OFFICE OF GROUP BENEFITS
FUND BALANCE ANALYSIS
STATE OF LOUISIANA

FINANCIAL AUDIT SERVICES
INFORMATIONAL AUDIT
ISSUED MAY 21, 2014

LOUISIANA LEGISLATIVE AUDITOR
1600 NORTH THIRD STREET
POST OFFICE BOX 94397
BATON ROUGE, LOUISIANA 70804-9397

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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

May 21, 2014

The Honorable John A. Alario, Jr.,
President of the Senate
The Honorable Charles E. "Chuck" Kleckley,
Speaker of the House of Representatives

Dear Senator Alario and Representative Kleckley:

This informational audit provides the results of our analysis of the actual and projected changes in the Office of Group Benefits' fund balance between January 1, 2012, and December 31, 2014. The scope of our work was significantly less than an examination conducted in accordance with *Government Auditing Standards*.

The accompanying report presents our conclusions, as well as management's response. This report is intended primarily for information purposes and use of the Louisiana Legislature. This is a public report, and copies have been delivered to the appropriate public officials.

We would like to express our appreciation to the management and staff of the Division of Administration and the Office of Group Benefits for their assistance.

Sincerely,

Daryl G. Purpera, CPA, CFE
Legislative Auditor

DGP/ch

OGB-FUND BALANCE ANALYSIS 2014

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Louisiana Legislative Auditor

Daryl G. Purpera, CPA, CFE

Office of Group Benefits
Fund Balance Analysis

May 2014

Audit Control # 80140094

Summary

The objective of this audit was to analyze the actual and projected changes in the Office of Group Benefits' (OGB) fund balance between January 1, 2012, and December 31, 2014, and to evaluate the financial sustainability of current operations.

Based on our analysis, the OGB fund balance of $482 million at December 31, 2011 declined to a balance of $275 million by November 30, 2013. OGB's actuarial projections as of November 2013 indicate that the fund balance will be further reduced to $56 million by December 31, 2014. Based on an estimated 2014 average monthly shortfall of $17 million, OGB's remaining fund balance may be liquidated by April 2015. Any deficit before the end of fiscal year 2015 could require additional General Fund monies to sustain program operations, depending on OGB's cash flow.

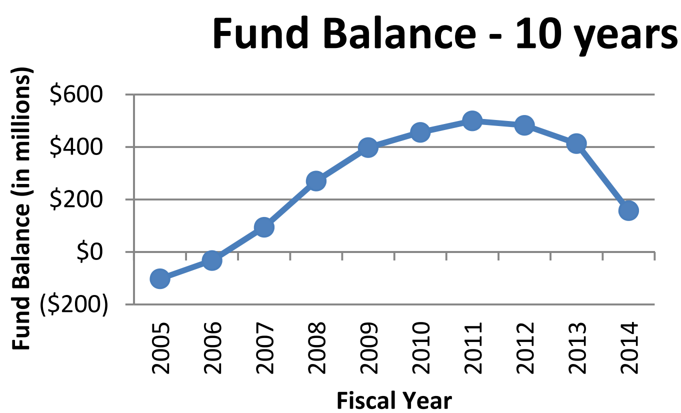
OGB has indicated that it is evaluating options to stabilize its fund balance. However, if no benefit or structural changes are made by OGB, we estimated that a premium increase of 17% would be necessary to prevent continued losses through December 2014.

In its official response in Appendix A, OGB stated that it has developed "a comprehensive plan to ensure its solvency," including a 5% premium rate increase beginning July 1, 2014, and $131.8 million in claims cost savings from plan changes during fiscal year 2015. If both actions result in their intended outcomes, the Legislative Auditor projects the $17 million monthly deficit could be reduced to a $10 million monthly deficit, based on OGB's projected reduction in fund balance of $119.6 million between July 1, 2014, and June 30, 2015, as disclosed in its response. In separate correspondence, the interim OGB CEO explained the $131.8 million in projected cost savings as follows: "The estimated $131.8 million represents the total projected savings in claims cost realized from aggressive plan changes proposed by OGB and Alvarez and Marsal. Those changes include standardized coverage benefits that better align services with the appropriate plan, pharmacy benefit changes which will promote the use of step therapy management, the launch of Live Better Louisiana - a comprehensive wellness program that will incentivize preventive care, smoking cessation support, prior authorizations for certain medical procedures, and member education on selecting the most appropriate for their lifestyle and risk factors. These preliminary plan changes have not been finalized. We hope to have additional data to share in June."

Our procedures consisted primarily of examining selected financial transactions, records, and other documentation obtained during the audit process. The scope of our work was significantly less than an examination conducted in accordance with *Government Auditing Standards*. Appendix A includes the Division of Administration's response to this report, and Appendix B provides our scope and methodology.

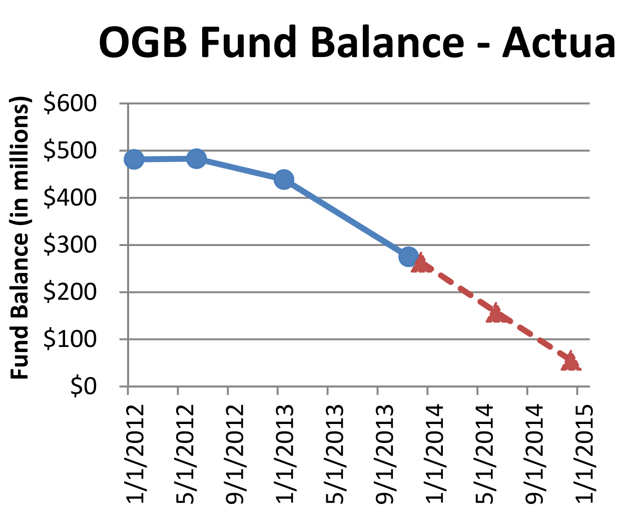
Analysis of OGB Fund Balance

The Office of Group Benefits (OGB) is authorized by law to provide health and accidental benefits and life insurance to both active and retired state employees and their dependents. The OGB fund balance is the accumulation of the surplus or deficit of revenues minus expenses over time and includes incurred but not reported claims. The chart below shows the changes in the OGB fund balance for the last ten years, including the balance projected for June 30, 2014:



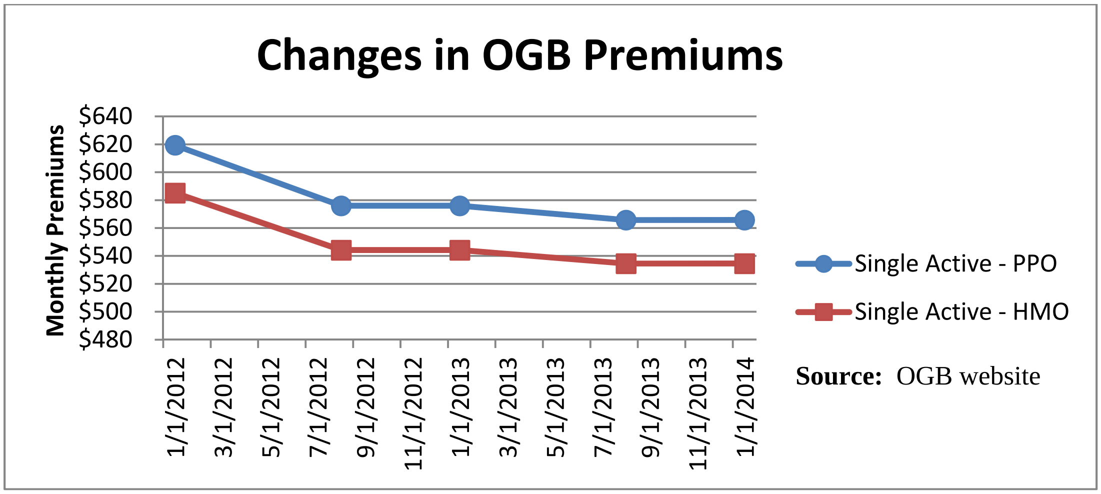
Source: OGB Annual Fiscal Reports, as adjusted

The OGB fund balance decreased substantially from $482 million on January 1, 2012 to $275 million on November 30, 2013, the last date that OGB's contracted actuaries provided a fund balance calculation. Actuarial projections as of November 2013 indicate that the fund balance will be further reduced to approximately $56 million by December 31, 2014. The actual changes in fund balance and the actuarially projected changes in fund balance through the end of calendar year 2014 are shown on the chart below:



Source: OGB Actuarial Reports

When the fund balance was near its historic peak, OGB reduced its premiums by 7% on August 1, 2012, with a further reduction of 1.77% on August 1, 2013. The chart below illustrates the changes in premiums for active, single PPO and HMO members:



The reductions in premiums have contributed to program losses at the same time that increased costs for medical and drug claims have further reduced fund balance. Actuarial assumptions by OGB's contracted actuary at January 2014 include cost trends for medical and drug claims of 5-8% and 8%, respectively.

Based on an estimated 2014 average monthly shortfall of $17 million, OGB's remaining fund balance could be liquidated by April 2015. Any deficit before the end of fiscal year 2015 could require additional General Fund monies to sustain program operations, depending on OGB's cash flow.

OGB has indicated that it is evaluating options to stabilize its fund balance. In the absence of benefit or structural changes, we estimated that a premium increase of 17% would be necessary to prevent continued operational losses. Our calculation is derived from the actuarial estimated monthly shortfall between July and December 2014 of $17.0 million divided by the average estimated monthly health insurance premiums for calendar year 2014 of $99.7 million.

In its official response in Appendix A, OGB stated that it has developed "a comprehensive plan to ensure its solvency," including a 5% premium rate increase beginning July 1, 2014, and $131.8 million in claims cost savings from plan changes during fiscal year 2015. If both actions result in their intended outcomes, the Legislative Auditor projects the $17 million monthly deficit could be reduced to a $10 million monthly deficit, based on OGB's projected reduction in fund balance of $119.6 million between July 1, 2014, and June 30, 2015, as disclosed in its response. In separate correspondence, the interim OGB CEO explained the $131.8 million in projected cost savings as follows: "The estimated $131.8 million represents the total projected savings in claims cost realized from aggressive plan changes proposed by OGB and Alvarez and Marsal. Those changes include standardized coverage benefits that better align services with the appropriate plan, pharmacy benefit changes which will promote the use of step therapy management, the launch of Live Better Louisiana - a comprehensive wellness program that will incentivize preventive care, smoking cessation support, prior authorizations for certain medical procedures, and member education on selecting the most appropriate for their lifestyle and risk factors. These preliminary plan changes have not been finalized. We hope to have additional data to share in June."

APPENDIX A: MANAGEMENT'S RESPONSE

May 15, 2014

Daryl Purpera
Legislative Auditor
1600 North Third Street
Baton Rouge, LA 70804

Dear Mr. Purpera,

The Office of Group Benefits (OGB) has reviewed the Legislative Auditor's Report regarding the OGB fund balance. The last few years have seen dramatic changes to the health care industry. The impact of the Affordable Care Act, the country's aging demographics, and the rising costs of health care have made it necessary for OGB to change the way it operates to become more efficient and provide better service and care to its members.

This report addresses the potential fund balance deficit if no plan changes or health initiatives are implemented. However, OGB has developed a comprehensive plan to ensure its solvency without burdening members with excessive rate increases such as the 17 percent increase mentioned in the report. OGB has already announced a five percent rate increase beginning July 1, 2014, which was not considered in the Legislative Auditor's financial projections. That increase combined with the plan changes outlined below will stabilize the fund balance and help to ensure the stability of OGB's plans and operations.

Historically, OGB's premium rates have risen in line with industry trends. More recently, however, OGB has been able to offer rate decreases to its members while national averages have continued to rise. According to the Kaiser Family Foundation, national average premium rates have increased by 25 percent since 2008. Comparing OGB's rates in 2008 to the ones offered today shows OGB's rates have risen by less than four percent in the same time period.

There are two reasons OGB has been able to contain costs better than the rest of the country. First, shifting many of the organization's administrative functions to a third-party administrator provided savings that offset part of the overall increase in health care costs. Second, because the fund balance had grown to exceed the amount necessary for claims payments, OGB was able to transfer some savings to members through rate decreases.

OGB is confident benefits from the public-private partnership with third-party administrators will continue. However, they will not entirely compensate for the rising costs related to the Affordable Care Act and treating an aging population.

To ensure OGB can continue to meet its goal, Alvarez & Marsal (A&M) was asked to assist OGB in formalizing its process for assessing whether its fund balance is sufficient to meet OGB's obligations, or if its available funds are excessive. A&M's financial projections and recommendations have been validated by OGB's actuary, Buck Consulting.

It is important to note that the report references fund balance while not acknowledging cash balance. The "cash balance" represents cash on hand in the fund's account. The "fund balance" generally represents cash on hand in the fund's account less the fund's liability reserves (for incurred but not reported claims).

A&M recommended that OGB adopt a targeted fund balance range. The targeted fund balance range is guidance for fiscal planning.

A fund balance standard for state benefit agencies like OGB does not generally exist. In the absence of such a standard, OGB should use a reasonable, common sense test that provides for adequate safeguards against adverse developments. A variety of factors were used to help develop a methodology under which OGB could best compute a Targeted Fund Balance Range. A&M considered its experience with levels of funds maintained by other insurer entities and the National Association of Insurance Commissioner's risk based capital standards for health insurance companies.

The targeted range should:

- Be easy to understand and calculate;
- Relate to OGB's obligations; and
- Represent a range in which OGB's funds are sufficient to meet its expense obligations, allowing for reasonable fluctuations in collections and payments, while not unduly burdening OGB funds.

A reasonable Targeted Fund Balance Range would be computed as follows:

Low end of the range – Highest monthly disbursement during the past six months

High end of the range – Two times OGB's average monthly disbursements during the past six months

Based upon the above considerations and OGB's reported expenses for the six-month period ended April 30, 2014, OGB's projected Targeted Fund Balance Range as of July 1, 2014 would be approximately:

Low end of the range: $122 million
High end of the range: $221 million

The beginning OGB cash balance for FY15 is projected to be $347.9 million with a fund balance of $222.9 million. This is above the recommended target fund balance range.

To continue its mission of providing comprehensive benefits to its members, OGB must address increasing costs and the health management of its membership. OGB is making changes to plan design and organizational structure. Those changes include a new model of integrated health plan management connecting all care/disease management and increased emphasis on preventive care leveraging our current administrative relationship with Blue Cross Blue Shield of Louisiana. Recent analysis of claims utilization has resulted in findings that create a case for change for improved plan management. Medical and pharmacy claims per OGB member are 17% and 129% higher than benchmarks, respectively. The plan has a 30% rate of repeat high claimants each year. Three of the top six conditions driving plan costs are due to cardio-metabolic diseases, which are preventable and can be managed through preventive care and disease management programming. Upcoming changes will include amendments to the formulary in the pharmacy plan which will provide lower prescription cost to members for use of more cost effective prescriptions. Standard Blue Cross Blue Shield plan management will also be implemented to prevent current abuses of the plan.

Plan changes are estimated to lower expected claims costs by $131.8 million for FY15. These changes will be implemented during FY 15 with full impact of savings in subsequent years. OGB estimates that at the end of FY15, the cash balance will be $229.3 million with a fund balance of $103.3 million, only slightly below the recommended target range of between $115 and $230 million. Combined, this comprehensive plan will reduce the rate of future premium increases and ensure the stability of OGB's fund balance.

Because the plan changes mentioned above will have a significant impact on OGB's financial stability and fund balance, the Legislative Auditor's Report does not accurately reflect OGB's projections for the upcoming year.

Sincerely,

Susan West

Susan T. West, MBA, CRM
Interim CEO, Office of Group Benefits

APPENDIX B: SCOPE AND METHODOLOGY

We conducted procedures for this informational audit to provide information to the Legislature about the actual and projected changes in the Office of Group Benefits' (OGB) fund balance between January 1, 2012, and December 31, 2014, and to evaluate the financial sustainability of OGB's current operations.

To obtain our objectives, we obtained and reviewed:

- information relating to actuarial projections of OGB revenues, expenditures, and fund balance;
- the official schedule of premium rates on OGB's website;
- data from OGB relating to monthly billed premiums; and
- data from the state's financial system relating to claims costs.

This audit was not performed in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.