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# Chapter 1

## Introduction

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Health benefits have become a significant component of the total compensation package for public employees and a significant cost to public employers. The large number of baby boomers approaching retirement, increasing health care costs, and retirees' increased life expectancy have raised concern about the future financial stability of the current pay-as-you-go funding method of the Hawaii Public Employees Health Fund (health fund).

The health fund has provided health and life insurance benefits for public employees and retirees since its inception in 1961. The fund provides these benefits through its own plans or through plans offered by public employee organizations (unions). In the mid-1980s, relatively few employees and retirees participated in union plans compared to the health fund plans. However, since the mid-1990s, active employees enrolled in union medical plans have accounted for nearly half of those enrolled in medical plans.

The Hawaii State Legislature requested the State Auditor to conduct an actuarial study and a programmatic audit of the Hawaii Public Employees Health Fund's operations. This request was made in House Concurrent Resolution No. 88, House Draft 1, Senate Draft 1, Conference Draft 1, of the 1998 session.

The resolution requested an assessment of future costs and liabilities of public employer contributions, including unfunded liabilities and the impact of porting funds to union benefit plans. The resolution indicated that the study should include a comparison of Hawaii's health fund to state employee and retiree health care benefit programs nationwide. In addition, the resolution sought information on long-term strategies to finance the retiree health benefit program and control expenditures, and recommendations on the advisability of replacing the health fund with a system based on an employer-union trust structure.

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### **Background on the Hawaii Public Employees Health Fund**

The Hawaii Public Employees Health Fund provides health and group life insurance benefits to eligible active state and county employees, retirees, their dependents, and reciprocal beneficiaries. Benefits available under the fund include medical, hospital, surgical, prescription drug, vision, dental, and life insurance plans, and Medicare Part B premium reimbursement.

For employees hired before July 1, 1996, public employers pay the entire monthly health care premium for employees retiring with ten or more years of credited service, and 50 percent of the monthly premium for employees retiring with fewer than ten years of credited service.

For employees hired after June 30, 1996, and who retire with fewer than ten years of service, public employers make no contributions. For those retiring with at least ten years but fewer than 15 years of service, public employers pay 50 percent of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, public employers pay 75 percent of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of service, employers pay the entire health care premium.

Retirees enrolled in both the federal Medicare plan and the health fund's Medicare Supplement plan or the Medicare Risk plan receive a monthly Medicare Part B reimbursement from the health fund. Spouses participate in these retiree benefits as well.

The health fund is also required to provide a long-term care benefits plan, available to employees, spouses, and beneficiaries who enroll between the ages of 20 and 85. However, this plan has not been initiated.

Established by Chapter 87, Hawaii Revised Statutes (HRS), the health fund is a trust fund attached to the Department of Budget and Finance for administrative purposes. The health fund is controlled by a nine-member Board of Trustees appointed by Hawaii's governor. The state director of finance is an *ex officio* member of the board and custodian of the fund. The board negotiates employee benefit plan contracts with insurance carriers and oversees enrollment and financial operations.

Three medical plans are offered: a fee-for-service medical plan through the Hawaii Medical Service Association (HMSA) and two health maintenance organization plans, Kaiser Permanente, and Kapi'olani HealthHawaii. Eligible employees and retirees can enroll in a union-sponsored health benefit plan in lieu of a plan provided directly by the health fund. Thirteen employee organizations or unions sponsor health benefit plans for their members, including the Hawaii Government Employees Association, the United Public Workers, the Hawaii State Teachers Association, the University of Hawaii Professional Assembly, the State of Hawaii Organization of Police Officers, and the Employees Association of the City & County of Honolulu.

Each month, the health fund receives contributions from employers and employees for health benefits. From FY1995-96 to FY1997-98, employer contributions rose from approximately \$235.3 million to \$262.6 million and employee contributions declined from about \$39.2 million to \$32.2

million because of the large migration of employees from the health fund plans to the union plans. As of July 31, 1997, a total of 77,478 active employees and retirees were enrolled in medical plans. Of those, 51,516 or about 66 percent of active employees and retirees were enrolled in the health fund medical plans and 25,962 or about 34 percent were enrolled in union medical plans. Among active employees, 22,973 or about 48 percent, were enrolled in the health fund's medical plan, while 25,403, nearly 53 percent, were enrolled in union medical plans. The health fund transfers (ports) the employer contributions to the union health plans each month. Employee contributions for union plan enrollees are paid directly to the union plans and do not pass through the health fund.

For the year ended June 30, 1998, the health fund paid approximately \$203 million in premiums to insurance carriers.

In response to concerns about the health fund's governance structure, benefit levels, and costs, the Legislature passed Act 309, SLH 1996 to develop an employer-union trust concept for determining and administering health benefits. The employer-union trust is purported to be a mechanism for linking benefit levels and costs, with the flexibility to establish appropriate health benefits coverage.

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## **Approach to Technical Terms**

This report contains many technical terms familiar to specialists in health benefit programs, actuarial science, and related subjects. To assist the general reader, we have explained key technical terms in the text where they appear and in the Glossary following the text of the report.

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## **Objectives of the Study**

The objectives of this study were to:

1. Project future demands upon, and costs and liabilities of, the Hawaii Public Employees Health Fund.
2. Develop long-term strategies to finance public employee and retiree health care benefits under the health fund while controlling costs.
3. Examine possible alternatives to the health fund's governance structure.
4. Assess the efficiency, effectiveness, and accountability of selected health fund operations.
5. Make recommendations as appropriate.

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## Scope and Methodology

Our study examined the health and life insurance benefit plans of the Hawaii Public Employees Health Fund and the employee organizations (unions). In this report we use the phrase “health benefit program” when referring to all of the plans available, whether they are offered by the health fund or the unions. In addition, statements about the “health plan(s)” refer to all—medical, drug, dental, vision, and life insurance plans.

To assist us with Objectives 1, 2, 3, and 5, the State Auditor engaged the services of Ernst & Young LLP, which provided actuarial and related services. The firm assisted us by estimating the future unfunded liabilities and annual costs to finance the retiree health benefit program under the health fund’s pay-as-you-go funding method compared with actuarial pre-funding methods, and assessing the impact of porting funds to union plans. The firm also assisted in identifying alternative strategies to finance health benefits and control expenditures, and in examining alternatives for restructuring the health fund’s governance, such as the employer-union trust.

The firm gathered information on other states’ employee and retiree health benefit programs including governance practices, management practices over reserves, the practice of porting funds to union benefit programs, information on computer systems and capabilities, customer service, and administrative services being provided.

The methodology used to project future costs and the unfunded liability of Hawaii’s program first involved projections of estimated future employer contribution costs per employee and retiree for the various benefits provided under the health fund program and the employer contributions ported to the union benefit plans. In addition, the firm projected the number of employees, retirees, dependents, and reciprocal beneficiaries anticipated to be covered under the program in total, as well as by type of coverage. Based on these population projections and the anticipated employer contribution costs per enrollee, the firm developed a 15-year projection of the future cost of the program and the estimated unfunded post-retirement benefit liability.

The firm applied generally accepted actuarial procedures to determine the anticipated impact on the health fund plan costs from an employer’s perspective due to the competition from the union benefit plans. The relative values of the union-provided medical benefit plans were compared to the health fund medical benefit plans using pricing data gathered by Ernst & Young from nationwide healthcare industry data. For the purpose of determining the impact on the health fund for this aspect of the study, the firm restricted its analysis to the impact as a result of the basic

health benefit plans, such as medical, surgical, hospital, since these benefits, along with prescription drugs, represent about 85 percent of the amounts paid out by the health fund to carriers or to union plans.

While the Hawaii Government Employees Association, the Hawaii State Teachers Association, and the United Public Workers did not provide the information that we requested such as experience reports, premiums/dues revenue, stabilization reserves, tiered rate and enrollment history, and experience refunds among their various health plans, the firm was able to estimate the expected impact that the union plans have had on employer contributions.

The firm performed a large scale Internet search for available information on other states' public employee benefit programs and supplemented this information with direct telephone and e-mail communications. In addition, the firm contacted the Government Finance Officers Association, National Association of State Retirement Administrators, National Conference on Public Employees Retirement Systems, and National Council on Teachers Retirement.

The Office of the Auditor relied upon the expertise of Ernst & Young and did not independently verify the actuarial computations and analyses performed by the firm. In addition, the auditor's office did not independently verify the data provided by the health fund or the Segal Company, the fund's consultant.

The Office of the Auditor obtained general background information and performed fieldwork for Objective 4. We reviewed the health fund's duties and responsibilities under Chapter 87, HRS. We reviewed the health fund's mission, functions, responsibilities, and management practices. We reviewed relevant documents and reports regarding the fund. We also reviewed the request for proposal and specifications for the health fund's new computer system.

We interviewed the health fund trustees, the administrator, selected staff, and the health fund's consultant. We interviewed public employer representatives from the State and counties. We interviewed officials from the public employee unions and representatives from the insurance carriers and a third-party administrator. We also interviewed administrators from the Executive Office on Aging, the Department of Human Resources Development, and the Department of Budget and Finance.

We contacted other states' health benefit programs. We also obtained information on other states' customer service activities.

We relied to some extent on the results of our recent financial audit of the health fund, Report No. 99-18.

We attended the December 1998, January 1999, and February 1999 meetings of the fund's Board of Trustees.

We surveyed a random sample of active employees and retirees about their experiences with their health coverage through the health fund or union plans, their experience with their insurance carriers, and their impressions of customer service.

Our work was performed from June 1998 through March 1999 in accordance with generally accepted government auditing standards.