Gallagher Benefit Services, Inc.
A Subsidiary of Arthur J. Gallagher & Co.

August 20, 2004

Senator Karen Krebsbach
Chair, Regulative Employee Benefits Committee
Bismarck, North Dakota

Re: Review of Proposed Bill:
50054.01 - Allows the Board to accept and expend funds from sources other than premiums; allows Board to negotiate with bidders on both price and specifications; allows Board to self-administer its programs; allows Board to establish its own independent provider network

Dear Senator Krebsbach

The following summarizes the above proposed bill and our analysis of its financial and compliance impact.

Overview of Proposed Bill

As proposed, this bill would permit PERS to do the following:

- To accept and expend funds from sources other than premiums. This would allow PERS to accept any subsidies payable as a result of the Medicare Modernization Act of 2003.
- To negotiate with bidders on competitive bids after the submission of proposals
- To self-administer should it decide to self-fund its health benefits
- To establish its own independent health provider network, which would be limited to PERS use only

Expected Financial Impact

The provision in the proposed bill to allow PERS to accept funds other than premiums in anticipation of possible Medicare prescription drug subsidies is a sound fiscal strategy. Although the rules addressing how public employers will be compensated when the subsides begin in 2006 have not yet been clarified, it is important for PERS to be in a position to accept and use any resulting funds that it

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receives from the federal government. We cannot envision any adverse financial impact to this provision of the proposed bill.

Regarding the provision in the bill to allow PERS to negotiate with bidders on price and specifications, this is a relatively common among other public sector employers that we have worked with. Some states such as New Mexico, allow a "best and final" offer after the initial proposal. Others allow the plan sponsor to negotiate with the finalist or finalists as part of contracting. If negotiations cannot be successfully concluded, the plan sponsor then turns to other proposers in some predetermined order.

As long as all bidders are given equal opportunities and the negotiation process is conducted according to established procedures, we do not contemplate any adverse financial impact to PERS from this proposed provision. If it results in more competitive proposals and creative options that would not occur under present regulations, it could financially benefit PERS and the State.

Concerning self-administration, the practice is not common at the state health plan level. We are aware of two states, Utah and Louisiana, that currently self-administer their health plans. We are not aware of any national trend towards States self-administering.

There is nothing inherent in self-administration that would cause adverse financial impact to PERS. However, there are many reasons that plans elect not to self-administer:

1. The initial cost of claim adjudication hardware and software

2. The initial and ongoing recruitment and training needs of claim staff

3. Rapidly changing technology and legislation (e.g. HIPAA) that require costly hardware and software upgrades

4. Legal liability concerns

5. Privacy concerns

6. Objectivity concerns when adjudicating claims for fellow employees

7. Fraud and security concerns.

Before considering self-administration, we suggest that PERS undertake a thorough feasibility study to determine the long-term cost and administrative impact of such a change. However, having the option to self-administer does put bidders on notice that PERS has alternatives at its disposal. This could result in more competitive bids, which would be beneficial to the State and its participating political subdivisions. This is especially true in North Dakota where the market is dominated by one carrier with little competition.

The last provision of this proposed bill would allow PERS to establish its own proprietary health provider network or work to make its existing network portable. As Gallagher Benefits Services has very recently experienced while conducting PERS' medical RFP project, no managed care organization other than BCBSND has an established statewide physician and hospital network. Financially, it is not feasible for other carriers to establish a provider network unless they were assured of PERS' business. Until such time as BCBSND agrees to allow other organizations to access the existing PERS PPO and EPO networks, it is unlikely that PERS will be able to attract other bidders on its medical plan. Please note that PERS does presently have its own PPO network and EPO networks that were developed with BCBS as part of the present PERS/BCBS insurance plan. Therefore, the issue is not that PERS needs to create its own PPO network but rather making its existing PPO network portable.

Although PERS having its own independent network provides no guarantee of more favorable provider discounts, it would make the medical plan less dependent on one provider and perhaps improve PERS negotiating power with providers. It could also create a more competitive environment with carriers and TPAs having equal access to the same provider network.

Maintaining an independent provider network is not a simple task. PERS or its designee would need to manage these functions:

- Initial and ongoing provider credentialing
- Contracting
- Fee schedules
- Provider relations
- Appeals and grievances
- Disciplinary actions
- Provider recruitment

In conclusion, we see no inherent adverse financial impact to PERS from any provision of this proposed bill. In fact, to the extent that this bill would create a more competitive environment for PERS' health plan business, it could result in lower costs. For example, if increased competition just reduced costs by ½%, the resulting savings to PERS would be almost $1.2 million per year. If passed, it would give PERS more flexibility in the areas of contract negotiations, accepting outside funds, evaluating self-administration and establishing its own health provider network. If given the legislative freedom to pursue these concepts, PERS could evaluate each on its own merit as to potential short and long term cost savings that it would provide.

Please let me know if we can provide any additional information this proposed bill.

Sincerely,

William F. Robinson, Jr.

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Area Vice President

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