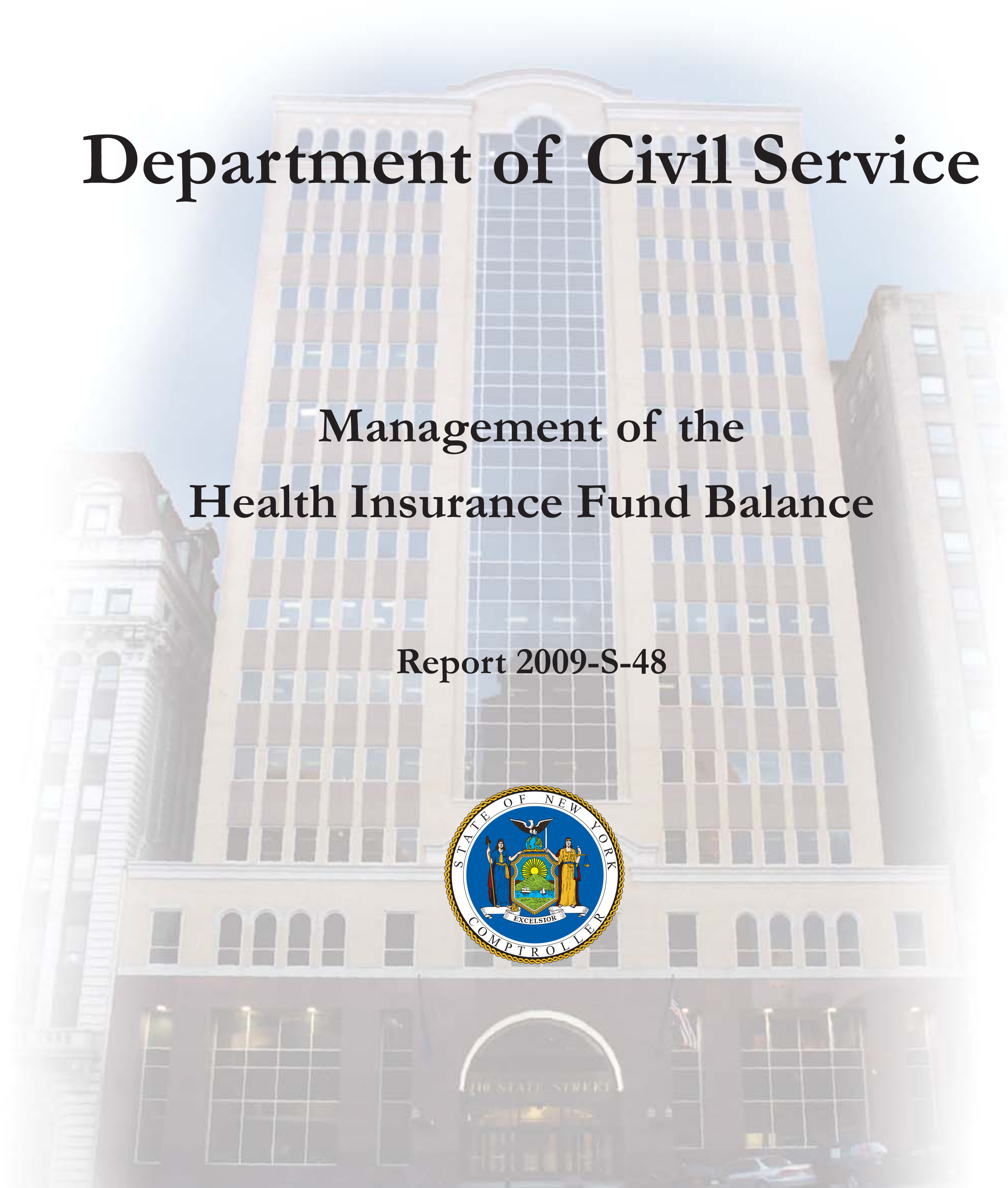
Office of the New York State Comptroller

Division of State Government Accountability



Department of Civil Service

Management of the Health Insurance Fund Balance

Report 2009-S-48

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of State Government Accountability

September 22, 2009

Ms. Nancy G. Groenwegen, Commissioner
Department of Civil Service
Alfred E. Smith State Office Building
80 South Swan Street - 8th Floor
Albany, NY 12239

Dear Commissioner Groenwegen:

The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of the Department of Civil Services' Management of the Health Insurance Fund Balance. This audit was performed pursuant to the State Comptroller's authority under Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

Audit Objective

Our objective was to determine whether the Department of Civil Service (Department) is maintaining a balance in its Health Insurance Fund that is appropriate, in that it both minimizes employer, employee and taxpayer costs for the New York State Health Insurance Program (NYSHIP) and ensures sufficient funds are available to pay the insurance carriers for the costs of their coverage.

Audit Results - Summary

The Empire Plan is the primary health insurance program in NYSHIP, covering nearly 1.1 million State and local government employees, retirees and their dependents at a cost of more than $5.1 billion a year. This cost is borne by the State and local government employers that participate in the Empire Plan. (Depending upon the employer, some portion of the costs may be borne by the employee). The employers and employees pay monthly premiums based on the Empire Plan's estimated costs for the year. The Department collects the premiums and remits them to the insurance carriers providing coverage under the Empire Plan.

At the end of the year, the Department compares the costs actually incurred by the carriers against the estimates on which the premiums were based and collected, and settles the differences with the carriers. In most years, the premium payments exceed the actual costs, and the carriers return the surplus (known as a "dividend") to the Department. The Department keeps the dividends in its Health Insurance Fund (Fund), and uses them to reduce future years' premiums charged to employers and employees as is required by the law governing the Fund.

We analyzed the year-end balance in the Fund to determine whether it has been maintained at an appropriate level in recent years. For example, if too much of the Fund balance is retained, public employers and employees (and, by extension, taxpayers) would be paying higher premiums than necessary. If too little of the Fund balance is retained, the Department may risk not being able to settle carrier costs or to mitigate future premium increases payable by employers and employees.

We noted that the Fund's year end balance has been consistently and substantially rising since December 31, 2004 when it totaled about $142 million. In fact, as of December 31, 2009, the Fund balance will total an estimated $711 million which excludes a projected $121 million in dividends earned in 2009 that will be realized in the spring of 2010. If the 2009 dividends are considered, the Fund would have as much as $600 million more than will be necessary to adequately manage future unanticipated risks. Because of certain statutory restrictions on the use of premium overpayments, the accumulated dividends in the Fund balance cannot be returned at once as a refund. Therefore, we recommend the Department return up to $600 million to State and local government employers, and employees, in the form of reduced monthly premiums for 2010. In addition, to keep the Fund balance at an appropriate level, we recommend the Department work with the carriers to ensure that their annual cost estimates are reasonable. One of the reasons the Fund balance has become excessive is that the carriers have been consistently overestimating their costs by significant margins and the State accepted the large overestimates.

During our audit fieldwork Department officials stated that they were planning on using $275 million of the excess Fund balance to reduce the monthly premiums throughout 2010. Department officials stated that they had already taken steps to reduce the annual cost estimates, beginning in 2008, and as a result, the premiums for 2009 were only about 1 percent more than they were in 2008. They also stated that they were reluctant to reduce the Fund balance further, in case additional funds were needed to prevent future premium rate spikes.

(In their response to our draft audit report, Department officials agreed that significantly more than $275 million of the current Fund balance should be used to offset premium charges in 2010. However, they did not believe it was appropriate to apply $600 million of the balance.)

Auditor's Comments: If the Department's final assessment is that applying the entire $600 million of accumulated dividends presents too much risk, we urge the Department at a minimum to consider applying $479 million as premium reductions for 2010. This amount represents accumulated dividends above the proposed $232 million in reserve requirements and excludes 2009 dividends estimated at $121 million which are payable in March of 2010. This would provide the State, localities and employees with much needed fiscal relief.

This report, dated September 22, 2009, is available on our web site at: http://www.osc.state.ny.us.
Add or update your mailing list address by contacting us at: (518) 474-3271 or
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

Introduction

Background

The New York State Department of Civil Service (Department) is responsible for administering the New York State Health Insurance Program (NYSHIP). NYSHIP provides health insurance coverage to State and local government employees, retirees and their dependents. NYSHIP includes several health plan options, of which the Empire Plan is by far the largest. Nearly 1.1 of the more than 1.2 million individuals covered by NYSHIP are members of the Empire Plan.

While the Empire Plan is a State program, it is also open to other public employers in New York State. If a public authority, local government agency or school district elects to participate in the Empire Plan, it signs a participation agreement with the State. Currently, a total of 98 public authorities and more than 800 local government units participate in the Empire Plan.

In the Empire Plan, the Department contracts with insurance carriers to provide four types of health insurance coverage: medical/surgical coverage; hospitalization coverage; prescription drug coverage; and mental health and substance abuse-related coverage. Each carrier is responsible for establishing a network of participating providers in its area of coverage, establishing the reimbursement rates for these providers, and processing payment claims from all providers serving Empire Plan members.

Annually, the carriers estimate their total claim payments and administrative expenses for the upcoming calendar year, and submit their estimates for the Department's review and approval. Once the estimates are approved by the Department (in October), they become the basis for the premiums that are charged to the employers and employees in the upcoming calendar year.

Each employer is responsible for its share of the total premiums, a portion of which may be paid by its employees. The Department is responsible for calculating each employer's share, billing the employers for their premiums, collecting the premium payments, and remitting the total premiums to the carriers. Generally, the Department bills the employers and remits payments to the carriers on a monthly basis.

At the end of the year, the Department compares the payments to carriers during the year to their actual expenses for claims and administration (including a profit margin) for the year. If payments made to carriers exceed carriers' actual costs (as is usually the case), the carriers return the excess funds to the Department. These excess funds, which are called a "dividend," are then used to offset future premiums. If payments to a carrier are less than actual costs, the carrier recovers the uncovered costs in the following year.

For example, in 2008, the employer premiums for the Empire Plan totaled $5.15 billion. The Department calculated each employer's share of these premiums, and on a monthly basis, it billed the employers for their shares and remitted the collected amounts to the carriers. Early in 2009, it compared the payments to the carriers in 2008 to their actual costs in 2008 and found that the payments exceeded the actual costs by a combined total of $498.3 million (the actual costs of one carrier exceeded its payments by a small margin, while the actual costs of the other three carriers were less than their payments). In March 2009, the carriers returned this $498.3 million "dividend" to the Department.

This $498.3 million dividend was then available to offset future premiums to be charged to employers and employees. For example, the Department applied $449.2 million in accumulated dividends to reduce 2009 premiums from $5.62 billion to $5.17 billion.

Department officials confer with officials at the New York State Division of the Budget when deciding on the amount of accumulated dividends to apply against future premiums. According to officials at the two agencies, their main objective when making this decision is to promote stability and avoid premium fluctuations that could negatively impact the fiscal situations of the employers participating in the Empire Plan.

In accordance with State law, the dividends from the Empire Plan's insurance carriers can only be used to offset future premiums. They cannot be used for other purposes and they cannot be refunded to the employers. Specifically, Article 11, Section 167, subdivision (6) of the New York State Civil Service Law states that the dividends must be "credited to such fund [the Health Insurance Fund] and retained therein as a special reserve for adverse fluctuation in future charges."

The Department uses a designated account (the Health Insurance Fund) for all premium-related transactions. Premium payments from the employers are credited to this account and payments to the carriers are made from this account. In addition, the carriers' year-end dividends are credited to this account. The available balance in the Health Insurance Fund is expected to be $710.9 million at December 31, 2009.

Audit Scope and Methodology

We audited the Department's practices for managing the balance in the Health Insurance Fund through June 30, 2009. To accomplish our objective, we interviewed officials at the Department and the State Division of the

Budget, and we reviewed Department documents and records. We also reviewed relevant laws, rules and regulations.

We initiated our audit, in part, in response to a request from the Comptroller of Nassau County (a participating employer in the Empire Plan), who questioned whether the balance in the Health Insurance Fund has been maintained at an appropriate level. In particular, he questioned whether the balance was too high, and whether employers were having to pay higher premiums than necessary to maintain this high balance.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

Reporting Requirements

We provided a draft copy of this report to Department officials for their review and formal comment. We considered the Department's comments in preparing this report. Department officials agreed that significantly more than $275 million of the current Health Insurance Fund balance should be used to offset premium charges in 2010. However, they did not agree that the entire $600 million of the balance should be applied. The Department's comments are included in their entirety at the end of this report. Our rejoinders to the Department's comments are included in our State Comptroller's Comments thereafter.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Department of Civil

Service shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Contributors to the Report

Major contributors to this report include Steven Sossei, Brian Mason, Ed Durocher, David Fleming, Theresa Podagrosi, Mary Roylance, and Dana Newhouse.

Audit Findings and Recommendations

Fund Balance

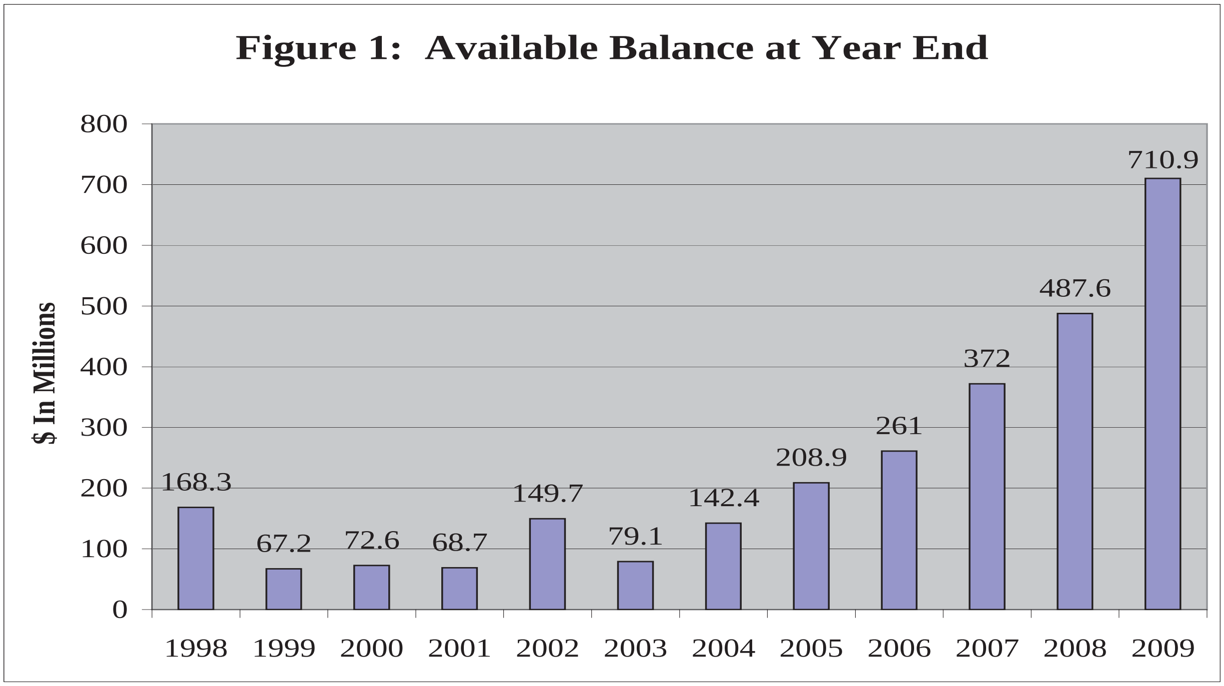
The available balance in the Health Insurance Fund (Fund) consists of accumulated dividends from the Empire Plan's insurance carriers. Accordingly, the Department manages the Fund balance by managing the dividends, which are, in fact, surplus premium payments from employers and employees.

Department officials must consider competing needs when managing the Fund balance. A higher balance provides more of a cushion in the event that the carriers' premium charges increase sharply. The Department's goal is to manage the Fund balance in a way that can "smooth out" unpredictable fluctuations in the carriers' costs and promote a rate stability that makes it easier for the employers and employees to budget and plan for their health insurance costs.

To determine whether the Department has adequately managed the Fund balance at a level that is neither too high nor too low, we analyzed the level of the available balance in recent years, focusing on the year-end balance, because that is when the Department settles the differences in the carriers' estimated and actual costs. As is shown in Figure 1, we found that the year-end balance was maintained at a relatively moderate level between 1998 and 2004, as it ranged between $67.2 million and $168.3 million during this period.

However, in 2005, the balance increased to $208.9 million, and in each of the following three years, it escalated, until it reached $487.6 million in 2008. As a result of these increases between 2004 and 2008, the Fund balance has risen by a total of $345.2 million, or 242 percent. Moreover, the Department projects that, at the end of the 2009, the Fund balance will be $710.9 million, a 399 percent increase since 2004. In comparison, the cost of the Empire Plan grew from $3.87 billion in 2004 to $5.13 billion in 2008, an increase of 33 percent.

It thus appears that the Fund balance has become excessive. In fact, as is explained later in this report, the Fund balance has risen to a level that may be as much as $600 million higher than it needs to be.



Management of the Fund Balance

One of the reasons for the large increase in the Fund balance after 2004 is that carriers consistently overestimated their costs by significant margins and the State accepted the overestimates in setting employer premiums. Another reason is that the Department reduced the percentage of available dividend applied to offset future years' premium increases. Thus, the applications of available Fund balances (to offset premium increases) did not keep pace with the growth in annual dividends, particularly in recent years.

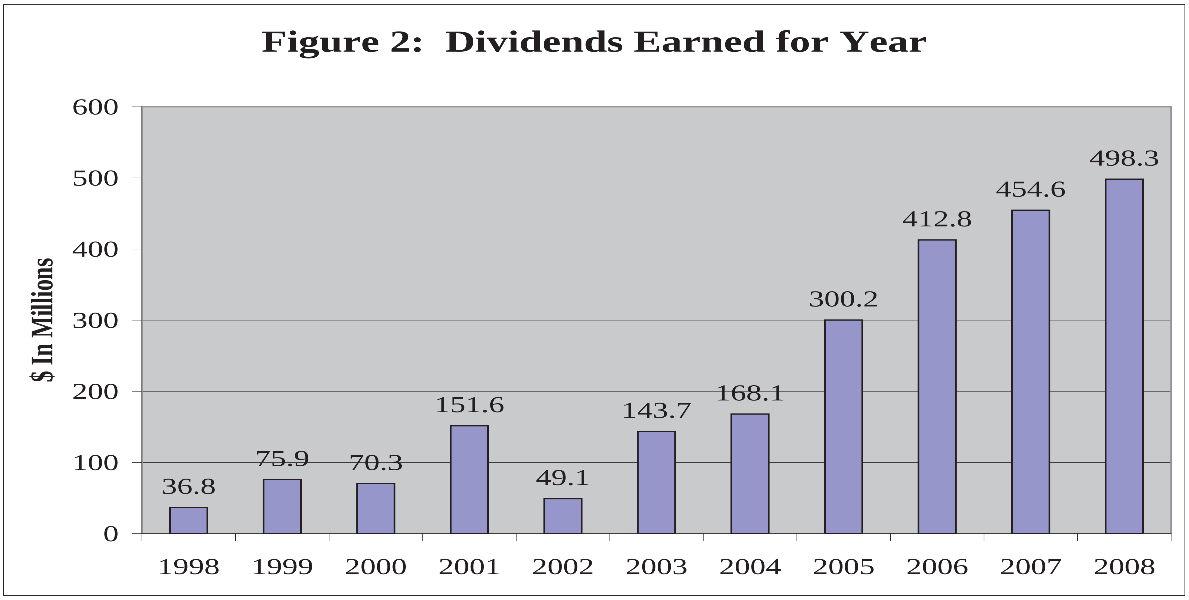
(In response to our draft audit report, Department officials further commented that growth in the dividends since 2004 reflect a nationwide reduction in the rate of increase in health care costs since 2004, the effects of rebidding the Empire Plan prescription drug coverage, negotiated benefit changes that generated savings and litigation settlements.)

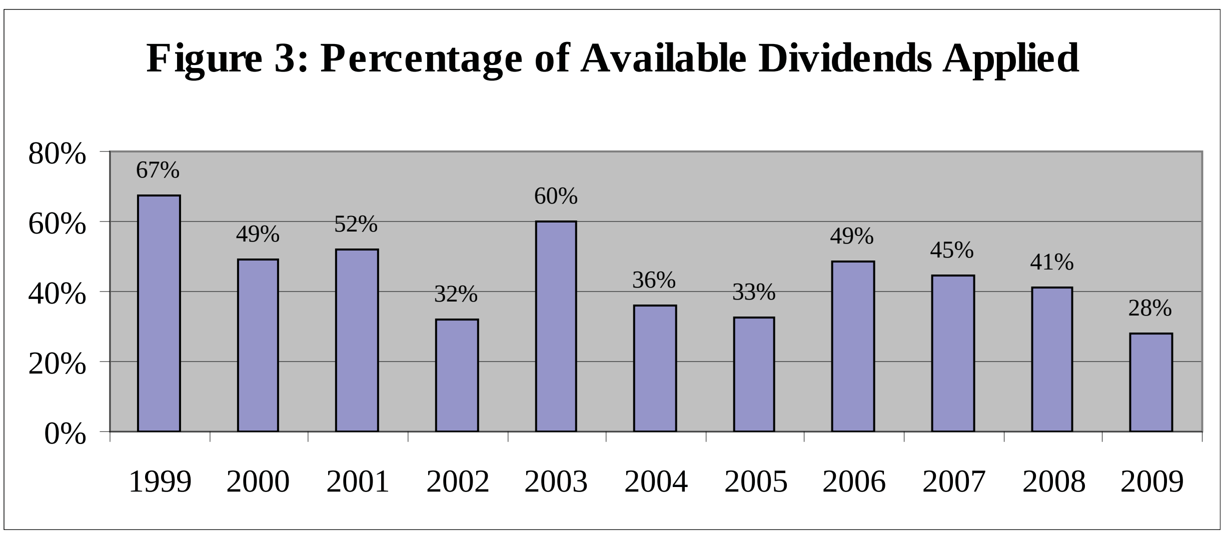
<u>Auditor's Comments</u>: We acknowledge the Department's position.

As is shown in Figure 2, between 2004 and 2008, dividends increased steadily from $168.1 million in 2004 to $498.3 million in 2008, an increase of 296 percent. Since dividends represent surplus premium payments (i.e., the portions of the premiums exceeding the carriers' actual costs) and the premiums are based on the carriers' estimates of those costs, the significant increase in dividends indicates that the carriers consistently overestimated their costs by significant margins during this period and the State accepted the large overestimates.

As is shown in Figure 3, the percentage of the available dividends that the Department applied against the following year's premiums decreased from at least 49 percent and as much as 67 percent in four of the five years before

2004, to less than 50 percent and as little as 28 percent in 2004 and after (for the purposes of this analysis, the available dividends consist of both the accumulated prior years' dividends that are available at the end of the year and the current year's dividends that are received in March of the following year).





It thus appears that the substantial increase in the Fund balance was part of the Department's strategy for managing that balance. Department officials told us they have developed a new strategy that will result in a lower Fund balance, as they plan to work with the carriers to lower the annual cost estimates on which the premiums are based. The lower estimates will result in lower premiums, lower year-end dividends, and eventually, a lower Fund balance.

The officials said that they began implementing the strategy in 2008, and as a result, the premiums for 2009 were only about one percent more than the premiums for 2008. In contrast, between 2005 and 2009 premiums increased by an average of about six percent a year, and between 2000 and 2004, the premiums increased by an average of about 15 percent a year. Also, as of July 2009, the year-end dividends for 2009 are projected to be about $121 million, which would be lowest amount since 2003. The officials explained that the carriers agreed to the lower cost estimates in exchange for the Department's commitment to reserve a portion of the Fund ($174.2 million) as a contingency that could be used to pay the carriers if their actual costs in 2009 exceed their total premiums for the year.

We support the Department's efforts to make the carriers' cost estimates more reasonable. As was previously noted, the large overestimates were one of the main reasons for the high Fund balance. We also support the creation of a contingency reserve to offset unexpected carrier costs, and believe that a reserve of about $200 million is appropriate (as shown in Figure 1, prior to 2005, the year-end Fund balance did not exceed this amount).

However, we note that the Department's new strategy does not change the Department's practices for applying available dividends against future premiums. This is generally done in October, when the premiums are set for the following calendar year. When Department officials decide how much of the available dividends to apply against the following year's premiums, they generally do not take into account the current year's dividends, even though those dividends will be received in March of the following year - and therefore would be available to apply against the premiums for most of that year. Rather, they only consider the dividends that have already been accumulated from prior years.

For example, in October 2007, when Department officials were deciding how much of the available dividends to apply against the 2008 premiums, they only considered the $372.1 million in dividends that had been accumulated from prior years, and applied $339.1 million of this amount. They did not consider the dividends for 2007 (projected at $408.1 million at that time) even though these funds were to be received in March 2008, and thus could have been used to fund the payments that were made to the carriers for 2008. (Actual dividends totaled $454.6 million).

Department officials believe that dividends earned in the current year and paid in the subsequent year should not be taken into account when premiums are set for the subsequent year, because the funds are not yet in the State's possession. We note that State agencies routinely plan for the use of funds that are not yet in their possession, but in all likelihood will be (e.g., taxes). Also, the Department monitors the carriers' actual costs throughout the year and develops quarterly estimates of their year-end dividends. Therefore, each October, when the premiums for the following year are set, the Department has a reliable basis for estimating the amount of dividends that will be paid the following March.

If the Department had adopted this approach in the past, and considered the current year's dividends, as well as the prior years' dividends, when setting premiums, the premiums could have been significantly lower. For example, in the preceding example, if the Department had considered both the current year's ($408.1 million estimated) and the prior years' ($372.1 million) dividends when setting premiums for 2008, and had applied $300 million of the current year's dividends in addition to the $339.1 million that it applied from the prior years, it could have reduced the total 2008 premiums from $5.13 billion to $4.83 billion (a reduction of 5.8 percent in the total premiums) and still maintained a Fund balance of $187.6 million. This would have exceeded the amount the Department set aside for contingency payments to carriers ($174.2 million) for 2009, as noted previously.

Similarly, if the Department were to adopt this approach in the future, and consider the current year's dividends, as well as the prior years' dividends, when setting premiums, future premiums should be lower. For example, at the time of our audit, the Department was beginning to develop preliminary estimates for the 2010 premiums. To get the carriers to agree to lower cost estimates for 2010, it planned to reserve about $232 million as a contingency against unexpected costs. In addition, it planned to apply $275 million of the $479 million in available prior years' dividends against the 2010 premiums.[1] However, it was not taking into account the projected dividends for 2009, which would be received in March 2010 and were estimated to be about $121 million.

We recommend the Department take these dividends into account. We further recommend that the Department apply a greater portion of the total available dividends against the following year's premiums. In applying only $275 of the $479 million in available prior years' dividends, the Department is adding a second, $204 million cushion, in addition to the $232 million contingency reserve cushion (The estimated $121 million in current year's dividends is a third such cushion.). We question the need for these additional cushions.

Department officials believe the additional cushions are needed for future years, to enable it to counter large increases in the carriers' costs, and thus moderate spikes in the annual premiums. They believe the cushions would ultimately benefit the employers participating in the Empire Plan, as they

1 The $479 million in available prior years' dividends is the $711 million expected year-end balance for 2009, less the $232 million contingency reserve for 2010.

would stabilize the premiums and thereby make it easier for the employers to plan for future costs.

We acknowledge that the Department must ultimately manage the Fund balance in a manner to address various risks. However, we also point out that in the current economic climate, employers, employees and taxpayers are in need of fiscal relief. We also note that the contingency reserve could be used to stabilize rates.

For example, as illustrated in the following analysis, it may be possible for the Department to apply $325 million more of accumulated dividends beyond the $275 million already planned for in establishing 2010 premiums and still maintain the minimum contingency reserve of $232 million.

Prior Years' Dividends	$711 million
Current Year's Dividends	121 million
Total Available Dividends	$832 million
Less: Contingency Reserve	(232 million)
Available to be Applied Against 2010 Premiums	$600 million
Amount Department Plans to Apply	(275 million)
Additional Amount	$325 million

The preceding analysis also confirms that the Fund balance has become excessively high, as it shows that the balance has risen to a level that is as much as $600 million higher than it needs to be to maintain the required minimum reserve.

Therefore, to bring much needed fiscal relief to the Empire Plan's State and local government employers during these difficult economic times, we recommend the Department consider applying up to $600 million in available dividends against the employers' premiums (i.e., both the $275 million that was to be applied and the $325 million that was not). Because of the statutory restrictions on the use of the surplus premiums, the entire excess Fund balance cannot be applied at once. However, the Department could apply a portion of the surplus to monthly premiums throughout 2010.

During the audit, Department officials stated that they were reluctant to reduce the Fund balance beyond what is already planned, in case the additional surplus funds are needed to prevent future premium rate spikes. However, our analysis of the Department's financial projections shows that the additional surplus funds would not be needed in the foreseeable future, and the balance could be reduced by much more than the planned $275 million in 2010.

Recommendations

1. Based on the Department's risk assessment, as well as the need for employer, employee and taxpayer relief, apply up to $600 million in surplus premium payments against monthly premiums in 2010. At a minimum, we urge the Department to consider applying $479 million of the Fund balance as premium reductions which represents accumulated dividends above reserve requirements exclusive of 2009 dividends payable in March 2010.
2. Ensure that the annual cost estimates on which the premiums are based are reasonable.
3. Maintain the Fund balance at the level of the contingency reserve, and apply enough of the total available (i.e., both accumulated and projected) dividends against the following year's premiums to achieve this level.

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DAVID A. PATERSON
GOVERNOR

NANCY G. GROENWEGEN
COMMISSIONER

August 28, 2009

Mr. Steven E. Sossei
Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, New York 12236

Dear Mr. Sossei:

The Department of Civil Service agrees with the central conclusion of the draft audit entitled "*Management of the Health Insurance Fund Balance" (2009-S-48)*: that surplus funds generated when health insurance premiums exceed claims should be applied aggressively to reduce premiums for State and local government participants in the New York State Health Insurance Program and their employees. Our actions in 2008 demonstrate that commitment unequivocally. Our repeated statements to participants promise that commitment will not slacken in 2010.

Article 11, Section 167 subsection (6) of the Civil Service Law (CSL) gives the Department no other choice in its management of the Employee Benefit Fund. The law states:

"The income derived from any dividends, premium rate adjustments or other refunds....shall be credited to such fund and retained therein as a special reserve as determined by the president to minimize adverse fluctuation in current or future charges under any such contract or contracts"

Minimizing next year's premium while neglecting the implications for future year premiums is inconsistent with that charge and not in the long-term best interests of the Plan, the State or its subdivisions. The draft audit's recommendation to apply a full $600 million from the Health Insurance Fund to offset 2010 premium increases would nearly exhaust available fund reserves and result in increases to premiums of 19.8% in 2011 and by 7.8% in 2012. It would create just the kind of "adverse fluctuations" the law says should be minimized. *** Comment 1**

This Department has established a track record of effectively managing this multi-faceted health insurance program:

- The 2009 premium increased by just 1.16 % even though underlying Plan costs rose by 7.8%.

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*See State Comptroller's Comments on page 25.

- The Department demanded and insurance carriers accepted expanded retrospective premium arrangements that reduce the amount charged to Plan participants throughout the year but oblige the Plan to make additional payments at the end of the year only if needed to cover actual claims and expenses.
- The Department requested and received resources in the 2007-08 State Budget to conduct a comprehensive review of NYSHIP management that goes well beyond just the premium rate-setting process.
- The Department drafted legislation to add a provision to CSL Section 167(6) allowing the budget director to adjust premiums for reasons other than *solely* to offset adverse fluctuations in cost.

That track record, we believe, should dispel any question of the Department's acute awareness of the fiscal issues confronting local governments and its commitment to maintaining both low costs and comprehensive benefits. Yet it seems at odds with the statement in the audit report's Executive Summary, "Department officials state that they were planning on using $275 million of the excess fund balance to reduce the monthly premiums throughout 2010."

This selected excerpt from staff interviews *significantly* understates the Department's declared intent. Department staff interviewed by the auditors characterized the $275 million figure as merely a "placeholder." The Department's *Fourth Quarter Empire Plan Experience Reports for 2008* issued in May 2009 and the *EMPIRE PLAN 2009 First Quarter Experience Report* issued in June 2009 said:

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Comment
2**

"...the actual amount of dividend to be applied as a credit in the 2010 premium rates will be determined in October 2009 based on a number of factors including, but not limited to, the following:

- *The final results of premium negotiations with the carriers.*
- *The impact on the stability of premium over time (2010–2014).*
- *The status of the economy, as well as the State and Local Government fiscal climate.*

We will work together with the Division of the Budget to ensure that NYSHIP rate for local governments are kept as low as fiscally prudent."

Contrary to the draft audit's implication, the Department intends to apply the entire dividend available in the Fund—other than that necessary to cover known premium obligations— in a manner that will minimize spikes in the premium charged to Plan participants in 2010 and later and is consistent with statutory requirements. We expect the actual amount applied in 2010 to be well in excess of $275 million, though less than the $600 million that the draft audit recommends. As the Comptroller has wisely decided that local pension fund contributions should not disappear even when investment returns soar, we too are determined to maintain health insurance premiums that are stable and predictable for local governments and their employees.

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Comment
2**

*See State Comptroller's Comments on page 25.

The draft report blames growth of the dividend balance in recent years to the fact that "the State accepted the (insurers') overestimates in setting employer premiums." That statement fails to recognize several important and unanticipated factors that contributed to the growth of the dividend balance since 2004:

- A nationwide reduction in the rate of increase in health care costs. During the period 2002 to 2004, plan costs increased at an average rate of 12%. From 2005 to 2008, the rate of increase slowed to just 6.8% annually.
- Rebid of the Empire Plan's prescription drug contract twice during that time period left incumbent carriers at risk for any loss incurred in the final year of their contract and incoming carriers unsure of the claims projections left them by their predecessors. The result in both cases was more conservative projections than usual and four consecutive years of higher-than-usual dividends associated with the prescription drug contract.
- Unions representing State employees agreed to several benefits changes during the period that generated significant savings.
- Settlements from litigation raised the fund balance by over $30 million.

*** Comment 3**

The draft report correctly notes that the Department, with occasional exceptions, does not recommend application of projected dividend. Typically, the Department waits until the dividend is deposited in the fund before it commits to spending it. While a government may frequently base planned expenditures on revenue forecasts, it can adjust spending if revenues fail to materialize as expected. NYSHIP expenditures, on the other hand, are driven primarily by the utilization of health services by active and retired employees covered under the Plan. Since it cannot directly control utilization, the Department would have no option but to implement a mid-year rate increase. This is problematic in that once the rate is established for a year, Plan participants, including local governments and employees, expect that rate to remain in place for the entire year. Mid-year premium increases disrupt the budgets of both households and local governments. They may also trigger union demands for an additional option transfer period and pre-tax premium contribution programs and alter the amounts employees can contribute to a Flexible Spending Account.

*** Comment 4**

It has been the consistent policy of the Department of Civil Service to minimize the dividend balance in the Health Insurance Fund consistent with fund stability. We will continue to do so.

Sincerely,

Nancy G. Groenwegen

Nancy G. Groenwegen
Commissioner

cc: Thomas Lukacs, Division of the Budget

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*See State Comptroller's Comments on page 25.

State Comptroller's Comments

1. We have revised recommendation number 1 to reflect Department concerns. We also point out that the application of $600 million from the Health Insurance Fund balance to 2010 premiums would still leave a reserve of about $232 million to cover unanticipated premium costs. Furthermore, as the Department acknowledges, there has been a nationwide reduction in the rate of increase in health care costs in recent years. From 2005 to 2008, the rate of increase for the State averaged about 6.8 percent annually.

2. This is inconsistent with information provided to us by the Department during the course of our review. During the review, Department officials formally advised us that they planned to apply $275 million of the available dividend to the 2010 premium. Officials did not indicate the $275 million was merely a "placeholder." Also, officials did not indicate that the amount to be applied to the 2010 premium would be "well in excess of $275 million." Nonetheless, we are pleased that the Department recognizes that the status of the economy, as well as the fiscal condition of the State and local governments, should be considered in the determining the amount of the Fund balance to apply to the 2010 premium. Further, we are pleased the Department is considering applying significantly more than $275 million of the balance to the 2010 premium.

3. On page 15 of our report, we clearly noted that the rate of increase in health insurance premiums has decreased in recent years. We have added the Department's comments about unanticipated factors to the body of our report.

4. We acknowledge that the financial operations of any entity can be impaired if projected revenues fail to materialize. However, in recent years, quarterly dividend reports and projections for the Fund have been sufficiently reliable indicators of the actual dividends to be received. Moreover, from 2003 through 2008, the actual dividends realized exceeded the projections. For example, as noted in the report, the projected dividend for 2007 was $408.1 million, and the actual dividend was $454.6 million. Consequently, the concern that actual dividends will fall significantly short of projections is inconsistent with the pattern of recent years. Given the magnitude of the dividends and the consistent reliability of their projections, we maintain that the Department should make some provision for the projections in determining the amount of the Fund balance to be applied to future premiums.

   In addition, we have modified recommendation number 1 to recognize the need for the Department to exercise its assessment of risk in deciding how much of the $600 million in accumulated dividends to apply to premium reductions in 2010. In this regard, we urge the Department, at a minimum, to consider applying $479 million of the Fund balance as premium reductions which represents accumulated dividends above reserve requirements exclusive of 2009 dividends, payable in March 2010.