Gallagher Benefit Services, Inc.

A Subsidiary of Arthur J. Gallagher & Co.

July 28, 2008

Representative Bette Grande, Chair
Employee Benefits Programs Committee
State of North Dakota
Bismarck, North Dakota

DRAFT

Dear Representative Grande,

Re: Review of Proposed Senate Bill 90125.0100 – A bill relating to the expansion of the uniform group insurance program to allow participation by permanent and temporary employees of private sector employers and other individuals as well as allowing agents to sell the group insurance program and receive commissions.

The following summarizes the above referenced proposed legislation and our assessment of the financial and technical impacts of the bill.

Overview of the Proposed Bill

As proposed, this bill would modify the State Century Code relating to the expansion of the uniform group insurance program as follows:

- Allow "permanent employees" (as defined) of private employers to join the uniform group insurance program.
- Allow "temporary employees" (as defined) of private employers to join the uniform group insurance program.
- Allow "private citizens" (as defined) to join the uniform group insurance program.
- Allow licensed agents to sell the uniform group insurance program and receive commissions for sales.
- Appropriate up to $300,000 to implement the changes in the uniform group insurance program.
- Authorize the NDPERS Board to add up to three full-time equivalent positions to implement the prescribed changes in the uniform group insurance program.

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Expected Financial Impact

The proposed bill addresses three distinct categories of individuals that would be newly eligible to enroll in the uniform group insurance program ("Program"). We will address the expected financial impact separately for each category.

Permanent Employees of Private Sector Employers

Section 4 of the bill would allow private sector employers with one or more employees to join the Program. The bill allows the formation of an additional "subgroup" consisting of "private sector employee and private citizen group medical and hospital coverage." Interestingly, there is no mention of adding prescription drugs, dental or vision coverages for this new subgroup. We presume that the bill's intent is to at least include prescription drugs along with medical and hospital coverages. This should be clarified with the bill's sponsor.

A critical aspect of projecting the financial impact of the bill allowing permanent private sector employees is the interpretation of the word "subgroup." If the word "subgroup" is meant to imply that private sector employees would become their own category for experience and premium rating purposes, then the financial impact to the existing NDPERS plan would be limited to the additional administrative costs needed to oversee an expanded plan. Adverse selection, which would likely occur as groups that are unable to secure coverage in the existing private sector insurance markets join the NDPERS plan, would be contained in the risk pool of like entities. As the bill specifically identifies that the coverage is to offered by an "insurer," covering a distinct private sector permanent employee subgroup would be contingent upon an insurance company being willing to underwrite this group with limited adverse risk selection protections.

Section 54-52.1-2 of the North Dakota Century Code gives the board the authority to establish actuarially distinct subgroups under the uniform group insurance plan. If private sector employers were assigned their own subgroup, there would be no financial impact from the bill on the existing NDPERS group. However, as written, the bill would likely cause concerns for NDPERS' insurer (who would have to assume the financial risk) of any private sector groups that join the uniform group insurance plan for the following reasons:

- The prospective private employer is allowed to determine the amount of its contribution to the Program. This runs counter to traditional insurance underwriting and actuarial practices where there is a minimum required employer contribution to protect a plan against adverse risk selection. Read literally, this bill would allow the plan to be offered with no employer contribution. It is highly questionable that an insurer would underwrite such an arrangement where there is no mandated employer cost participation.

- The bill does not contain a minimum eligible employee participation requirement, which is standard in group insurance plans. Insurers generally require a minimum percentage of eligible employees to participate in the plan to achieve a reasonable mix of risks.

Without that protection, the insurer could end up just covering the higher risk (and high cost) individuals.

- The bill indicates that the "board may apply medical underwriting requirements." As discussed under the Technical Comments section below, HIPAA essentially eliminates the ability for a group health plan to use any individual medical underwriting. Group underwriting and pre-existing condition limitations are permitted, but evaluating individual prospective plan participants is prohibited. Therefore, the insurer would only be able to determine if a private sector group met minimum underwriting standards to join the Program. If it did not, then all individuals in the group would be denied coverage.

- The bill also allows the board to use "risk adjusted premiums" for new private sector groups applying for coverage under the Program. This does offer some protection to the insurer, as risk adjusted premiums, if applied to the entire group, are not prohibited under HIPAA. However, having one or more risk adjusted premium levels would add to the administrative complexity of the Program.

The bill allows the board to establish "minimum requirements" for private sector participation. If passed, we would recommend that the board adopt participation standards for all of the issues raised above to be consistent with insurance industry standards, not only to protect the financial integrity of the Program, but to increase the likelihood that an insurer would agree to underwrite the risk.

The bill does recognize the need for a long term financial commitment for any new private sector employers applying for coverage by requiring a minimum participation period of sixty months. Failure to meet this sixty month participation period would result in financial penalties to the employer. This is a sound underwriting requirement.

Temporary Employees of Private Sector Employers

Section 5 of the bill would allow temporary employees of private sector employers to participate in the Program. The board would be allowed to establish minimum requirements.

If, as discussions have indicated, NDPERS could require that a separate subgroup for rating and experience purposes be established for temporary employees only of private sector employers, we would have no concerns about adverse financial impact on the existing NDPERS health plan. Assuming a carrier would underwrite the group as defined in the bill (which is questionable, as noted below) premiums would be established for this distinct risk pool independent of the existing NDPERS' health plan experience.

We should point out that traditional insurance industry underwriting and actuarial practices exclude temporary employees from group coverages. The potential for adverse selection against a group insurance plan is extreme when a temporary employee can gain coverage only by working a minimal number of hours and timing insurance coverage to correspond with health care needs. However, the bill does allow the board to establish minimum standards for what is deemed a "temporary" employee. If the board adopted the current PERS plan definition of a temporary employee (one that is expected to work 20 or more hours per week and 20 or more weeks a year), our adverse selection concerns would be reduced. Insurance carriers will determine if the board's definition of a temporary employee would enable them to underwrite the risk.

Even if a separate subgroup was established for temporary employees, the likely insurance company underwriting concerns noted above for permanent employees apply to this group also. In summary, these include:

- No mandated employer contribution amount
- No mandated minimum participation requirement
- Inability to apply medical underwriting to individual applicants due to HIPAA restrictions
- Risk adjusted premiums can be used for entire groups, but application to specific individuals, such as temporaries within a group, is prohibited by HIPAA

As with permanent private sector employees, the bill allows the Board to set minimum standards. If the bill passes, the Board should consider adopting standards that would make this group reasonably palatable to insurers.

Participation by Private Citizens

Section 6 of the bill would allow an individual who is a resident of ND and does not have health insurance through a private insurer or a public plan to participate in the Program, subject to minimum standards established by the Board.

The bill includes the language "individual insurance contracts" in its summary of the coverage to be offered. As long as the actual intent is to offer true "individual" insurance, then our financial impact concerns on the existing NDPERS health plan are limited to a (significant) increase in administrative costs is inherent in any individually underwritten plan. As noted with the two subgroups addressed above, we have presumed that NDPERS is allowed to isolate individuals into a separate subgroup whose claim experience and administrative costs do not financially impact the existing Program employers and plan participants.

HIPPA portability and non-discrimination standards do not apply to individual coverages. Individual insurance carriers are free to medically underwrite all applicants, including dependents. Consequently, as long as NDPERS or its insurer conducts thorough medical underwriting of individuals and dependents, the underlying risk characteristics of the individual coverage pool should be no different than those of a comparable private sector insurer that utilizes standard industry underwriting techniques.

Administrative costs, on the other hand, are significantly greater for individual plans due to the relative labor-intensive nature of underwriting and plan operations compared to group coverages. We note that the bill appropriates up to $300,000 for the biennium beginning July 1, 2009 to expand the Program to include all new plan participants. It also authorizes three additional full time employees to implement the bill. It is beyond the scope of this analysis to determine if the additional funding and staff allocations would be adequate to cover the additional administrative services that NDPERS would be required to provide due to the expansion of the Program. We suggest additional study be done to estimate additional administrative costs to PERS.

Technical Comments

The bill anticipates many of our technical concerns with similar previously proposed legislative initiatives. Specifically, it includes these conditions:

- "The Board shall apply to the federal government to receive exempt status under the Employee Retirement Income Security Act (ERISA) to allow for the expansion of the uniform group insurance program [as contained in the proposed bill]." (Section 1) Further, the bill would not become effective until the Board receives notification that the proposed changes to the Program will not revoke its governmental exemption from ERISA (Section10).

- The Board must determine that "utilizing medical underwriting requirements and risk-adjusted premiums does not violate [HIPAA]." (Section 10)

Section 1 of the bill confirms that NDPERS must obtain prospective approval from the federal government that adding private sector employees and individuals would not cause the Program to lose its preferred governmental status and subsequently become subject to the regulations required of ERISA plans.

Section 2 of the bill confirms that the Board cannot institute any underwriting practices that violate HIPAA's portability provisions. As mentioned previously, adherence to HIPAA restricts the Program's ability to exclude high risk individuals under group health plans. Of particular concern, temporary employees could not be individually medically underwritten.

A nonfederal governmental employer that provides self-funded group health plan coverage may elect to exempt the plan from the portability requirements of HIPAA. However, because the proposed bill specifically calls for "an insurer to provide coverage" (Section 10), there is a question whether the self-funding option is available to NDPERS as a means to avoid HIPAA's medical underwriting restrictions. Further, because the bill would extend coverages to private sector employees, there is also a question whether the governmental self-funding exemption option would even be available. These are questions for qualified legal counsel if NDPERS wishes to explore the pursuit of a possible HIPAA exemption by self-funding.

Other Issues

As written, the bill would cause NDPERS to compete with commercial carriers for non-governmental group and individual coverages. This is likely to evoke challenges from the private sector. A less contentious alternative might be to enact small group/individual insurance reform legislation that creates better access for citizens of the State.

Another area of discussion is how this proposed bill would interact with the Comprehensive Health Association of North Dakota (CHAND) program. CHAND does provide coverage to residents of the state who have been denied coverage or have excessive premiums due to high risk conditions. CHAND is offered on a guaranteed issue basis, without medical underwriting. There appears to be some potential overlap between what the proposed bill is attempting to provide (universal access to coverage) and this existing program for some, but not all, state residents that cannot obtain insurance coverage..

In recent months, there has been considerable national activity involving legislation to allow private sector access to public sector plans. Most of the activity has been with state retirement plans, but there have also been efforts to allow private sector participation in governmental health plans. Wisconsin, Minnesota, Connecticut. Michigan and California are five states that have considered such a concept. To our knowledge nothing similar to the bill proposed in North Dakota has yet passed in any state. Other jurisdictions, such as Massachusetts, New Hampshire and the City of San Francisco have enacted universal coverage plans, but none involve a state or local retirement system as the health plan access vehicle.

Conclusions

The proposed bill has addressed most of the technical concerns mentioned in previous legislation to expand coverage in the Program to private sector groups and individuals. Advance federal approval that adding private employees would not jeopardize the Program's governmental status would be required. Also, the Board is required to comply with HIPAA portability and nondiscrimination provisions.

Financially, the bill has two primary areas of impact. The first, added administration costs, have not been addressed in this analysis other than to point out that they could be significant depending to what extent they are handled by NDPERS staff rather than insurers. Section 9 of the bill appropriates up to $300,000 per biennium to fund added administrative costs for NDPERS. It is beyond the scope of this analysis to determine whether this appropriation or the additional three full time employees would be sufficient.

As long as NDPERS is allowed to separate private sector groups, temporary employees and individual plan participants into their own distinct rating subgroups, there should be no direct financial impact to the existing Program. Any adverse claim experience from these non-governmental plan participants would be restricted to their own subgroup(s). The question then becomes whether the uniform group insurance private sector group and individual subgroups could effectively compete against comparable insurance company plans. The marketplace would ultimately make that determination.

If individuals are not required to be offered group coverage, the ability to medically underwrite them should make their risk pool comparable to the private sector equivalent. Administrative costs, however, for individual coverage are substantially greater than for group coverages and it would have to be determined whether a NDPERS administered individual plan could compete on overall costs.

The Bill is predicated upon the assumption that an insurance company will be willing to underwrite the new subgroups that would be offered coverage under the Program. Temporary employees have historically have not been a market segment that carriers have been willing to underwrite. Further, unless the board adopts insurance industry underwriting standards for private sector groups (which would result some being denied coverage), it is also doubtful carriers will underwrite this market segment.

Gallagher Benefit Services, Inc. is not licensed to provide legal advice. If NDPERS desires to have a qualified legal opinion concerning this proposed legislation, we suggest that it consult qualified employee benefits legal counsel.

We appreciate the opportunity to provide input on this proposed bill. Please let me know if we can provide any further assistance.

Sincerely,

William F. Robinson, Jr.

William F. Robinson, Jr.
Area Senior Vice President