends to pay for its retiree health benefits, including both current year costs and prefunding of future retiree health liability. Jurisdictions that do not already this policy may find it helpful to create one. Such a policy serves as a guide for retiree health funding. It takes into account both good and lean years of revenue availability. It can also help balance funding between health plans and other governmental needs. Entities that already have a retiree health funding policy should reexamine it in light of GASB's new statements. Policies that tie funding to the OPEB valuation will need to be revised. An example would be a policy to contribute a percentage of the ARC.

Although GASB does not require prefunding of OPEB liabilities, given how large these values are likely to be, their inclusion on financial reports will have a measurable impact on the jurisdiction's reported financial status. These changes could spur interest in prefunding, which is a proven management tool. The advantages of prefunding include longer-term savings, higher interest rate assumptions with correspondingly lower annual required contribution levels and lower total liability amounts.[1]

Jurisdictions Begin to Take Action to Address Current and Future OPEB Liabilities

Relatively few jurisdictions responding to the survey indicate that they are taking actions to address OPEB retiree benefit liability.

The most prevalent plan design change noted is changes to eligibility for retiree health benefits. Forty-three percent of respondents indicated that they have either completed, nearly completed or partially implemented eligibility changes to mitigate current and future OPEB retiree benefit liabilities. Over one-third of the responding jurisdictions (37 percent) have been making changes to the cost share for retiree member coverage. Just over one-quarter of the responding jurisdictions (27 percent) have been making changes to the benefit levels for retirees.

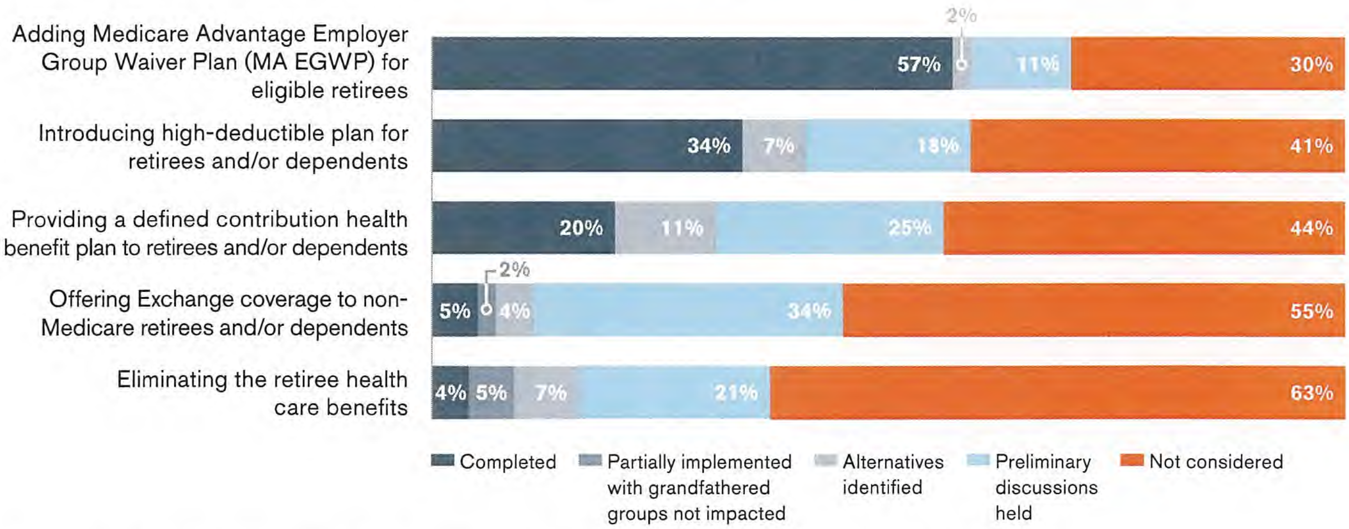


Source: SALGBA, Public Sector HealthCare Roundtable and Segal Consulting *Public Sector Retiree Health Survey*, 2016

Relatively few jurisdictions responding to the survey indicate that they are taking actions to address OPEB retiree benefit liability.

[1] A forthcoming issue of Segal's *Public Sector Letter* will discuss creating a funding policy, summarize prefunding options and outline prefunding sources.

Responding jurisdictions indicated what actions they are taking or considering regarding alternative delivery models for retiree health benefits. A large percentage (57 percent) have either completed, nearly completed or partially implemented a Medicare Advantage group waiver plan for their Medicare eligible retirees, but only a few have considered or are acting on eliminating retiree health benefits entirely. Also, about 30 percent of the responding jurisdictions indicated that they are moving toward a defined contribution funding approach for retiree health benefits.



Source: SALGBA, Public Sector HealthCare Roundtable and Segal Consulting *Public Sector Retiree Health Survey*, 2016

The survey also asked respondents to list other potential actions they are considering. This is some of the information they shared:

- "Eligibility changes for retiree health [that will] only affect those hired after a specific date."
- "Legislative remedies, as retiree benefits are mandated to be offered."
- "Provide Medicare retirees coverage via Medicare Advantage and EGWP plans."
- "Modify Rx plan to steer retirees to more efficient medications and management utilization to the most appropriate clinical protocols."
- "Offering a flat cash subsidy allowing the retirees to pursue coverage on their own or providing access to coverage via an exchange."

Segal Observations Planned strategies for mitigating the impact of GASB's new OPEB accounting requirements include making plan design changes — such as revising eligibility requirements, increasing cost sharing for retiree and/or dependent coverage, changing benefit levels and introducing different coverage for future retirees[2] — and using alternative methods for delivering retiree health coverage, such as consideration of a private health insurance exchange.

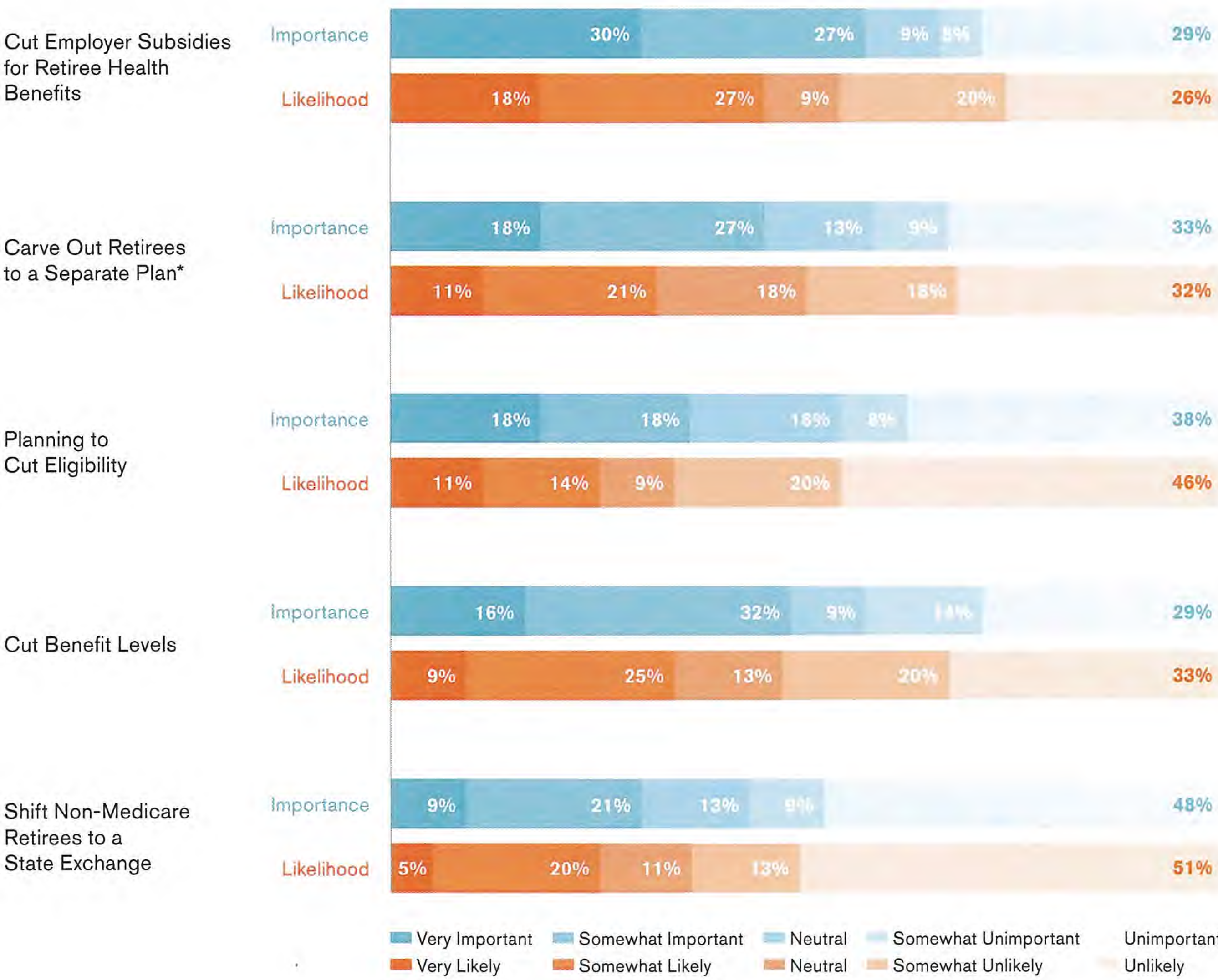
[2] A forthcoming issue of Segal's *Public Sector Letter* will present an overview of these options.

Jurisdictions Are More Likely to Deem Changes "Important" than to Implement Them

The survey asked:

- What factors are important to your plan or jurisdiction in alleviating the potential increases in reported liabilities that may be triggered by the new GASB statements?
- What is the likelihood of your plan or jurisdiction taking any of the following actions to alleviate the potential increase in reported liabilities that may be triggered by the new GASB statements?

The results are illustrated below.

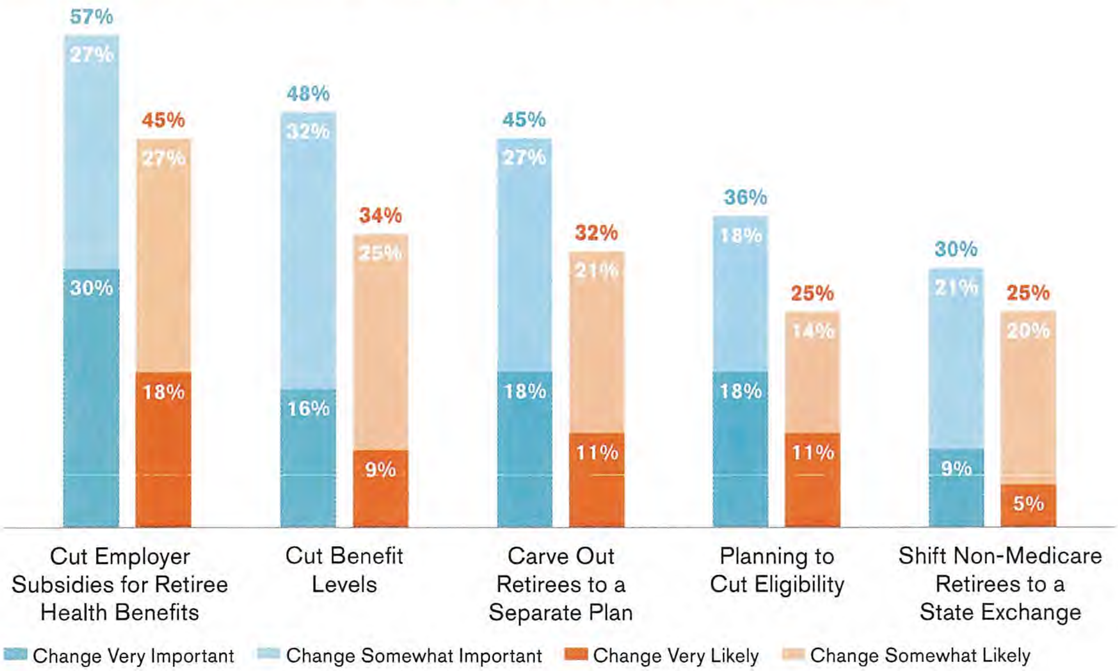


* While establishing a separate retiree plan in its own right does not lead to lower costs, it does provide a structure that facilitates the implementation of retiree specific strategies. Other benefits include reduced Excise Tax exposure and any subsidies between actives and retirees being much more apparent.

Source: SALGBA, Public Sector HealthCare Roundtable and Segal Consulting *Public Sector Retiree Health Survey*, 2016

More jurisdictions rate specific actions as either very important or somewhat important than indicate they are either very likely or somewhat likely to take those actions.

Importance and Likelihood of Changes to Address GASB Statements



Source: SALGBA, Public Sector HealthCare Roundtable and Segal Consulting *Public Sector Retiree Health Survey*, 2016

Segal Observations It is clear from the survey responses that many jurisdictions are actively considering a variety of approaches and options to address their OPEB liability issues. Jurisdictions appear to be working on the factors that are easiest for them to control internally: cost sharing, eligibility and carving out Medicare retirees to plans designed for retirees, such as Medicare Advantage. Most jurisdictions are not actively considering eliminating retiree health benefits for their non-Medicare eligible retirees.

Jurisdictions appear to be working on the factors that are easiest for them to control internally.

Next Steps

It is time to assess the impact of GASB's OPEB changes and consider options to better manage future liabilities. As was the case previously when Statement No. 43 and Statement No. 45 were implemented, entities appear to be in various stages of understanding the impact of the Statement No. 74 and Statement No. 75. The transition will possibly have a greater impact on plans and employers with benefits that are not funded than on those with well-funded benefits.

Understanding the impact of the new statements is the first step.

After the impact of the new statements is fully understood, the next step is to assess the sustainability of the current retiree health program. It may be prudent to explore options to manage or mitigate the impact.

It is worth considering the retiree health program's role and impact on staffing, recruitment and retention strategies. The relative value of OPEB within the total wage package will need to be determined because paying for OPEB may displace other benefit programs or pay increases. The survey responses indicate varying degrees of this kind of comprehensive total compensation analysis.

Evaluation of possible changes might include prefunding mechanisms, plan design and alternative delivery methods. It is a good idea for jurisdictions that already prefund retiree health benefits to review their investment policy. Those that decide to start prefunding the benefit can work with their investment consultant to create an investment policy.

An important final step is to communicate any planned changes as well as the reason for making them to employees, retirees and other stakeholders.

The bottom line is that the new statements are likely to result in many entities taking a new look at their retiree health benefits. In many instances, that examination may result in substantial change.

It is time to assess the impact of GASB's OPEB changes and consider options to better manage future liabilities.

About the Survey Respondents

States and cities make up more than half of the jurisdictions represented in the survey.

More than one-third of the jurisdictions in the survey cover at least 10,000 retirees in their health plans.

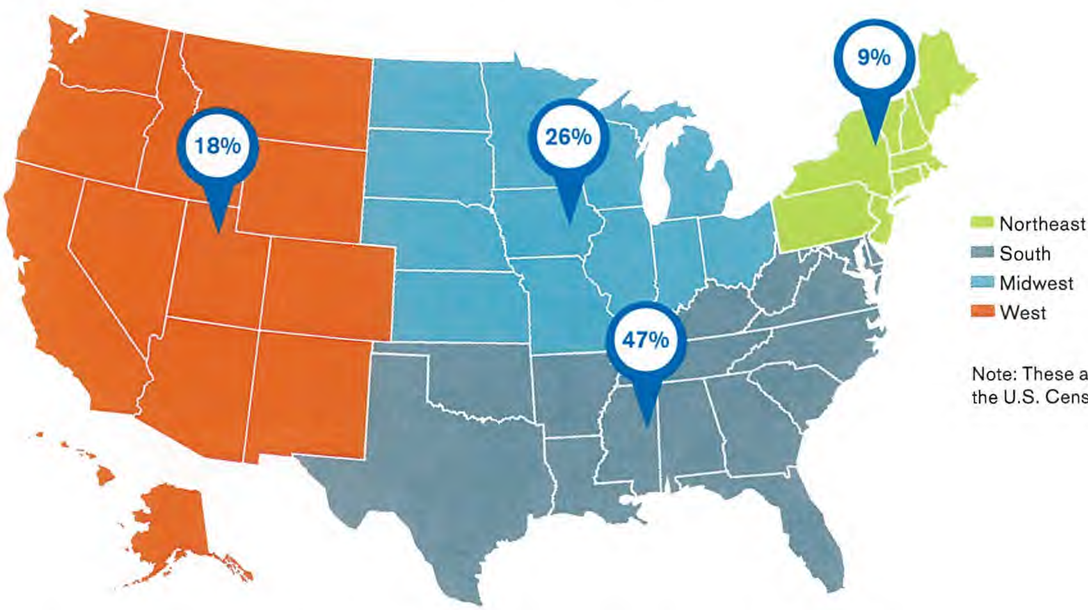
State City Retirement System County Other*

More than 10,000 1,001 to 10,000 101 to 1,000 1 to 100

* Other includes a higher education institution, a municipal association plan and a political subdivision.

Source: SALGBA, Public Sector HealthCare Roundtable and Segal Consulting *Public Sector Retiree Health Survey*, 2016

Nearly half of the jurisdictions in the survey are in the South.



Note: These are the regions used by the U.S. Census Bureau.

Source: SALGBA, Public Sector HealthCare Roundtable and Segal Consulting *Public Sector Retiree Health Survey*, 2016

Questions? Feedback? Contact Us.

If you have questions about the Public Sector Retiree Health Survey, contact your Segal consultant or Cathie Eitelberg.

To receive *Data* and other Segal publications, join our email list.

Strategic Consulting Services for Public Sector Retiree Health Plans

Segal's strategic retiree health consulting services for state and local government employers and plan sponsors include:

- Determining the potential immediate and longer-term impact of GASB's OPEB requirements on plans and practices;
- Helping employers and public plans to reassess their retiree health strategies for both Medicare-eligible and pre-age-65 retirees, including evaluating alternative options for medical and prescription drug coverage that balance plan design, costs and liabilities; and
- Performing funding and long-term solvency projections on either a deterministic or stochastic basis to help public plans and employers develop a sustainable financing approach to OPEB; and
- Drafting and designing communications to participants and other stakeholders.

For information about these services and how Segal can help your jurisdiction, contact your Segal consultant or one of the experts listed.

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Segal Consulting

Segal Consulting Understands the Public Sector

Public sector entities face tough decisions. We understand those challenges as well as options for meeting them. Having worked with hundreds of public sector clients for more than 50 years, we have insight into the spectrum of design characteristics and features of all types of compensation and benefit plans throughout all levels of government.

A forthcoming issue of our *Public Sector Letter* will discuss mitigating the impact of GASB's new OPEB standards through plan design strategies and prefunding strategies.

Segal Consulting is a member of The Segal Group. See a list of Segal's offices.

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OPEB Contributions in Accordance with Act 268

Employer	2016 Required Contribution	2016 Actual Contribution	2016 Excess	2017 Required Contribution	2017 Actual Contribution (Through 2/28/17)	2017 Excess (deficiency)
Hawaii Department of Water Supply	$ 379,000	$ 1,071,000	$ 692,000	$ 497,000	$ -	$ (497,000)
Honolulu Board of Water Supply	$ 1,246,000	$ 6,400,000	$ 5,154,000	$ 1,143,000	$ 6,000,000	$ 4,857,000
Kauai Department of Water	$ 172,000	$ 204,000	$ 32,000	$ 257,000	$ 319,000	$ 62,000
County of Maui	$ 5,972,000	$ 14,930,000	$ 8,958,000	$ 9,703,000	$ 16,172,000	$ 6,469,000
County of Hawaii	$ 6,930,000	$ 7,180,400	$ 250,400	$ 11,459,000	$ 5,729,500	$ (5,729,500)
County of Kauai	$ 3,156,000	$ 8,057,894	$ 4,901,894	$ 4,450,000	$ 7,768,890	$ 3,318,890
City and County of Honolulu	$ 30,845,000	$ 30,845,000	$ -	$ 48,797,000	$ 48,797,000	$ -
State of Hawaii	$ 163,615,000	$ 194,615,000	$ 31,000,000	$ 230,185,000	$ 327,749,500	$ 97,564,500
HART	$ 195,000	$ 195,000	$ -	$ 286,000	$ -	$ (286,000)
Total	$ 212,510,000	$ 263,498,294	$ 50,988,294	$ 306,777,000	$ 412,535,890	$ 105,758,890