City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 24, 2008

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER

SUBJECT: BUDGET MEMO #118__: PROPOSAL TO ENTER INTO A SELF-FUNDING ARRANGMENT WITH THE SCHOOLS FOR HEALTH CARE BENEFITS PROVIDED BY MAMSI/UNITED HEALTH CARE

City and Schools staff, in consultation with our health care consultant, have been meeting to develop a proposal for self-funding (sometimes called "self-insurance") the MAMSI/United Health Care health benefit program offered to both City and Schools employees.[1]

Under this proposal, the City and the Schools would continue to contract with MAMSI/United Health Care and offer the same health insurance benefits to our employees, but the City and the Schools would pay 100% of the cost of claims. In effect, the risk of the cost of claims would shift 100% to the City and the Schools. The health plan provider would provide administrative services for a fee. Health care premiums would be set by the City and the Schools to cover the risk of claims.

The attached document, jointly drafted by City and Schools staff, provides a proposal for consideration by the City Council and the School Board for self-funding the MAMSI/United Health Care health benefit program in FY 2009. In the long run, staff believes that sizeable savings can be achieved – potentially $1.0 million annually for the City and $1.1 million annually for the Schools. In the short term, the actual savings in the FY 2009 budget would be much more limited -- $300,000 for the City's FY 2009 budget and $0 for the Schools -- for reasons discussed in the attached proposal, primarily related to building up sufficient reserves by the Schools to successfully manage the financial risks.

We put this proposal on the table at this time so that City Council may consider it as part of the add-delete process (a net decrease in City expenditures of $300,000 to be shown as a negative allowance in the Non-Departmental account and the savings will be distributed to Departmental budgets in the final approved budget).

The School Board has been briefed on the basic concepts of this proposal.

Attachment: MAMSI/United Health Care Proposed Self Funding Option

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1 Kaiser does not yet offer this self-funding option, but it is planning on doing so soon. We are in discussions with Kaiser concerning the possibility of doing so in FY 2010.

MAMSI/UNITED HEALTH CARE
PROPOSED SELF FUNDING OPTION
FOR THE
CITY AND SCHOOLS

- The City and Schools currently spend $23.9 million on health insurance provided by MAMSI/UHC. This represents both the employer and employee shares, and constitutes $11.4 million for the City and $12.5 million for the Schools. MAMSI is now owned by United Healthcare (UHC).

- The City and Schools both purchase health insurance where MAMSI/UHC sets the rates and takes 100% of the claims risk. The City and the Schools pay for MAMSI/UHC for taking the claims risk. The risk is that claims will exceed those anticipated for a given year, and funds paid out will exceed the funds earned from the rates charged.

- The City and Schools are legally and contractually able to switch to a self-funded (i.e., self-insured) basis. This means that all of the cost of claims risk transfers to the City and Schools.

- Self-funding is a common, long-standing practice in this region, particularly for large municipalities.

- Total self-funding could potentially and eventually save up to about $2.1 million per year ($1.0 million for the City and $1.1 million for the Schools).

- Catastrophic claims risk protection insurance can also be purchased to cap claims paid by the City and Schools to a certain dollar amount, but that would cut significantly into the $2.1 million savings, reducing the savings by half. In addition, the City and Schools insured pools are large enough that one or two catastrophic cases with high claims costs should not cause a major funding shortfall.

- Self-funding creates the opportunity for some employee incentives, as over time the City and/or Schools could determine that the employees could get a one-time proportionate share of savings (premium rebate method after a low claims cost year), or a share in the annual savings (i.e., a lower total rate structure results in a lower employee share).

PROPOSAL

- For FY 2009 it is proposed that the City and Schools implement self-funding of the MAMSI/UHC plan.

- The City potentially would have $1.0 million and the Schools would have $1.1 million in premiums that would not need to be paid to MAMSI/UHC. The amount of savings could vary from one year to the next.

- The City and Schools would each set employer and employee rates for the fiscal year based on estimates of self-funded costs provided by MAMSI/UHC. Some additional margin could also be added to create less risk that actual costs would exceed charged rates.

- During the fiscal year, the City and Schools rates for the employer and employee shares would be charged as part of payroll, as currently is the practice. The amounts charged would be placed in a balance sheet account.

- MAMSI would bill its actual costs plus an administrative fee each month. The City and Schools would each pay their own bills out of their respective balance sheet accounts.

- Since medical billing runs in arrears, the City and Schools would continue to pay the submitted bills from the balance sheet account (i.e., from funds held in suspense in a balance sheet liability account) from the end of the fiscal year until the City and Schools books are closed for the fiscal year.

- At the end of each fiscal year, MAMSI would calculate the *incurred-but-not-reported* (IBNR) and unpaid amounts from that fiscal year for the City and the Schools. The respective balance sheet accounts for the City and the Schools would need to hold sufficient funds at the end of each fiscal year to cover estimated unpaid bills. If there were not enough funds available from charged premiums, the differential would need to be funded and expensed separately by the City and Schools on their respective books.

- The City and Schools would each manage their own risks.

- Unless there was an exceptional claims year, in practice there would nearly always be a cash balance since bills for health care have a “long declining tail” (i.e., the time between the patient date of service and when the City and Schools are billed can be two to six months).

- If the IBNR indicates that there are excess funds in the balance sheet account, those funds could be available to temper future rate increases or to establish one-time employee and employer premium holidays.

SCHOOLS:

a) The Schools overall year-end Operating Fund fund balance is already obligated by policy, and the Schools have no current additional source of reserves to cover the risk of self-funding. To cover potential excess health claims the Schools would set aside the entire $1.1 million in premium savings (i.e., the difference between self-funded rates and fully insured rates) in fund balance as a designated amount. The budgeted Schools contingent account ($0.4 million in FY 2009) would be added to the balance sheet account at the end of each fiscal year, if the contingent reserve was not needed for emergency purposes.

b) This new Schools' fund balance designation would be used to cover any excess MAMSI/UHC health care costs (expenditures plus incurred but not reported claim estimates) that the total annual premiums could not cover in any fiscal year.

c) Any collected premiums not needed in a fiscal year (for expenditures and IBNR) would also be added to this reserve.

d) The goal would be to build the designated fund balance in the Schools Operating Fund to 25% of the annual estimated total cost of claims and administration. For FY 2009 this amount is $3.2 million. Until this goal is met, the City would agree to provide aggregate protection up to $2.0 million (from when self-funding is initiated until 25% level is reached) to the Schools to cover MAMSI/UHC expenses and IBNR amounts that could not be covered by the Schools MAMSI/UHC balance sheet amount plus the School Board's Contingent Reserve.

e) If in the unlikely situation the City's $2.0 million aggregate protection is fully utilized in the self-funded program's start-up years, the City and Schools would use best efforts and faithful cooperation to revisit the self-funding financial structure to determine the best health care financing direction for the City and the Schools for subsequent fiscal years.

f) Until the targeted amount is reached (estimated to take two fiscal years, assuming typical medical claim years), the Schools agree not to improve the MAMSI plan's benefits. This does not preclude changing the current employee and employer cost sharing ratios.

CITY:

a) The difference between MAMSI self-funded rates and fully insured rates is $1.0 million for the City. The $1.0 million is proposed to be allocated in the following manner.

  1) $0.4 million would go in FY 2009 towards the higher than budgeted MAMSI health insurance rate increases.

  2) $0.3 million would remain and be added to the self-funded rates as margin to create less risk in the event that costs exceed charged rates.

3) $0.3 million could be cut from the FY 2009 proposed budget. Thus, saving the City $270,000 and employees $30,000.