MIDDLESEX-LONDON HEALTH UNIT

REPORT NO. 068-12

TO: Chair and Members of the Board of Health

FROM: Graham L. Pollett, MD, FRCPC
Medical Officer of Health

DATE: 2012 May 17

FUNDING STABILIZATION RESERVE CONTRIBUTION FOR EMPLOYER PAID BENEFITS

Recommendations

It is recommended:

1) ***That the accrued benefit savings to December 31st, 2011, in the amount of $581,841, be shown for accounting purposes as part of the Funding Stabilization Reserve, recognizing that the funds are held with the insurance provider; and further***

2) ***That $120,000 be withdrawn from the Funding Stabilization Reserve to offset 2012 benefits costs.***

Background

Beginning in 2002, the Health Unit changed how employer paid benefits were managed. Previously, premiums were paid to the insurance company who provided the benefits to eligible employees. The insurance company would realize gains or losses on the difference between the premiums received and the actual costs of the claims paid plus the cost of administering the benefit plans.

In 2002 the Health Unit changed to a hybrid model known as "Administrative Services Only" (ASO) for group health, dental and travel insurance. Under this model, the health unit pays the costs of the benefits received by the employee plus administrative fees paid to the insurance company for handling the claims. Life, Accidental Death & Dismemberment (AD&D), and Long Term Disability (LTD) benefits continued to be insured in the traditional way with the insurance company taking the risk of profit or loss with premiums being set based on the pooled experience of many employers. MLHU pays the Life Insurance premiums for all employees, but LTD benefits are 100% employee paid.

Under the ASO model, monthly premiums were still required but any gains or losses for group health, dental and travel claims accrued back to the Health Unit in the following year.

Current ASO Balance

In fact, there have been significant gains realized since changing to the ASO model. The current balance of the accrued gains that remains with the insurer (Manulife Financial) is anticipated to total $584,241. This figure includes $581,841 plus $2,400 estimated interest to December 31st, 2011. The details of the annual experiences can be found in Appendix A. As can be seen, there are significant variations year to year, however, a benefit surplus has occurred in each of the years since moving to the ASO model. That is, each year the premiums paid more than covered the cost of the claims and the administration fees.

It can also be seen by examining Appendix A that three withdrawals totaling $287,000 were made to maintain the growth in the amount held with the insurer. These withdrawals (2002/2003; 2006/2007;

2011/2012) reduced the benefit costs for the particular operating years and contributed to the annual operating surplus which was returned to funders (City, County and Province).

Recognition of the ASO Balance

Until 2011, the ASO balance was not formally recognized in the Health Unit financial statements. During the annual audit, it was determined that the amount held by Manulife Financial had reached and in fact surpassed the materiality level set by KPMG. Therefore, an entry was made in 2011 to recognize the $581,841 amount (the $584,241 less the estimated interest of $2,400). The audited financial statements will be presented to the Board of Health at the June 2012 meeting.

In practice, keeping a balance held by the insurance company is common among municipal agencies (e.g. City of London). The reasons for this practice include:

1) The insurer requires a balance or money in advance to be able to pay claims as they arise;
2) The additional amount over the premiums paid allows for variations from month to month, and is available should an extraordinary event occur;
3) A balance allows the organization (health unit) to negotiate modest annual premium increases therefore limiting budget requirements each year; and
4) While the actual surplus or balance is known, relating it back to experience of individuals is very difficult. For health unit programs, which are funded a number of different ways (cost-shared vs. 100% funded programs), it would be difficult to determine the amount owing to each program and hence funder.

For these reasons, it is recommended that the Board of Health approve a contribution to the Funding Stabilization Reserve in the same amount ($581,841) and the use of these funds be limited to programs geared toward reducing future benefit costs and continuation of lessening the impact increases in premium rates have on future operating budgets. In addition KPMG, the Health Unit's auditor, is in agreement to the treatment of the ASO balance on the financial statements as proposed.

Funding Stabilization Reserve

The Financial Stabilization Reserve was established in 1998 when the funding for public health programs was downloaded 100% to the municipalities. The purpose of the reserve is to eliminate or lessen the impact that events may have on future budget increases. The proposed benefit surplus contribution falls within the purpose of the reserve. Also at this time, given the current balance of the ASO, staff recommends a withdrawal of $120,000 be made in 2012 to reduce the cost of employer paid benefits in 2012. This withdrawal may result in amounts owing to the City and County, but this will not be known until closer to the end of the year.

Summary

During the annual audit it was determined that the accumulated ASO surplus had reached the materiality level set by KPMG, the Health Unit's auditor. An entry was made to the 2011 audited statements to include the balance of $581,841 to recognize this amount on the Health Unit's financial statements. To ensure these funds are available for efficient and unexpected benefit payments by the organization's insurer, it is recommended that the current premium balance be recognized in the Funding Stabilization Reserve. In addition, given the size of the current balance, staff recommends a withdrawal of $120,000 to reduce the costs of employer paid benefits for this year.

This report was prepared by Mr. John Millson, Director, Finance & Operations, and Ms. Louise Tyler, Director, Human Resources and Labour Relations.

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This report addresses Policy #2-010, Appendix A – By-laws of the Middlesex-London Board of Health, By-law # 2, sections 7 (b) & (e)