Financial Condition Of The ERS Pension And Health Plans

ERS
Employees Retirement System of Texas

Senate State Affairs Interim Hearing

November 15, 2010

ERS

EMPLOYEES RETIREMENT
SYSTEM OF TEXAS

FINANCIAL CONDITION OF THE STATE PENSION PROGRAM

Update on ERS Retirement Plans

August 31, 2010

Demographics

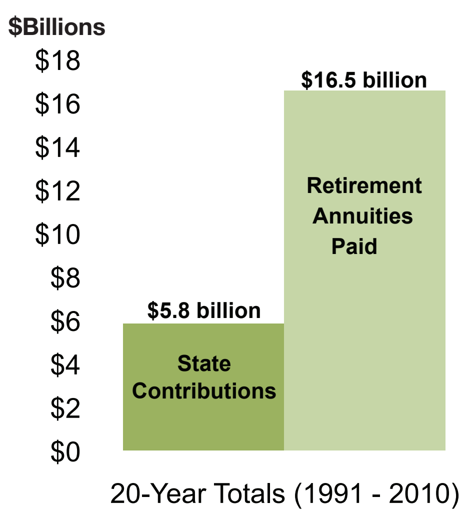
The Texas Legislature and the citizens of Texas adopted an amendment to the Texas Constitution in 1946 establishing retirement benefits for state appointed officers and employees. The 143,000 individuals that actively participate in one or more retirement plans have provided vital services as emergency first responders, child and elderly protection workers, public safety workers, lawmakers, judges, and more.

Employees Retirement System Plan					
	State Employees	Elected Officials and District Attorneys	Certain law enforcement officers & custodial officers at DPS, TABC, TPWD, TYC, TDCJ & TBPP*	Total State Employees	Judges, justices and certain commissioners of court
Active Employees					
Contributing Members	103,103	335	39,052	142,490	539
Average Age	44.50	53.00	41.89	43.81	55.85
Average Years of Service	9.51	10.41	8.52	9.24	9.54
Average Annual Salary	$42,104	$63,048	$37,979	$41,022	$127,560
Retirees					
All Annuitants	71,455	692	7,164	79,311	164
Average Annual Annuity	$17,526	$40,118	$30,302**	$18,372	$58,640
Service Retirees	59,581	537	6,562	66,672	147
Average Age	68.43	69.86	61.03	67.71	66.94
Average Years of Service @ Retirement	22.23	16.49	25.72	22.51	13.67
Non-Active/Non-Contributing Members					
Vested with at least 5 years of service				15,629	25
Non-vested with less than 5 years of service				66,096	105

**Members of the Law Enforcement and Custodial Officers Supplemental Retirement Fund are also members of ERS.*

***Sum of the average annuity received by LECOSRF members from the ERS fund ($24,708), plus the average annuity received from the LECOSRF fund ($5,594).*

The various issues laid out in this paper should not be presented without highlighting other important aspects. As shown in the chart below, the ERS retirement plan has been a cost effective way for the state to provide reasonable retirement benefits that help attract and retain an efficient workforce.



ERS has strong, balanced management and governance standards. The benefits provided are for career employment.

The contribution the state makes has many returns. The benefits provide a crucial safety net to thousands of Texans and their families, reducing the need for public assistance.

ERS retirees spend most of their retirement money in Texas, and the National Institute on Retirement Security reports that each employer dollar invested in Texas' public pensions supported $8.32 in total economic activity.

Actuarial Status

ERS State Employee Fund

The financial health of a defined benefit retirement plan is dependent on an equal balance between assets and liabilities. In other words, the contributions and investment earnings should equal the benefits being earned. (The actuarial funding equation is: contributions + investment earnings = benefits + expenses.)

The FY 2010 valuation of the ERS plan's current assets and liabilities show that ERS has 83 cents for each dollar it will pay towards the benefits earned by the current active and retired state employees and elected officials

	August 31, 2009	August 31, 2010	Difference
ERS State Employee TrustFund			
Accrued Liability	$26,907,779,257	$28,411,814,508	$1,504,035,251
Actuarial Value of Assets	$23,509,621,791	$23,629,296,456	$119,674,665
Unfunded Accrued Liability	$3,398,157,466	$4,782,518,052	$1,384,360,586
Funded Status	87.4%	83.2%	(4.2%)
Amortization Period	Infinite	Infinite	No change
Normal Cost as a Percent of Payroll	12.38%	12.30%	(0.08%)
Actuarially Sound Rate (funds normal cost and amortizes unfunded accrued liability over 31 years, per Texas law)	15.84%	17.07%	1.23%
Contribution Rates			
State	6.45%	6.95%	0.50%
Employee	6.45%	6.50%	0.05%
Total Contribution Rate	**12.90%**	**13.45%**	**0.55%**
Difference between current contribution rate and actuarially sound rate	2.94%	3.62%	0.68%

ERS' 83% funded ratio as of fiscal year end 2010 compares well to other public pension funds and is above the median funded ratio as of July 2009, of 80%. However, the results of the August 31, 2010 actuarial valuation show how the gap between contributions, investment earnings and the plan's total liability continues to widen.

Actuarial Status

Law Enforcement, Custodial Officers and Judicial Funds

Law Enforcement & Custodial Officer Supplemental Retirement Fund (LECOSRF)			
Accrued Liability	$907,101,634	$966,603,698	$59,502,064
Actuarial Value of Assets	$780,807,727	$802,897,017	$22,089,290
Unfunded Accrued Liability	$126,293,907	$163,706,681	$37,412,774
Funded Status	86.1%	83.1%	(3.0%)
Amortization Period	Infinite	Infinite	No change
Normal Cost as a Percent of Payroll	2.07%	2.07%	0.00%
Actuarially Sound Rate	2.58%	2.72%	0.14%
Contribution Rates			
State	1.59%	1.59%	0%
Employee	0.50%	0.50%	0%
Total Contribution Rate	**2.09%**	**2.09%**	**0%**
Difference between current contribution rate and actuarially sound rate	0.49%	0.63%	0.14%
Judicial Retirement System of Texas Plan II (JRS II)			
Accrued Liability	$255,568,774	$281,760,475	$26,191,701
Actuarial Value of Assets	$248,279,312	$264,515,185	$16,235,873
Unfunded Accrued Liability	$7,289,462	$17,245,290	$9,955,828
Funded Status	97.1%	93.9%	(3.2%)
Amortization Period	4.8 Years	12.6 Years	7.8 Years
Normal Cost as a Percent of Payroll	20.30%	20.19%	(0.11%)
Actuarially Sound Rate	20.94%	21.68%	0.74%
Contribution Rates			
State	16.83%	16.83%	0%
Employee	5.99%	5.98%	(0.01%)
Total Contribution Rate	**22.82%**	**22.81%**	**(0.01%)**
Difference between current contribution rate and actuarially sound rate	(1.88%)	(1.13%)	(0.75%)

Investments and Assets

The largest contributing component to the ERS Trust comes from investments of state and member contributions, with investment gains making up 62% of the trust's assets.

The $22 billion (as of October 2010) ERS Retirement Trust is professionally managed within the asset allocation and risk management defined by the ERS Board of Trustees and pursuant to the Texas Constitution and state law.

ERS continues to work toward its long-term target asset allocation, finding opportunities in new asset classes that further diversify Trust assets and reduce risk.

Asset Allocation		
Asset Class	**August 2010**	**Long-Term Target**
Global Equity	58.5%	45%
Fixed Income	36.2%	33%
Private Equity	1.4%	8%
Diversified Real Estate	2.4%	8%
Hedge Funds	0%	5%
Cash	1.4%	1%

ERS is more than meeting its long-term investment goals, although the unfavorable investment markets in 2008, 2009, and the early 2000's have resulted in short-term returns that are lower than the actuarial assumed return of 8%.

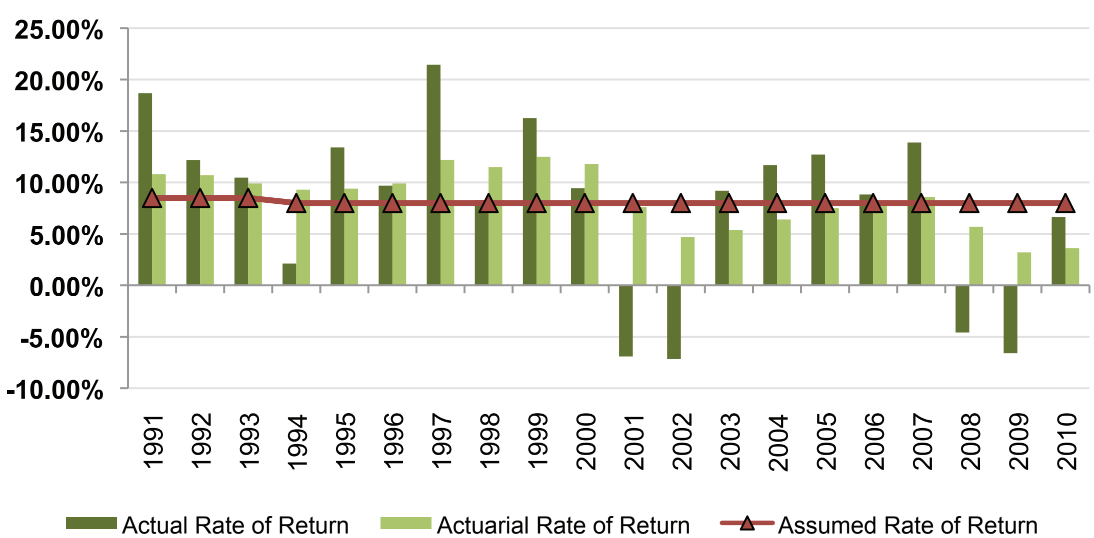
Annualized Returns as of August 31, 2010	
30 year	8.54%
10 year	3.42%
5 year	3.33%
1 year	6.65%

For purposes of discounting future liabilities, ERS assumes long-term investment returns at the average rate of 8%, which is consistent with most state pension plans. ERS reviews capital market theories annually and conducts asset/liability studies at least every five years.

ERS' actual returns have exceeded its assumed return 14 out of the last 20 years.

Actual investment gains and losses are recognized in the retirement plan over time to help offset short-term market volatility and stabilize the contribution rates needed from employees and the state. These are listed as "actuarial returns" in the chart below.

History of ERS Investment Returns
Comparison of the Actual, Actuarial and Assumed Rates of Return

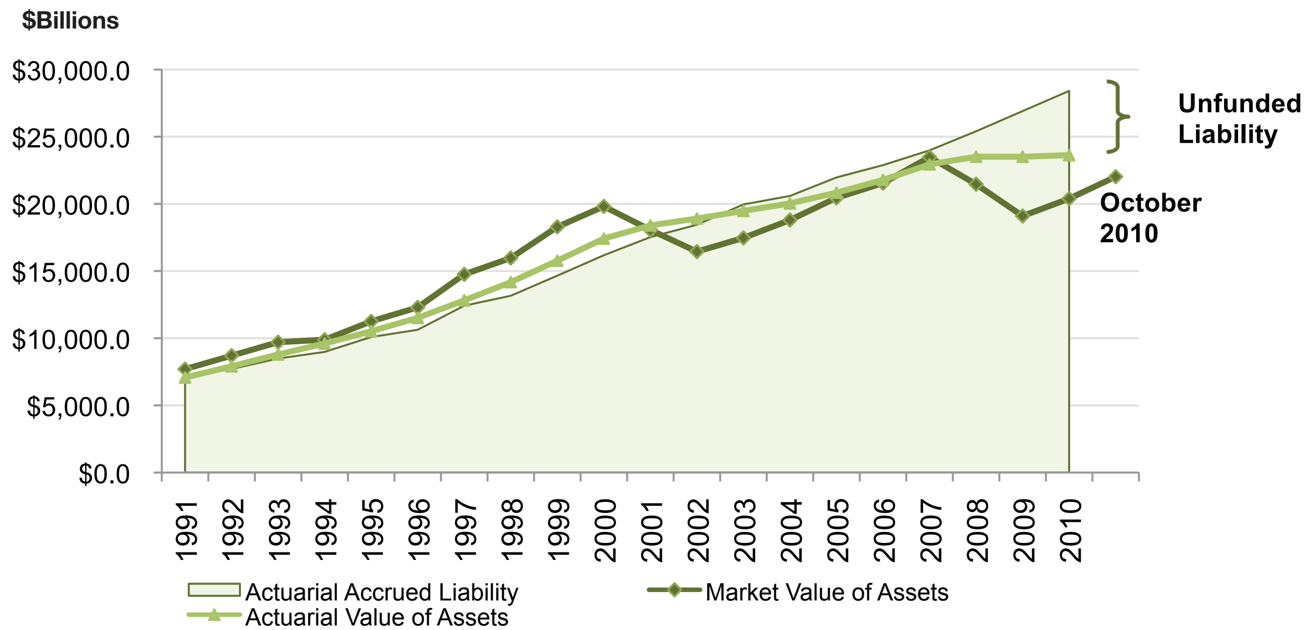


Investments and Assets

Because investment gains and losses are smoothed over time, the market value of assets and actuarial value of assets are rarely the same. Over the past two decades, there have been periods when the market value has been both above and below the actuarial value. It is also important to note, that the actuarial value of assets is a one-day snapshot as of the fiscal year end date. Over the course of the year, the actual market values rise and fall with the values of investments.

The retirement plan's liability is an actuarial figure based on the plan's membership as of the last day of the fiscal year, and certain demographic and economic assumptions. The actuarial value of assets, or the smoothed value, is used for purposes of calculating unfunded accrued liability.

History of ERS Investment Returns
Comparison of the Market and Actuarial Asset Values to Plan Liability



Analysis of Actuarial Sound Contribution rate

FY2007 – FY2010

At the end of fiscal year 2002, ERS remained well funded with a net asset balance that was $460 million more than its accrued liability. The imbalance between ERS' assets and liabilities has been occurring since 2003, following a period when regular retiree cost-of-living adjustments were made and contributions were less than normal cost.

However, investment returns during this period were well above the assumed rate and more than offset the difference between the benefits and contributions.

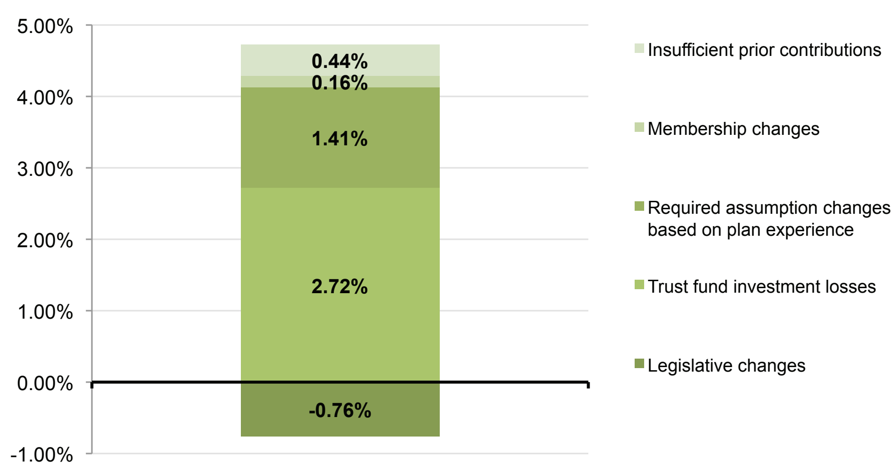
Also in the years leading up to and immediately following 2003, various statutory changes and policies were enacted that provided more ways for employees to add service credit, become eligible to retire earlier, and encourage individuals to retire early through monetary incentives and elimination of retiree return-to-work restrictions. These types of policies can have a dual negative impact on the retirement plan if they cause a trend in early retirements, because ERS must adjust the retirement rate assumption used to calculate the value of future benefits. Action taken by the 81st Legislature through House Bill 2559 mitigated some of the effect of these changes. The longer-term impact of HB 2559 will be evident when ERS conducts its next experience study.

The effect of the imbalance between benefits and contributions, investment losses, and recognition of early retirements is reflected in the increasing actuarial sound contribution rate that began at the end of fiscal year 2008.

As shown in the charts below and at the bottom of page 9, following many years with a stable actuarial sound contribution rate, ERS has experienced an increase of almost 4% since 2008, from 13.10% at the end of FY2007 to17.07% at the end of 2010.

ERS Actuarial Sound Contribution Rate				
	Fiscal Years Ending			
	2006 to 2007	2007 to 2008	2008 to 2009	2009 to 2010
Year-to-year increase/(decrease)	**-0.10%**	**2.35%**	**0.39%**	**1.23%**
Explanation of Increases				
Insufficient prior contributions		0.06%	0.15%	0.23%
Membership changes		0.35%	-1.7%	-0.02%
Required assumption changes based on plan experience		1.41%	0.00%	0.00%
Trust fund investment losses		0.53%	1.17%	1.02%
Legislative changes		0.00%	-0.76%	0.00%

Change in ERS Actuarial Sound Contribution Rate
2007 - 2010



ERS' base requests for retirement are at the state contribution rates currently in place. The base request covers the normal cost of benefits but is not enough to pay off outstanding liabilities.

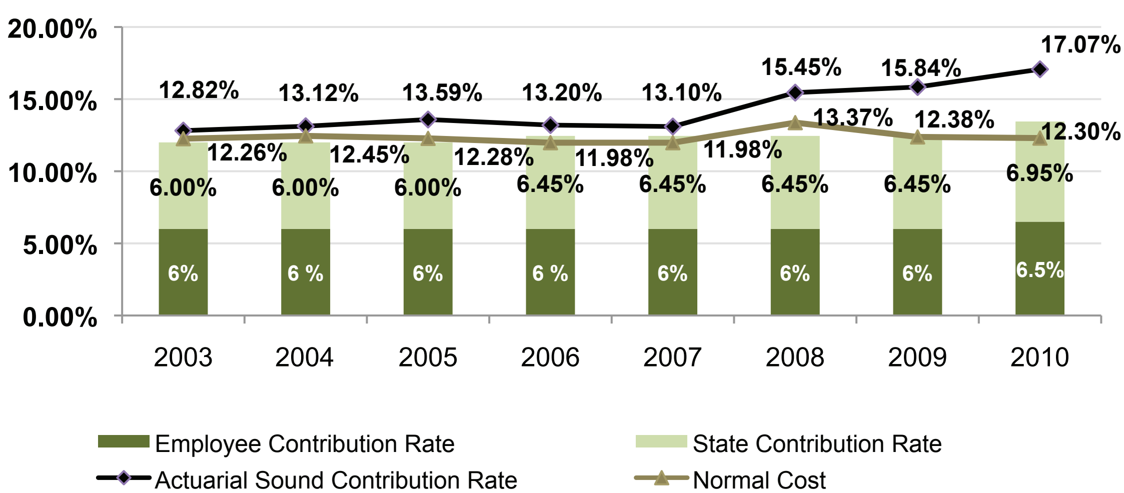
Retirement Base Requests			
	2012	2013	Biennium Total
ERS @ 6.95% of payroll	$ 407,055,299	$ 407,055,303	$ 814,110,602
LECOS @ 1.59% of payroll	23,848,390	23,848,391	47,696,781
JRS II @ 16.83% of payroll	11,366,057	11,366,058	22,732,115
JRS I	27,245,110	27,245,110	54,490,220
Public Safety Benefits	6,048,207	6,048,207	12,096,414
Retiree Death Benefits	8,0880,040	8,088,040	16,176,080
Total Base Request	**$ 483,651,103**	**$ 483,651,109**	**$ 967,302,212**

ERS will request exceptions totaling $627,019,775 in order for ERS to receive the constitutional maximum contribution rate of 10%, and for LECOSRF to meet the actuarially sound standard under Texas law, based on its August 31, 2010 actuarial valuation.

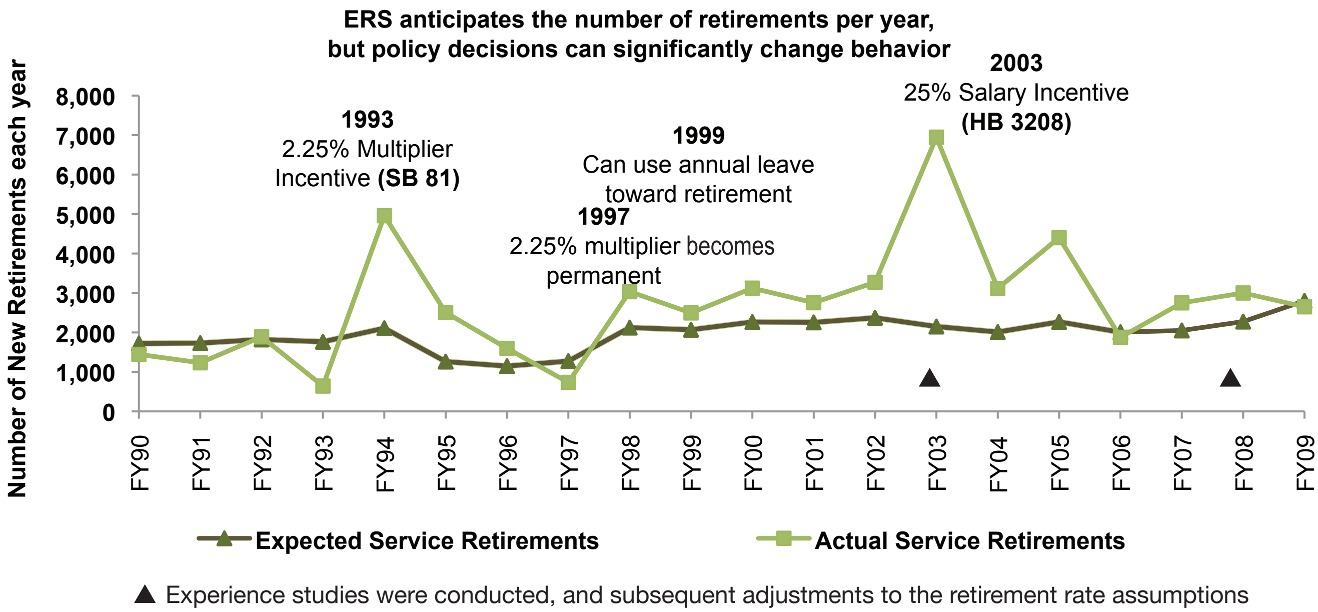
In order for ERS to meet Texas' actuarially sound standard, the contribution rate would need to be increased by an additional 0.57% of payroll, or $67,016,962, above the exceptional item request for ERS listed in the table below.

Retirement Exceptional Items - Updated						
	2012		2013		Biennium Total	
	GR & GR Dedicated	All Funds	GR & GR Dedicated	All Funds	GR & GR Dedicated	All Funds
ERS - Increase of 3.05%	$114,450,818	$181,236,449	$114,450,818	$181,236,449	$228,901,636	$362,472,898
LECOS - Increase of 0.63%	8,492,871	9,329,750	8,492,871	9,329,750	16,985,742	18,659,499
Total Exceptional Requests	**$122,943,689**	**$190,566,199**	**$122,943,689**	**$190,566,199**	**$245,887,378**	**$381,132,397**

History of Actual vs. Needed Contribution Rates



Potential Pension Issues



Strategies intended to reduce state workforce

The impact on the retirement plans should be carefully weighed when considering policies that will reduce the state budget through reduced payrolls. Often, a policy that can be positive for the budget can have a lingering negative effect on the retirement plan. This is particularly true when the policy is applicable to individuals that have met or are near to meeting the retirement eligibility requirements. As shown on page 7, changes that cause a trend in early retirements, have a double negative impact on the retirement fund.

Retirement incentives have proved to be very popular and effective in moving employees off of the state payroll, and onto the retirement trust fund payroll. When members retire in numbers that are higher than anticipated and funded, as reflected in the following table, it increases the amount of money the plan needs to be actuarially sound.

Furloughs and layoffs could easily become a retirement incentive. 13% (about 18,000 people) of the current state workforce is eligible to retire, but continue to work. Many of these workers may choose to retire instead of taking reduced pay, or a reduced retirement benefit. Again, this compounds the retirement plan's funding issue.

Strategies that could have unintended effects

Cutbacks in the health insurance program, particularly if they are applied to one set of employees, may increase an urgency to retire by members who mistakenly believe they can "lock in" their insurance benefits. The State has consistently communicated that insurance benefits can and will change based on available funding.

Potential changes to pension accounting and reporting

The Governmental Accounting Standards Board (GASB) has proposed a new set of accounting reporting standards for public sector pension plans. While GASB says the new standards are not intended to determine a plan's funding needs, the proposals could significantly change public pension actuarial methods and have a corresponding effect of increasing funding pressures.

It is also important to note, that one proposal moves responsibility for any unfunded liability from the retirement plan to the employing governmental entity, and subsequently would requiring reporting of the unfunded obligation on the government's financial statements. Deliberation of the GASB proposals is ongoing. Final statements are not expected to be issued until June 2012.

Texas Employees Group Benefits Program

Financial Status

Summary of Health Plan Experience (including higher education)

(through September 2010)

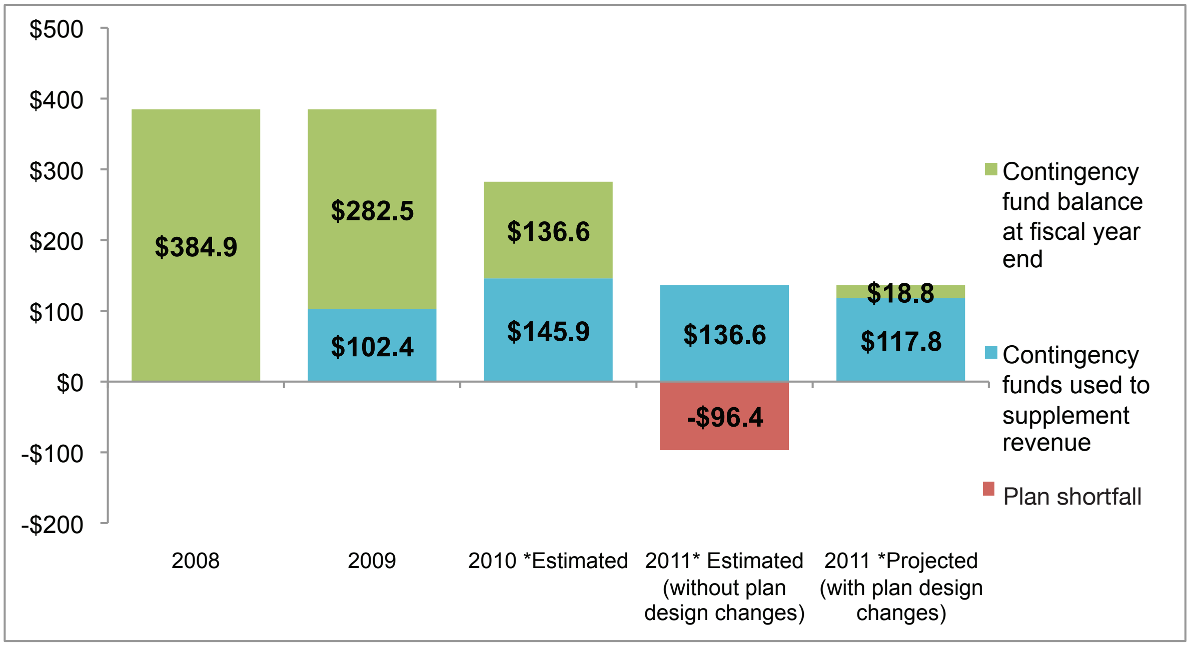
	$Millions		
	FY09	FY10* Estimated	FY11* Projected
Revenue from State/Members			
State Contribution - State Agency	$1,076.7	$1,184.3	$1,279.1
State Contribution - Higher Education	436.9	476.8	514.9
Contribution - Other[1]	34.6	47.1	50.9
State Employee Contribution - Total	$1,548.2	$1,708.2	$1,844.9
Member Contribution	336.0	371.0	401.5
Total Contributions	$1,884.2	$2,079.2	$2,246.4
Revenue from Other Funding Sources			
Refunds, Rebates and Part D Subsidy	$93.8	$93.5	$120.5
Net Investment Income[2]	37.5	26.7	(8.2)
Total revenue from other sources	$131.3	$120.2	$112.3
Total Revenue	$2,015.5	$2,199.4	$2,358.7
Health Care Expenditures			
Plan	$2,117.9	$2,345.3	$2,476.5
Total Expenditures[3]	$2,117.9	$2,345.3	$2,476.5
Net Gain/(Loss)	($102.4)	($145.9)	($117.8)
Fund Balance	$282.5	$136.6	$18.8
Other Expenses incurred outside the fund			
Member Cost Sharing	$461.6	$498.5	$658.2

[1]Non-state employee groups

[2]Net investment income represents the excess of investment income over ERS operating expenses related to the insurance program.

[3]Revenue and expenditure amounts for FY11 are based on projected enrollment growth of 1% from FY10 to FY11.

GBP Contingency Fund (in $millions) *(through September 2010)*



Estimated FY2011 projections of the contingency fund balance are shown before and after 5% of costs were shifted to members through plan design changes on September 1, 2010.

Without plan design changes, the contingency fund would have seen a $96.4 million shortfall. The $96.4 million shortfall is smaller than the $142.9 million projected in FY10, because of the positive impact on the fund of the AWP lawsuit and some small unrealized gains.

The projected $18.8 million positive balance at the end of the FY2011 fiscal year is mainly due to activation of the Most Favored Nations clause of the HealthSelect[SM] of Texas contract, which adjusts the terms of the HealthSelect contract to the most favorable contract in effect among comparable plans.

Assessing the Impact

Of Approved Benefit Changes on FY2011 Costs

Many have asked how much the September 1, 2010 changes will cost our participants. Because everyone uses the plan differently, there is no such thing as an average person or average cost—some people will pay more, and others will pay less. For example, 17% of participants had no medical costs last year. Here's a closer look based on last year's expenses.

Physician Office Visit Copayment Change	
PCP visit change to $25	38% of participants did not visit a primary doctor 20% of participants had 1 visit 14% of participants had 2 visits **Based on this plan change, the cost for 72% of participants would increase by $10 or less a year for primary care**
Specialist visit change to $40	52% of participants did not visit a specialist last year 19% of participants had 1 specialist visit 10% of participants had 2 specialist visits **Based on this plan change, the cost for 81% of participants would increase by $20 or less a year for speciality care**
HealthSelect Coinsurance Stop Loss Change	
Coinsurance change to: $2000 network/ $7000 out of network/ $3000 out of area	29,389 active participants or 5.9% of the total participants reached their coinsurance maximum 5,065 retired participants or 1.0% of the total participants reached their coinsurance maximum 3,735 unclassified participants or 0.7% of the total participants reached their coinsurance maximum **Based on this plan change, 93.4% of participants would not be affected**
Inpatient Copayment Change	
Inpatient copayment change to: $150 per day/5 day max	44,250 participants had a hospital admission or approximately 9% of the participants Of these participants, 64% had a hospital stay of 4 days or less **Based on this plan change, 91% of participants would not be affected**
Emergency Room Copayment Change	
Emergency room copay change to $150	78,569 (16%) of HealthSelect participants had an emergency room visit **Based on this plan change, 84% of participants would not be affected**
Prescription Drug Copayment Change	
Prescription drug copayments change to Tier 1 $15/Tier 2 $35/Tier 3 $60	232,779 or 46.6% of participants utilized a tier 1 drug at least once 223,371 or 44.7% of participants utilized a tier 2 drug at least once 90,375 or 18.1% of participants utilized a tier 3 drug at least once Tier 3 drugs are the most expensive because lower cost alternatives are available
Chiropractic Care	
Chiropractic care change to 30 visits per year with a $75 maximum charge per visit	18,500 or 3.7% of participants received chiropractic care 1,461 had more than 30 visits 7,585 visits were more than $75 **Based on this plan change, 94.3% of participants would not be affected**
Urgent Care	
Lower non-emergency care copayment of $50	5,500 or 7% of all emergency room visits were for non-emergency care They would have saved $275,000 using this lower copay
High Tech Radiology	
$100 copay on all CT Scans, MRI and Nuclear Medicine +20% coinsurance	39,550 procedures were performed

Update on OPEBs

Other Postemployment Benefits

What are OPEBs?

The Employees Retirement System (ERS) administers OPEBs (health and basic life insurance) under the Group Benefits Program (GBP), for retired employees from the following employers:

- State agencies,
- Certain quasi-state agencies and Community Supervision and Correction Departments, and
- Public higher education institutions, other than the University of Texas and Texas A&M University Systems.

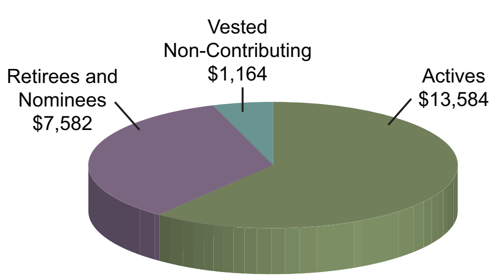
Governmental Accounting Standards Board (GASB) Statement No. 43 requires ERS to include OPEB information in the Notes to the Financial Statements and Required Supplementary Information included in its Comprehensive Annual Financial Report (CAFR). The Texas Comptroller of Public Accounts uses that information to prepare the State of Texas CAFR.

ERS is required to report the projected OPEB ARC, but employers are not required to fund those costs.

OPEBs are funded on a pay-as-you-go basis

The State funds health insurance benefits, including OPEBs, on a pay-as-you-go (PAYGO) basis. These benefits are not advance funded. Under PAYGO funding, annual employer contributions should equal annual benefit costs.

Actuarial Accrued Liability of OPEBs by type of member (FY10)
(in millions $)



In contrast, GASB No. 43 requires ERS to calculate and report the annual amounts that would be required to advance fund all future OPEBs for current, retired and terminated vested employees.

The methodology used to make such calculations is similar to the methodology used for the advance funding of retirement benefits. Although GASB No. 43 requires that the OPEB ARC be reported, there is no requirement that the employers contribute at that level. If employer contributions are less than the ARC, the deficiency is reported in the CAFR as Required Supplementary Information.

GBP OPEB Valuation Results (FY07-FY10) (in millions $)

	FY07	FY08	FY09	FY10
Unfunded Actuarial Accrued Liability (UAAL)	$17,67	$20,131	$21,992	$22,330
Normal Cost	$716M	$940	$1,044	$1,045
Amortization of the UAAL	$766	$874	$954	$970
Annual Required Contribution (ARC)	**$1,482**	**$1,814**	**$1,998**	**$2,015**
Normal Cost as a percent of payroll	8.1%	10.0%	10.4%	10.0%
Amortization as a percent of payroll	8.7%	9.4%	9.5%	9.3%
Annual Required Contribution (ARC) as a percent of payroll	16.8%	19.4%	19.9%	19.3%

What affects OPEB projections?

Recent benefit changes lowered the total unfunded liability estimate by $1.7 billion.

OPEB projections can change due to a number of factors, including:

- Changes in the health benefit cost trend,
- Demographic changes among the plan's membership,
- Changes in the benefits, and
- Changes in eligibility for benefits.

The GBP health plan benefit changes that increased member cost sharing effective September 1, 2011, had the effect of reducing the OPEB UAAL by about $1.7 billion below the level that otherwise would have been reported as of August 31, 2010.

Fiscal Year 12-13

Base Request for Health Insurance

Assuming Current Levels With Legislative Budget Board (LBB)
Adjustments as Base for All Programs
Request is for state agencies only

Provide Employees and Retirees with Quality Health Program

Manage GBP for State & Higher Education Employees
GBP - GENERAL STATE EMPLOYEES

Requested 2012	Requested 2013	Requested 2012-2013 Base	Projected 2010-2011	Increase
$1,250,491,206	$1,250,491,209	$2,500,982,415	$2,463,561,665	$37,420,750

How was the insurance base request determined?

The Legislative Budget Board sets the baseline request. The $2.5 billion is less than the current cost to provide health care to GBP participants. The LBB used the following formula to determine the baseline-funding amount:

LBB - Projected FY 10 and FY 11 GBP expenditures	$ 2,463,561,665
LBB - Minus 5% ($75.8 million) reduction in GR/GRD, converted to all funds $	$ -122,772,724
LBB - Plus $98.9 million for the spend-down of the GBP contingency reserve fund, converted to all funds $	$ +160,193,474
LBB Base funding level for FY 12 (Total Base $2.5 billion Divided by 2)	$ 1,250,491,208
ERS - FY 11 Projected Expenditures including reserve fund spend down (current annual spending level)	$ 1,340,543,662
ERS - Annual shortfall of LBB base below current levels before health benefit cost trend increases	$ - 90,052,455

Fiscal Year 2012-13 Exceptional Items for Health Insurance

	GR and GR Dedicated for 2012	All Funds for 2012	GR and GR Dedicated for 2013	All Funds for 2013	GR and GR Dedicated for 12-13 Biennium	All Funds for 12-13 Biennium
Funding needed to maintain plan benefits	$137,286,858	$222,322,830	$218,139,566	$353,255,995	$355,426,424	$575,578,825
Funding needed for 60 day Reserve Fund	$91,987,431	$148,964,776	$100,163,023	$162,204,358	$192,150,454	$311,169,134

If the GBP received baseline level funding, could the program operate without benefit changes?

No, funding at this level would not be enough to maintain the existing plan benefits or structure.

The effect of the averaging, plus the 5% total reduction, puts the baseline figure $90 million under the actual amount the plan is projected to pay in health and prescription claims in FY11. It provides no additional funds for increased costs from rising costs, health care reform and replacing other sources of revenue the plan has used instead of State funding.

What type of benefit changes would the plan have to make to operate at the baseline funding level?

The administrator's statement in the LAR lays out two alternatives to deal with funding at the baseline level. It's important to note that under both alternatives, participants would not have to pay for preventive health care expenses. Federal health care reform requires plans to provide preventive care at no cost beginning in FY 2012.

1. Legislatively change the premium contribution strategy to require all employees and retirees to contribute towards the plan. Instead of the current State contribution of 100% of the employee and retiree premium, the State would contribute 80%. The dependent contribution would decrease from the current 50% of premium to 40% of premium.

2. Restructure the plan as a high deductible health insurance plan with two options:
   a. Each plan participant would pay the full cost of health and drug expenses up to $2,400, with the plan covering 80% of expenses after satisfying the deductible, or
   b. Each plan participant would pay the full cost of health and drug expenses up to $3,400, with the plan covering 100% of expenses after satisfying the deductible.

How much money does the plan need in order to stay essentially the same as it is today?

The plan needs $575.6 million all funds for state agencies to maintain existing benefits at the projected increased cost. Medical inflation accounts for $417.7 million of that amount. The State would also have to replace the $111.6 million that was spent from the contingency reserve fund to cover unappropriated health and drug costs.

The plan also will need to comply with federal health care reform and provide certain preventive services at no cost to the member. ERS estimates this and other health care reform provisions could cost the plan $46.2 million.

Does the plan have any reserves that can provide some of this funding?

By the end of FY11, the health plan will have nearly depleted the contingency reserve fund (estimated ending balance of about $20 million) that has been used to supplement State appropriations to cover plan costs. Using this fund has created a structural deficit where the appropriations have consistently been lower than actual costs.

In addition to this contingency reserve fund, Texas Insurance Code, Sec. 1551.21 requires a reserve fund equal to 60 days of claims payments. ERS requested $311.2 million as an exceptional item, as required.

Can the plan cut costs to meet the funding level?

ERS cut costs about 5% for FY11 through a variety of methods, including raising member copays for higher cost services when lower cost services are available, such as increasing high-tech radiology copays.

The plan can cut other costs by restricting provider choice, limiting coverage, shifting costs, lowering provider reimbursement and charging certain groups, such as smokers, more for their insurance. We do not expect that these changes could save enough money to preserve the plan as it is today.

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Texas Employees Group Benefits Program Other Cost Considerations

	Background	Impact on State Budget
Dependent Eligibility Audit	HB 2559 clarified the definition of an eligible dependent in anticipation of the upcoming audit. ERS will conduct a 100% dependent eligibility audit this biennium to identify and remove ineligible dependents from the insurance plan.	The Dependent Eligibility Audit is expected to create a one-time savings through the removal of 3% to 4% of dependents from the plan. A future audit will be scheduled if the current audit reveals an unusually high number of ineligibles. Based on the FY09 average healthcare cost of a dependent (spouse or child), a 3% reduction in the number of covered dependents could reduce health plan expenses by $20 million.
Dependent Premium Surcharge *(when they have access to other coverage)*	As a group, the most expensive HealthSelect participants are dependent spouses. Eight of the top 10 highest HealthSelect claims are paid on behalf of dependents. 26% of HealthSelect participants report that their dependents have access to other health care coverage, but are enrolled in GBP coverage.	Adding an alternative coverage surcharge would have a positive impact on claims costs if dependents (a) opted out of HealthSelect, and/or (b) made HealthSelect secondary payer. No impact on the state budget as the surcharge would be above and beyond state contribution. Excess revenue from the surcharge would be utilized to offset health claims costs.
Therapeutic substitution of generic equivalent	Currently in the PDP, when a physician allows generic substitution on the prescription form, the pharmacist may substitute a generic drug that is the same chemical entity in the same dosage form as the prescribed drug. Therapeutic substitution would automatically replace a physician-prescribed brand-name drug with a chemically different generic drug within the same therapeutic category. A member who chose to fill the brand-name drug would pay the difference.	The HealthSelect generic dispensing rate (GDR) is 66.8%, compared to a “best-in-class” GDR of 72% for the most successful plans. Each 1% increase in the GDR reduces overall prescription drug costs by more than 2%. For example, a 5% increase would reduce overall prescription drug costs by an estimated $45 to $46 million.
Tiered/ Restricted Provider Network *(medical and/or pharmacy)*	HealthSelect provides two levels of benefits for medical providers: in-network and out-of-network. Currently members can fill prescriptions at any retail pharmacy or by mail service. The goal of a tiered network is to reduce costs by steering participants to the most cost-effective providers. A tiered network would preserve choice but stratify member out-of-pocket costs. A restricted network would reduce access.	A tiered medical provider network (including physicians, hospitals, free standing facilities and lab and imaging) could provide a potential savings of $35-$40 million annually. Eliminating all but two major chain pharmacies from the pharmacy network could save up to $10.4 million by generating a 2.5% reduction in brand name costs at retail.
Tiered Retiree/ retiree dependent premium contribution *(based on years of service)*	In a survey on cost savings ideas for the health plan, most members favored the idea of basing retiree contributions on years of service. For example; the state would contribute 50% for retirees with 10 yrs of service; 75% for 15 yrs; and 100% for 20+ yrs.	No direct impact on claims costs. Potential risk that healthier retirees would drop coverage which could lower revenue (fewer contributions). Savings would depend on the breadth of the change and the extent of the grandfathering. An additional consideration would be the potential impact on the ERS pension fund. Utilizing the current contribution rates, applying this method of tiering contributions for retirees to all current and future retirees would reduce the state’s contribution (from all sources including higher education) to the health plan by $53 million.

Senate State Affairs Committee

November 15, 2010

Estimated Cost Impact of Federal Health Care Reform

Estimated cost impact of selected federal health reform (PPACA) provisions on the Texas State Employees Group Benefits Program		
Provision	**Notes**	**Potential GBP Cost Impact**
Provides Free Preventive Care. All new plans must cover certain preventive services (ex. mammograms and colonoscopies) without charging deductibles, co-pays or coinsurance	The requirement to provide free preventive care has a potential cost impact to the plan of $46 per person. This does not include prescription drugs or nonprescription medications.	Increased cost 9/1/2011 (est. $14.2M in FY12; $15.5M in FY13)
Covers dependents up to age 26. The federal law requires plans to cover all children, regardless of marital status. It may allow previously excluded children back into the plan.	GBP covers all unmarried children up to age 25. There are 5,500 children age 25 who could rejoin the GBP.	Increased cost 9/1/2011 (est. $7.7M in FY12; $8.4M in FY13)
Eliminates Lifetime Limits on Insurance Coverage. Insurance companies cannot impose lifetime dollar limits on essential benefits, like hospital stays.	The GBP has a $1 million lifetime limit on out-of-network coverage. No limits apply to other coverage.	Increased cost 9/1/2011 (est. $87K in FY12; $101K in FY13)
Imposes Plan Sponsor Fees. Charges plan sponsors a $1 fee per covered life in 2013 and $2 fee per covered life in 2014. From 2014 to 2019, the fee is based on the percentage increase in health care costs.	The GBP covers 530,000 lives.	Increased cost 9/1/2013 (est. $309K in FY13)
Creates an Early Retiree Reinsurance Program. Allows ERS to apply for reimbursement of claims for retirees older than age 55 who are not qualified for Medicare. Reimbursement is for 80% of the cost of claims between $15,000 and $90,000.	The GBP application to apply for reimbursement was approved. $5 billion of federal funds are available nationwide. The potential positive impact on the GBP would be $60 million, if the GBP is reimbursed for eligible expenses.	Potential revenue for FY11 and FY12
Limits flexible spending account contributions. TexFlex contributions will be limited to $2,500 a year starting January 1, 2013.	Current annual limit is $5,000; 15% of TexFlex participants contribute more than $2,500	State's FICA tax will increase 1/1/2013
Limits waiting periods. Coverage waiting periods cannot exceed 90 days.	GBP coverage starts the first day of the month after the 90 day wait.	Increased cost 9/1/2014
Limits on increased member cost sharing. PPACA could limit the plan's options for increasing member costs in the future.	For example, if a member's health care contribution exceeds a certain percent of their household income, they could opt out of the GBP and get coverage from the exchange. In that case, the plan could be assessed penalties.	Potential increased cost 9/1/2014
Imposes a Cadillac Plan Excise Tax. Imposes an excise tax on "Cadillac Plans," defined as employer-sponsored health plans with aggregate values exceeding $10,200 for individual coverage and $27,500 for family coverage, an amount that will be adjusted for inflation in the future.	GBP does not currently meet the threshold for a "Cadillac Plan."	Neutral, may increase future costs. 9/1/2018
Closes the Medicare Part D "donut hole." Mandates prescription drug discounts for Medicare beneficiaries who reach the coverage gap, and gradually phases down the Medicare drug coinsurance rate to close the gap by 2020.	Unless there are structural changes to the Retiree Drug Subsidy program, closing the donut hole would not impact ERS.	Neutral