LRB-Research & Analysis Section

Finance & Personnel Committee **July 1, 2009**
File: 090223 **Aaron Cadle**

Title

Resolution authorizing the Department of Employee Relations to extend a contract for one year only through December 31, 2010 with UnitedHealthcare for insured health maintenance medical services only.

Introduction

This resolution grants a one-year contract through year-end 2010 to UnitedHealthcare ("UHC") to insure the City's insured Health Maintenance Organization ("HMO"). UHC proposes to raise HMO premium rates 20.40% across the board.

The City must offer employees an insured HMO under existing labor contracts. The DER informs the LRB the Milwaukee Police Association union and Local 215 of the Professional Firefighters union have informally agreed to allow the City to replace its insured HMO with an Exclusive Provider Organization ("EPO"). An EPO is essentially a self-insured HMO enabling the City to act as its own healthcare insurer and pay healthcare claims directly much as it does under the City's Basic Plan.

DER expects all future labor contract agreements will allow the City to replace its insured HMO with an EPO. Healthcare insurers have been increasingly reluctant to provide the City with an insured HMO in recent years. This year, UHC was the only insurer responding to the City's insured HMO request for proposals. DER is concerned there may be no insured HMO bidders in the near future.

The City Review Team recommends adoption of this resolution. City Review Team members include:

Mike Brady	DER - Employee Benefits Division
Jim Michalski	Office of Comptroller
Katrina Whittley	DER – Employee Benefits Division
Ed Reyes	DER – Business Section
Renee Joos	Budget Office
Nicole Fleck	DER - Labor Relations Section
Aaron Cadle	Legislative Reference Bureau

Background

The City offers employees two healthcare benefit plans, an insured HMO program where the City pays healthcare insurance premiums (less any contribution paid by employees) to an insurer and claims are paid by said insurer, and the Basic Plan, a self-insured plan where the City acts as it own insurance company and pays claims directly after a third-party administrator approves payment.

The HMO does not include prescription medication coverage. Prescription medication benefits are paid directly by the City in a self-insured program administered by Navitus.

UHC, the City's 2008 HMO provider, was awarded a one-year HMO contract for 2009 after UHC proposed a 9.99% premium increase. Competitive bids for the 2009 HMO contract were not sought because UHC's 2009 premium bid was lower than the 2008 bid proposed by Humana (the City's 2007 HMO provider) and informal inquiries indicated Humana would not bid less to win City's 2009's HMO contract than it bid for 2008's contract.

The following compares UHC's proposed 2010 monthly HMO premiums for active employees to premium rates paid in 2008 and 2009:

Monthly HMO Premiums - Active Employees			
UnitedHealthcare (UHC)	'08 Actual	'09 Actual	'10 Proposed
Single Coverage	$ 403.75	$ 444.08	$ 534.67
Family Coverage	$1,102.49	$1,212.63	$ 1,460.01

As of May, 2009, 5,728 active employees were enrolled in the City's HMO, up 350 from August, 2008, apparently indicating a migration from the City's Basic Plan to the HMO, and 1,555 retirees, about the same as in August, 2008. Based on May, 2009, enrollment, UHC's 20.40% premium increase will result in an aggregate annual cost increase of nearly $17 million (before reduction for any employee-paid share of premiums).

Discussion

Background – UHC's 2010 HMO Premium Quote

UHC's proposed 20.40% HMO premium rate increase for 2010 was calculated as follows:

1. **Cost Trend Line Projection:** UHC first estimated the cost trend line for healthcare claims during the quote period was 12.48% - meaning UHC

predicted the cost of healthcare claims would increase 12.48% per annum from May, 2009, (the quote date) until December, 2010, (the end of the proposed contract period). This 12.48% cost trend line is based on UHC’s paid claims experience – the combined history of all healthcare claims paid by UHC through its insured HMO programs including the City’s HMO.

2. **Projected Healthcare Claims for the City’s HMO:** UHC then applied its cost trend line to the paid claims history of Milwaukee’s insured HMO and determined premiums for the City’s HMO would need to increase 13.81% (compounding effect of 12.48% over 20 months) simply to pay projected future healthcare claims. This 13.81% increase represents the minimum premium UHC would need to pay expected healthcare claims. Any increase less than this 13.81% would result in UHC paying more in claims than it receives in premiums – a loss ratio in excess of 100%. At the minimum, premiums must equal or exceed paid healthcare claims – have a loss ratio equal to or less than 100% - if an HMO is to remain viable.
3. **Target Retention Rate:** Once UHC predicted the HMO premium needed to pay expected future healthcare claim costs it increased this basic cost premium by its expected retention rate. A retention rate is the portion of the HMO premium the insurer needs to cover overhead – i.e. claims processing, administration, premium taxes, etc. – and to earn a profit. UHC maintains its target retention rate is 16.09%. Retention rates are determined internally by the insurer based entirely on proprietary factors, and may include subjective considerations. While the City and Willis, the City’s healthcare insurance consultant, may make educated guesses on the components of UHC’s retention rate, the true rationale and basis for UHC’s retention rate remains opaque to those outside the company.
4. **UHC’s Final 2010 HMO Premium Rate Proposal:** After predicting expected healthcare claim costs for the City’s HMO and increasing this basic cost premium rate by its retention rate, UHC determined the City’s HMO premium rate should be increased 35.64% - meaning, based strictly on the math of its analysis, Milwaukee’s HMO premium rates should be increased 35.64%. However, without explanation, UHC proposed the premium rate increase be held to 20.40%.

With only a single proposal for the City’s insured HMO, the City Review Team’s analysis was somewhat hampered. The Team first analyzed UHC’s insured HMO premium rate proposal to determine if it seemed reasonable both on its own merits and when compared to healthcare industry market trends, and then discussed the possibility of switching the City’s insured HMO to a self-insured EPO program.

The Review Team concluded UHC’s 20.40% premium increase proposal was reasonable based heavily on Willis’ assessment that such an increase, though quite steep, made sense based on the paid claims history of the City’s HMO, general healthcare claim cost trends in the marketplace and prevailing industry retention rates.

Because an EPO is essentially an insured HMO in which the insured (the City) acts as its own insurer – in a City-insured EPO the City of Milwaukee plays the role played by UHC in an insured HMO – Willis used the same model UHC employed to set premiums rates for the City's insured HMO to determine costs of a City-insured EPO. Willis used UHC's cost trend line to predict future healthcare claim costs - healthcare claims experience will be the same under either an insured HMO or an EPO – and then used a retention rate of 7.40% to determine that the City would need to increase premium rates 22.91% to establish a viable EPO. Willis set the retention rate at 7.40% based on anticipated claims processing costs of 5.00% and a risk premium of 2.40%.

Willis' analysis indicated the City should opt for UHC's insured HMO proposal despite its 20.40% increase in premiums because the City would be forced to increase premiums 22.91% if the City created a self-insured EPO.

The LRB was concerned by UHC's unilateral decision to reduce the 35.64% premium rate increase its own analysis determined was needed to 20.40%. Using its own model, a request for a 20.40% rate increase suggested UHC was either exaggerating its cost trend line or its retention rate, or both. The LRB was assured by Willis that UHC's cost trend line was sound, leading the LRB to conclude UHC's retention rate needs were overstated in its final rate proposal.

Armed with this information, the LRB imputed UHC's actual, proposed retention rate to be 5.47% - well below its target of 16.09%.

Convention wisdom holds the retention rate for an EPO will always be lower than the retention rate for an insured HMO because the insured (the City) does not need to make a profit and will be exempt from certain taxes. By lowering its retention rate to 5.47%, almost two points below the retention rate Willis projects the City will need to recoup its basic costs to administer a self-insured EPO; UHC has in effect under bid the City for the HMO contract.

The following compares Willis' EPO projection (Column C) to the LRB's imputed UHC proposal (Column B) which was based on UHC's analysis (Column A):

2010 United Healthcare HMO Quote - EPO (1) Projections Comparison

	Column A	***Column B***	***Column C***	
	United Healthcare		EPO (1)	
	Analysis	Proposal	Projection	
Annual Cost Trend Line	12.48%	12.48%	12.48%	
Current Claims Experience	$ 345.87	$ 345.87	$ 345.87	
2-year Cost Trend Line	124.06%	124.06%	124.06%	
Projected Claim Costs	$ 429.09	$ 429.09	$ 429.09	
Pooling	$ 2.91	$ 2.91	$ 2.91	
Total Projected Claim Costs	$ 432.00	$ 432.00	$ 432.00	
Retention Rate	16.09%	5.47%	7.40%	(a)
Total Proposed Premium	$ 514.85	$ 457.01	$ 466.53	
Current Premium	$ 379.58	$ 379.58	$ 379.58	
Premium Increase	35.64%	20.40%	22.91%	
Lives Covered	18,123	18,123	18,123	
Annual Premium Increase (b)	$ 29,418,229	$ 16,838,911	$ 18,910,443	
Total Annual Premiums	$111,967,769	$ 99,388,451	$101,459,983	

(1) Exclusive Provider Organization - Self-Insured Coverage

(a) Provided by Willis Consultants - 5.0% claims processing plus 2.4% risk premium

(b) Before reduction for any employee-paid share of premiums

Fiscal Impact

This resolution will increase 2010 costs for the City's insured HMO by nearly $17 million based on enrollment as of May, 2009, of 7,283 employees and 18,123 lives (members).

The City's total healthcare benefit costs are budgeted at $109 million for 2009, including HMO premiums, self-insured prescription claims and self-insured Basic Plan medical claims.

As of this date, DER projects actual healthcare benefit costs for 2009 will be $2 million to $6 million less than budgeted.

In addition, DER asserts efficiently managed self-insured prescription and Basic Plan claim payments will continue to reduce the City's aggregate healthcare costs, and DER is projecting aggregate healthcare benefit costs for 2010 between $115 million and $120 million despite UHC's nearly $17 million aggregate HMO premium increase.

DER suggests that if 2009's projected surplus is carried forward to 2010, aggregate healthcare costs could be as low as $109 million – equal to 2009 budgeted level – or as high a $118 million – only $9 million greater that 2009's budget despite UHC's 20.40% HMO premium increase.

DER's assertions are summarized as follows:

2010 HMO & Claims Healthcare DER Projected Budget Range	LOW	HIGH
2009 Budgeted HMO & Claims Expenses	$109,000,000	$109,000,000
2010 Quoted HMO Premium Increase	16,838,911	16,838,911
2010 HMO & Claims Calculated Budget Estimate	$125,838,911	$125,838,911
2010 DER Projected Healthcare Savings	(10,838,911)	(5,838,911)
2010 HMO & Claims DER Budget Estimate	115,000,000	120,000,000
2009 Surplus Carry-forward	(6,000,000)	(2,000,000)
2010 HMO & Claims DER Net Projected Budget	$109,000,000	$118,000,000