



COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM
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To: Health Care Committee
From: Mark F. Schafer, Health Insurance Administrator
RE: Termination of Basic Option
Date: September 5, 2006

At the December 9, 2004 meeting the Retirement Board approved the recommendation of the Segal Company and adopted the Basic Option of the Health Options Program effective January 1, 2006. This Option provided all PSERS retirees eligible for premium assistance with supplemental hospital coverage when they are automatically enrolled in Medicare Part A (at age 65 in most cases). Like Medicare Part B, a retiree could opt-out of the Basic Option. To protect against situations where a retiree does not need the coverage but fails to opt-out, coverage would be terminated if no claims were filed with the plan and premium assistance benefits returned to PSERS. Attached is a copy of the Segal Company's report and recommendation.

On July 8, 2005, PSERS' staff recommended that the Retirement Board delay the implementation of the Basic Option for six months to one year due to the implementation of the Medicare Prescription Drug program and the restructuring of the 65 Special indemnity options. At the July 25, 2005 Special Board Meeting, the Board agreed to delay the implementation of the Basic Option until January 1, 2007.

At this time the PSERS' staff recommends that the Retirement Board terminate the Basic Option that was adopted but not implemented. This recommendation is based on the following:

- The complexity of implementing and monitoring the proposed Basic Option;
- The limited nature of the option, both as to coverage and those eligible for it;
- Questions concerning the continued need for the Basic Option in light of the plan design changes that have occurred to the HOP since the Basic Option was first proposed.
- Continuing concerns over the legality of the Basic Option.

Staff will be prepared to discuss the recommendation more fully at the Health Care committee on September 14, 2006.

Attachment

MEMORANDUM

FROM: J. Richard Johnson

DATE: December 8, 2004

TO: PSERS Health Care Committee

RE: HOP Basic Option Proposal

At the Health Care Committee's June 17, 2004 meeting, Segal presented a report on proposed strategic directions for the PSERS Health Options Program (HOP) that we believe would help the system improve its participation among school retirees in the Commonwealth and protect the program from experiencing larger than expected cost increases over the next few years. We made three primary proposals for changes to the structure and operation of the program:

1. Create an age 65 rate
2. Establish a new Basic Option plan
3. Revise the approval policy for Premium Assistance

The Health Care Committee considered the concepts and directed that additional study be made on each for further consideration and approval.

This memorandum presents additional rationale and justification for the second proposal – establishing a new Basic Option plan – and requests approval to begin offering the new Basic Option to PSERS retirees who become eligible for HOP on or after July 1, 2005 as a “default option”.

This proposal is intended as part of an overall initiative to help HOP deal with two major changes coming up in 2005 and 2006 for Medicare and retiree health benefits: (1) the implementation of the Medicare Modernization Act of 2003, and (2) the new accounting standards from the Governmental Accounting Standards Board (GASB) that require public sector retiree health benefit plans and sponsors to report the liabilities and expenses associated with the promise of providing post-retirement health benefits. It is important to start the process now to allow time to develop, implement and communicate valid program options for PSERS retirees under these new rules.

Background

Brief History. HOP has sponsored two options for the last eleven years. Effective January 1, 2002, the benefits provided by these Options were modified to be more competitive with

standard Medigap plans. The High Option is similar to the standard Medigap Plan J and the Standard Option is similar to the standard Medigap Plan C.

Retirees enrolling in either option can have some of their costs offset by the Premium Assistance Program. The current Board policy regarding Premium Assistance is to pay up to \$100 per month to retirees who have an out-of-pocket expense for their insurance costs and meet the eligibility requirements set forth in the Retirement Code. Even with Premium Assistance, HOP has maintained a static membership while the eligible retiree population has grown. For example, PSERS has seen a 17% growth in retirees since 1997 while growth of the HOP program over that period has been negligible.

Current Premium Assistance Participation. The following table shows the number of PSERS retirees who are eligible for and/or receiving Premium Assistance benefits. According to records maintained by PSERS, as of June 30, 2003, the health insurance status of retirees of the school system is as follows:

PSERS Retirees Who Are Eligible for and/or Receiving Premium Assistance Benefits

<p>Retirees eligible for Premium Assistance benefits are made up of the following:</p> <p>56,000 retirees receiving Premium Assistance benefits</p> <ul style="list-style-type: none"> — 20,000* enrolled in their school employer’s plan — 36,000 enrolled in HOP-sponsored plans <p>41,000* Retirees meeting the age, service or disability requirements, but no out-of-pocket premium expense from an approved plan.</p>	<p>Retirees not eligible for Premium Assistance are made up of the following:</p> <p>10,000 enrolled in HOP</p> <p>39,000* other</p>
<p>97,000 total retirees eligible for Premium Assistance benefits</p>	<p>49,000 total retirees not eligible for Premium Assistance benefits</p>
<p style="text-align: center;">Total PSERS retirees: 146,000</p> <p style="text-align: center;">*Potential participants for HOP program.</p>	

Of the 97,000 PSERS retirees eligible for Premium Assistance benefits, 41,000 are not receiving Premium Assistance benefits. These people either do not have medical coverage in addition to Medicare or are not participating in an approved plan. Some of the reasons these individuals may not be enrolled in a HOP plan or their School District’s plan include:

1. Having coverage through a spouse's insurance or other program not eligible for Premium Assistance.
2. Unaware of the HOP program offerings or becoming aware of the HOP offerings after their initial eligibility period.
3. Inability to afford a medical program.

The first two reasons have a negative cost impact on HOP. In the event that an individual has coverage through a spouse, when that coverage is lost, those individuals may enroll in HOP. This may create a situation where HOP is the insurer of last resort for those individuals and as such have adverse selection.

An individual who enrolls in a standard Medigap plan after terminating coverage with their former school employer, in many instances, must refund Premium Assistance paid after they left their school plan. PSERS identifies these individuals during an annual verification process whereby each school employer is contacted to verify that the Premium Assistance recipient has an actual out-of-pocket premium expense from an approved plan. Due to the audit nature of the verification process, retirees who terminate school coverage and do not enroll in HOP must return Premium Assistance overpayments averaging \$1,500. The verification process is onerous to school employers and is very upsetting to retirees who are required to refund overpayments. Each year PSERS reduces the monthly benefit of approximately 500 retirees to collect overpayments.

Description of the "Default Basic Option Approach"

We propose the creation of a default Basic Option that would cover all PSERS retirees eligible for Premium Assistance once they are eligible for Medicare.

The Basic Option would be priced at \$80—less than the current \$100 per month Premium Assistance payment—so that there would be no net expense to the retiree. The Basic Option would pay hospital deductibles not covered by Medicare and for the first three pints of blood per hospital stay. If the retiree does not file a claim against the plan or positively elect continued coverage under the Basic Option (or another HOP Option) at the first Option Selection Period following his or her enrollment, termination of coverage procedures would begin. All Premium Assistance amounts would be repaid to the Premium Assistance account. Those retirees that are not eligible for Premium Assistance would not be defaulted into the Basic Option, but would have a less expensive HOP Option if they decided to enroll in the HOP.

The following are further details outlining how such an approach would work:

At the time of retirement and then again one year prior to the retiree's 65th birthday, the PSERS retiree eligible for Premium Assistance will be advised of the Medicare-supplement health care coverage provided by the Basic Option.

At each notification occasion, the retiree will be advised that he or she cannot participate in more than one Medicare supplement and instructed to decline the Basic Option coverage if they have coverage elsewhere.

On or about 45 days prior to the first of the month in which the retiree attains age 65, he or she will receive a Basic Option identification card and an explanation of plan benefits, including an overview of the offsetting, neutral financial impact of the premium deduction and Premium Assistance credit on their monthly retirement benefit. They will also have the opportunity at this time to add spousal coverage and/or upgrade coverage to another HOP plan.

Emerging retirees will also be advised that if they are covered under another health insurance plan they should notify the HOP Administration Unit to cancel coverage under the Basic Option.

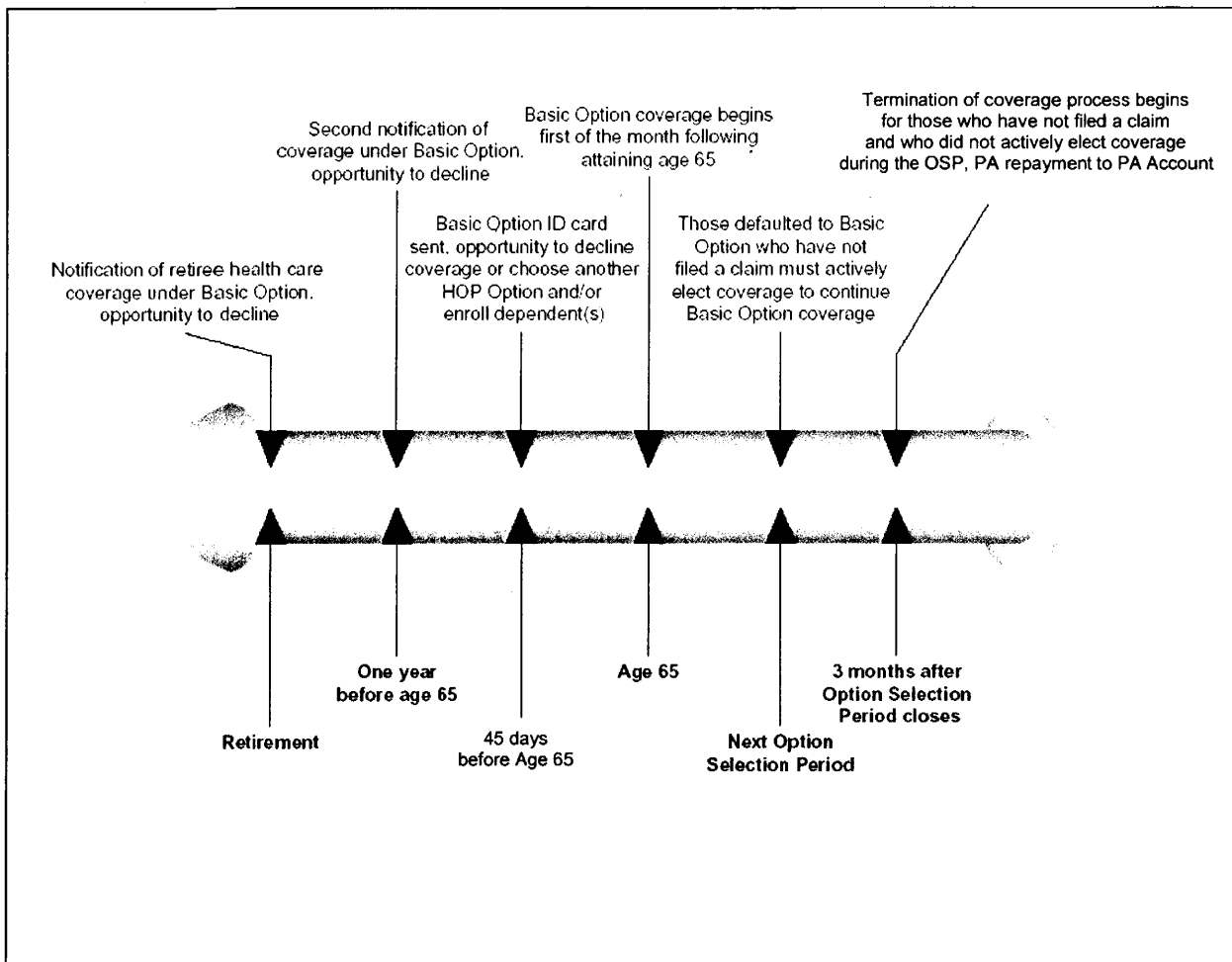
During subsequent Option Selection Periods, retirees with Basic Option coverage will have the opportunity to select another Option. They will also be advised again at that time that if they are covered under another health insurance plan they should notify the HOP Administration Unit to cancel coverage of the Basic Option plan.

If the retiree cancels coverage at any point in the process, they will be advised of their opportunity to enroll in HOP if they have a qualifying event.

Those retirees who are not eligible for Premium Assistance would not be defaulted into the Basic Option as they would have to pay the full \$80 per month for the plan. However, the Basic Option would be a less expensive HOP Option if they decided to enroll in the HOP when they reach age 65.

If the retiree does not positively elect the default coverage by the end of the first Option Selection Period after they become eligible, it will be assumed that the retiree does not want the coverage and it will be terminated retroactive to the retiree first becoming eligible. This refund will be made to the Premium Assistance account, not the member, as premiums for the Basic Option are less than the amount payable through the Premium Assistance program. A retiree will be deemed to positively elect the coverage by either submitting an enrollment form for the coverage or presenting a claim for payment.

Basic Option Default Enrollment Timeline



Proposed Effective Date and Implementation of the Basic Option Approach

On or after July 1, 2005, a new retiree eligible for Medicare or a current retiree who attains age 65 will be automatically enrolled in the Basic Option of the Health Options Program provided they are eligible for Premium Assistance. The effective date of coverage will be the first of the month following the month in which the member retires or the first of the month in which the retiree attains age 65, whichever is later.

Retroactive Cancellation of Basic Option Coverage

If it is determined that a Basic Option participant is covered under another Medicare supplemental plan or does not positively elect coverage by the end of the first Option Selection Period after they become eligible, the individual's Basic Option coverage will be retroactively canceled back to the original date of eligibility. In the event of a retroactive termination, the Premium Assistance account will be reimbursed for premiums paid to HOP on the individual's behalf during the period of double coverage. This transaction will have no impact on the member's monthly retirement benefit.

Plan Design and Cost

The Basic Option cost will be \$80 per month. The table below summarizes the benefits that will be provided:

Basic Option Plan Description

Type of Coverage	Medicare Pays...	Basic Option Pays...
Hospital stays of 1-60 days.	All but deductible of \$912	\$912 deductible
Hospital stays for the 61 st through 90 th day	All but deductible of \$228 per day	\$228 per day deductible
Hospital stays for the 90 th through 150 th day	All but deductible of \$456 per day	\$456 per day deductible
151 st day on	\$0	100% of cost
1 st three pints of blood	\$0	100% of cost

The actual experience of Basic Option participants will be reviewed each year and the premium or coverage will be adjusted as needed to maintain the objective for the Basic Option, including terminating the option with Board approval, should the need arise.

Advantages of the Basic Option and Automatic Enrollment

HOP has maintained a static membership while the eligible retiree population has grown. PSERS has seen a 17% growth in retirees since 1997 while growth of the HOP program over that period has been negligible. Newly eligible retirees under PSERS are increasingly going elsewhere for their health coverage. A recent survey of those eligible for Premium Assistance but not HOP participants showed that 32% were “not familiar” with HOP and that just 49% were “somewhat familiar” with HOP, with the percentages slightly higher for those under age 65. Introduction of a new default, Basic Option would help increase the percentage of these newly eligible retirees that join HOP, providing three main advantages:

1. **Mitigates adverse selection.** For many years the HOP has been the insurance plan of “last resort” for PSERS retirees, their spouse and dependents. Some PSERS retirees enroll in voluntary plans sponsored by former employers and receive the Premium Assistance benefit in conjunction with those plans. Also, some people who may be uninformed about the Premium Assistance benefit enroll in an individual policy purchased by an older spouse and do not receive the Premium Assistance subsidy.

When spouses die or plans terminate, these retirees have the opportunity to enroll in HOP. While this safety-net approach is a “benefit” for individuals not currently participating in HOP, it is funded by premiums paid by HOP participants. Individuals who delay enrolling in HOP past their initial eligibility for Medicare come into the program at a higher per-capita cost than those who enroll at age 65. Over the retiree’s lifetime, this results in higher costs for the retiree’s benefits compared to the amount of premiums paid by that retiree and thereby tends to increase the overall premium cost for

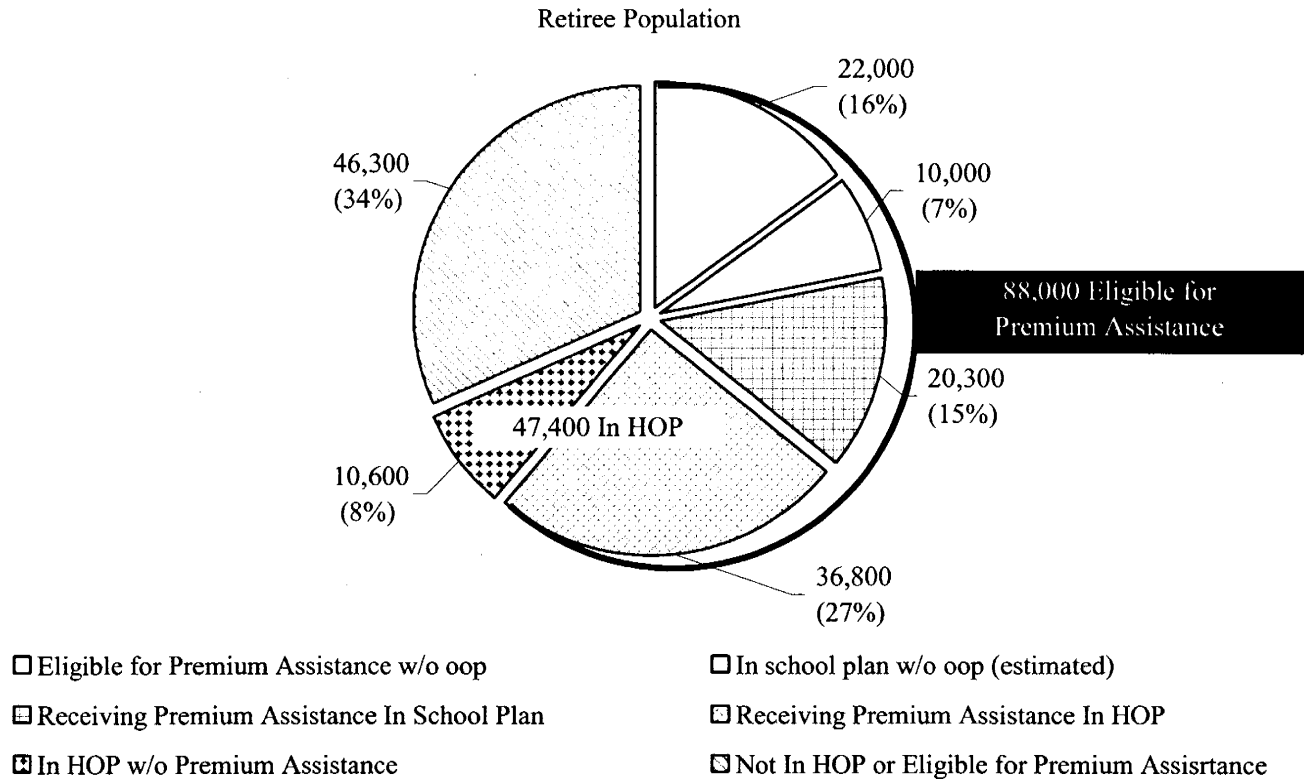
the HOP group. By automatically enrolling retirees in HOP at age 65, PSERS can increase the number of participants at younger ages and lower costs and increase the time horizon during which HOP will receive premiums from participants.

The Basic Option Plan will also mitigate the situation where an individual can not afford the current HOP plans but enrolls in them to treat an immediate significant medical condition with the intention of dropping coverage at the next open selection period. By having a lower cost plan, more individuals who cannot afford the current plans may be able to afford the Basic Option.

2. **Lowers non-benefit expenses.** Over the past ten years, the PSERS Health Options Program has “competed” with organizations that market and sell Medicare supplemental policies to PSERS retirees. Organizations such as AARP and Blue Cross and Blue Shield spend millions of dollars each year in television, print and radio advertising as well as significant direct mail marketing campaigns to entice seniors to enroll in its plans. Some of these organizations host free breakfast and lunch meetings and/or pay commissions to agents who go “door-to-door” to enroll seniors in its plans. While PSERS advises retirees about the benefits provided by the Health Options Program, no comparable marketing is conducted to enroll retirees in a plan established for their sole benefit. To attract new retirees into the program, PSERS will need to spend more and more on marketing campaigns each year. By automatically enrolling these retirees in HOP, PSERS can be more efficient in populating the HOP plan and avoid spending resources to compete for these retirees’ attention.
3. **Holds down premium cost for all HOP participants.** As a retiree-only medical benefit plan, HOP is operating in an environment of rapidly increasing medical costs and increased utilization where many plans experience double digit cost inflation each year. If non-benefit expenses are reduced and the participation rate in HOP increased, the cost of coverage will decrease. There is a direct correlation between a person’s age and health. Older people are more chronically ill than younger people and incur higher per-capita medical costs. Therefore, it is important to attract new HOP participants who are younger than the current average age of 75 in HOP. This will help to reduce the average age of the PSERS HOP participants and thereby hold down premium cost increases. Also, by utilizing the basic option, there will be fewer individuals who will be required to return Premium Assistance payments for programs not eligible for Premium Assistance.
4. **Improved Member Relations.** Each year PSERS notifies approximately 500 retirees that they must return Premium Assistance payments added to their monthly benefit after they terminated coverage with their school plan. These retirees are naturally upset that their school employer failed to notify PSERS and/or that the Board’s Premium Assistance policy should be changed to allow a continuation of Premium Assistance payments regardless of the plan selected by the member. The institution of the Basic Option plan will virtually eliminate the Premium Assistance collection process and members will be contacting PSERS because they do not need the extra coverage instead of inquiring about a \$1,500 debt that will be automatically deducted from their monthly benefit.

Increases in Premium Assistance Expenses

As of June 30, 2003, PSERS paid approximately 57,000 retirees a total of \$68 million per year in Premium Assistance. The following chart illustrates the categories of retiree population (excluding survivors and beneficiaries) as they relate to Premium Assistance and HOP:



Adopting a “default basic option approach” will, by design, increase the number of retirees receiving Premium Assistance. If the basic option becomes applicable to retirees retiring or becoming initially eligible for Medicare on or after July 1, 2005, the increase in payments will be gradual. Based upon the latest actuarial valuation, we can expect 230 retirees per month becoming eligible for Medicare. Of these, 85 will enroll in HOP and 40 will maintain their coverage in a school plan based upon current enrollment rates. If all other retirees are enrolled in the basic option (none declining coverage), 105 retirees will receive Premium Assistance each month who would otherwise forfeit the benefit. At this rate of increase, Premium Assistance payments could increase \$177,000 in the first year of the program and about \$1.3 million in the second year. For the year ended June 30, 2003, Premium Assistance payments were \$68 million.

Next Steps

Board approval is requested to establish a new Basic Option plan.

Upon approval, we will begin to prepare for implementation of the new plan to become effective for individuals who retiree on or after July 1, 2005 (or the later expiration of a collective bargaining agreement providing for retiree health benefits after age 65) and become eligible for

Medicare. We will assist PSERS in developing communications to announce the new Basic Option plan to school districts and emerging retirees.

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