

City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 3, 2006

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER

SUBJECT: BUDGET MEMO #64: (1) SELF-FUNDING OF EMPLOYEE HEALTH INSURANCE COSTS, (2) FURTHER CONSOLIDATION WITH THE SCHOOL EMPLOYEE HEALTH INSURANCE

I. SELF-FUNDING:

As Council is aware, staff has been studying changing the way the City pays for its health insurance costs. Currently, the City pays a fixed per enrolled employee rate, otherwise known as a premium, (set at the beginning of each year with set per employee rates for each health insurance carrier and for each type of coverage). Another method of funding would be to change to an actual cost basis (the health insurance carriers would submit monthly bills based upon actual charges incurred by employees and billed from those employees' health care providers to the health insurance carriers). Such an actual cost method is called "self-funding" (sometimes called self-insurance).

Under a self-funding plan, the City would set a fixed premium rate that it would charge each department's budget each month during the course of the fiscal year based on the specific health plans a department's employees sign up for. The funds collected from each department would be pooled and each month actual cost-based bills from the insurance carriers would be paid from this pooled account. At the end of the year, the account could have a positive balance, if bills did not exceed the amount of funds collected from each department. If the bills exceeded the amounts collected, then the pooled account would be at a deficit position and City funds would need to be transferred into the account in order to eliminate the deficit.

In effect, self-funding of employee health insurance would transfer the risk of health insurance costs exceeding expectations from the health insurance carrier to the City. The advantage of self-insurance is that over the long-term (on a cost-average basis), it can save the City about \$0.1 million to \$0.3 million per year, as it avoids the health insurance carrier from having to protect its risks, by either setting premiums with the assumption of higher health care costs, or purchasing re-insurance which shifts some risks to a third party insurance carrier. The downside to self-

funding is the City's assumption of risk. For example, in FY 2006 health insurance costs are running about 10% ahead of expected costs used to set the premium costs to the City. If the City were self-funded in FY 2006, it would have had to cover actual cost losses in excess of premiums by about \$0.9 million. Conversely, the Schools health insurance costs are running lower than previously projected and budgeted costs. The upside to self-funding is that in a "good year" costs would be less than premiums and the City would see a savings. In general, localities that self-fund keep savings in an account and use those savings to help offset future rate increases or losses in a "bad" year.

While staff thinks that the City could handle the risks of self-funding, it is recommended that self-funding not start until FY 2008. The reasons for this recommendation include:

1. Kaiser (as a facility-based HMO), which enrolls about 50% of our employees, is not ready to allow self-funding for any of its clients (including all other local governments in the region). The reason is that Kaiser does not yet have an internal cost structure which could produce bills for each of its participating employers. Kaiser expects to have the ability to allow self-funding in FY 2008.
2. The City Schools staff previously indicated that they are not eager to self-fund for FY 2007. While the City government could self-fund without the Schools, the risk volatility of self-funding could be smoothed out if both the City and Schools participated in a self-funding plan together. Having a larger number of employees in a self-funding pool in any given year tends to create less volatility leading to smaller savings or smaller losses in any one year.
3. Finally, the City's other health insurance provider, MAMSI/Optimum Choice is in transition as it was purchased by the national health care firm United Health Care. United has just indicated that if the City were to switch to self-funding in FY 2007 that the 5% higher "United" rates and not the "MAMSI/Optimum Choice" rates would be charged. (+5% in rates is about \$0.5 million more in costs to the City.) This transition difference reflects the higher health provider contract rates and fewer referral restrictions in the United Health Care system compared to the current MAMSI/Optimum Choice system.

As a result, self-funding for both MAMSI/Optimum Choice and Kaiser is either not available, or cost effective for FY 2007. However, at this time, it appears that self-funding will be an option for FY 2008. Staff will continue to pursue the self-funding option with the City's health insurance carriers, as well as continue to discuss joint self-funding with the Schools.

II. FURTHER CONSOLIDATION WITH SCHOOL EMPLOYEE HEALTH INSURANCE:

Last year the City and the Schools consolidated the administrative functions of our health plans. The Schools had offered MAMSI only, and were part of a Council of Governments joint pool

plan with a number of small local governments in the region. By moving their MAMSI plan to be administratively joined with the City, both the Schools and the City gained administrative savings. Also the Schools were able to offer Kaiser to its employees for the first time. In addition, for FY 2007 the School's MAMSI rates did not increase probably because the School's experience data was segregated for the first time, and not included in the COG experience data. With the experience showing that the School's premiums are running less than budget for the current year, MAMSI was able to propose a zero increase in premiums for FY 2007.

Further consolidation or collaborative efforts are feasible. City and School joint-self funding (described earlier in this memo) is feasible as an option to consider for FY 2008. It also has been suggested that the City and the Schools commonly pool their costs in order to save monies. Such pooling would not save monies. The costs would remain the same, but the premiums would be averaged. (Based on FY 2007 projected rates, the City government costs would go down, but the Schools would go up, causing the City's budget transfer to the Schools to go up.) The result would be a net zero change in costs to the City budget's total.

Cost savings for increased co-pays are another cost saving measure. The City's co-pays are now recommended to increase at an annual cost savings of \$0.6 million to the City. Optimum Choice rates would increase about 2.9 percentage points less. Kaiser rates would increase about 4.5 percentage points less. If the Schools were to adopt the same co-pays, savings to the Schools would occur in the same magnitude.

cc: Rebecca Perry, Superintendent, Alexandria City Public Schools