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Report to the Chairman, Committee on
Post Office and Civil Service
House of Representatives

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INSURANCE REFUNDS

Allocation Inequities in the Federal Employees Health Benefits Program

AO/HRD-86-52

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GAO

United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

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January 27, 1986

The Honorable William D. Ford
Chairman, Committee on Post Office
and Civil Service
House of Representatives

Dear Mr. Chairman:

In response to your March 18, 1985, request, we have reviewed the Federal Employees Health Benefits Program (FEHBP) reserves and the subsequent decision to refund about $1 billion in excess program funds. This interim report discusses the proposed method endorsed by the Office of Personnel Management (OPM) for dividing the refund between the government and the enrollees. A more comprehensive report on FEHBP reserves and alternatives for disposing of them, including the advantages and disadvantages of using a refund, will follow.

We have found that OPM's proposed method inappropriately divides the refund between the government and the enrollees. For some plans, the enrollees receive too little of the proposed refund and the government too much. For other plans, the enrollees receive too much and the government too little. Overall, FEHBP enrollees should receive $98 million more of the refund and the government $98 million less than has been proposed. We propose a method to distribute each plan's refund equitably between the government and the enrollees.

Background

FEHBP, established by the Federal Employees Health Benefits Act of 1959, is the largest employer-sponsored, voluntary health insurance program in the United States. OPM administers the program through contracts negotiated with various health plans. In 1985, the program insured more than 8 million federal employees, annuitants, and their dependents through 212 health plans with estimated total obligations of $6.7 billion.

The cost of FEHBP is shared between enrollees and the government through biweekly or monthly premium contributions. The government's contribution is generally fixed for FEHBP enrollees regardless of the enrollee's salary or the plan he or she joins. By law, the government's share for each nonpostal enrollment is equal to 60 percent of the unweighted average of the high option rates for six plans. These plans—the "Big Six"—are the two government-wide plans, the two employee organization plans with the largest enrollments, and the two comprehensive medical plans with the largest enrollments. For 1985 the Big Six were the (1) Blue Cross/Blue Shield Service Benefit Plan (Blue Cross/Blue Shield), (2) Aetna Indemnity Benefit Plan (Aetna), (3) Government Employees Hospital Association Benefit Plan (GEHA), (4) Mail Handlers Benefit Plan (Mail Handlers), (5) Kaiser Foundation Health Plan-Northern California Region (Kaiser-Northern CA), and (6) Kaiser Foundation Health Plan-Southern California Region (Kaiser-Southern CA). The government's share for any enrollee cannot exceed 75 percent of a plan's total rate. The Postal Service pays 75 percent of the Big Six average not to exceed 93.75 percent of the premium for postal workers.

All premiums over the indicated thresholds qualified for the same annual government contribution in 1985 regardless of the actual premium, as shown in table 1.

Table 1: Annual Government Contribution (1985)

	Premium threshold	Government contributions to premium: Postal	Government contributions to premium: Nonpostal
Self	$ 830	$ 778	$ 622
Family	1,850	1,734	1,387

Premiums below the thresholds qualify for government contributions of 75 percent and 93.75 percent of the premium for nonpostal and postal enrollees, respectively.

FEHBP premium levels are set with the intention of (1) covering claims and overhead costs and (2) maintaining surplus funds as a protection against unexpected costs. Holding these surpluses, known in the insurance industry as reserves, is a standard industry practice and is required by FEHBP law and regulation.

FEHBP reserves can be drawn upon when health care claims exceed annual program income. When OPM and the plans negotiate premium rates for FEHBP coverage (usually about 6 months before the beginning of the contract year), there are many uncertainties about factors that affect program costs—how many enrollees will move in and out of the plan during annual open season; how many services enrollees will use; and how much inflation will affect the cost of medical care in the upcoming year. Since these uncertainties make it unlikely that the premium rates will be pinpoint accurate, OPM requires that reserve accounts be established as a hedge against underestimates.

Reserves grow when actual costs are lower than negotiated premiums and investment income. Reserves diminish when actual costs exceed the program income. FEHBP reserves routinely fluctuate because of the uncertainties in estimating premiums. For example, the FEHBP reserves experienced great shortfalls in 1981, when rates were too low for the high utilization and costs experienced. By 1985, the situation had reversed. Reserves reached an all-time high of $2 billion (or about 30 percent of premium income) when premiums yielded significantly more income than needed to cover health care costs. Year-end reserves generally have been targeted at about 14 percent of premium income for the larger plans.

Generally, OPM manages the FEHBP reserve levels through contract negotiations. Two techniques have traditionally been used to build or reduce reserves—adjusting premiums and modifying benefits. However, facing an extraordinary reserve excess in 1985, Blue Cross/Blue Shield proposed a new reserve management technique—refunding excess reserves to enrollees and the federal government. Although an unprecedented action, legal analysis by the Justice Department and us concluded that such a refund was consistent with the Federal Employees Health Benefits Act.[1] OPM offered the refund option to the remaining plans as a strategy for drawing down excess reserves. In total, 11 plans decided to refund over $1 billion to the government and the enrollees in 1985. (See app. I.)

As a result of 1986 premium negotiations, OPM and each of the 11 plans have agreed on the total refund for each plan. However, details on how each of the refunds would be administered had not been agreed upon by December 1985. Indications are that the refunds will be divided between the enrollees and the government on a pro-rata basis. For example, if the government paid 70 percent of the plan's premium and the enrollees paid 30 percent, the refund would be similarly divided. Our report discusses the appropriateness of this method for the 11 plans offering refunds. The scope and methodology for our work can be found in appendix II.

[1]The opinions concluded that the existing statute did not authorize refunds for annuitants. The Congress subsequently passed legislation to entitle annuitants to refunds, but the bill was vetoed by the President on January 17, 1986.

Inequities Resulting From the Pro-Rata Refunds

Premium contributions of employees and the government are set according to the statute's formula for sharing costs. For this reason, we believe that the FEHBP refunds should return to the government and enrollees their respective premium overpayments for 1985 health care coverage in a manner consistent with the program's cost-sharing principles. However, the pro-rata method proposed by OPM inappropriately divides the refund.

For some plans, the enrollees will receive too little of the proposed refund and the government too much. In other cases, the enrollees will receive too much and the government too little. According to our analysis, enrollees in refund plans should receive $98 million more of the refund and the government $98 million less than has been proposed. Furthermore, the pro-rata refund method is contrary to a basic FEHBP cost-sharing principle that for plans above the premium threshold, each enrollee should receive the same government contribution no matter how expensive the plan. Enrollees who customarily benefit from equal government contributions will receive different government contributions for their health care as a result of the proposed refund.

Why does the proposed pro-rata refund create these inequities? The method used to share the refund differs from the method initially used to share the premium costs in FEHBP. While dividing the refund based on the pro-rata share of the premium seems reasonable, it is not the same technique used to share FEHBP costs. When one method is used to figure who pays the premiums and another is used to figure who overpaid premiums, inequities result.

The following examples illustrate how OPM's pro-rata refund method can shortchange enrollees. Suppose that in 1985 a non-Big-Six plan offered a refund, but no Big Six plan did. And suppose the annual premium for high option family coverage for this plan was $3,373, and the plan proposed a refund of $1,123 for nonpostal enrollees. This refund is a premium recalculation, an adjustment in price after the fact. Because of this price adjustment, the effective premium for this plan would total $2,250. The government contribution for FEHBP coverage is fixed for all plans with premiums over a certain threshold. (See table 1.) For this plan, both the original and the final premium fall above this threshold. As a result, the government contribution would remain the same before and after the premium adjustment. Since the government contribution would be the same in either case ($1,387), the government did not overpay. The entire refund should go to the enrollee. In contrast, the pro-rata method would return 41 percent of the refund to the government. Table 2 summarizes the premiums and the refund results for this hypothetical situation.

Table 2: Hypothetical Example: Only a Non-Big-Six Plan Offers a Refund (Nonpostal)

	Annual premiums				
	Total amount	Government amount	Percent	Enrollee amount	Percent
Original	$3,373	$1,387	41	$1,986	59
Final	2,250	1,387	62	863	38
Premium overpayment	**1,123**	**0**	**0**	**1,123**	**100**
OPM's pro-rata refund	1,123	462	41	661	59
Refund error:					
Overpayment		**$ 462**			
Underpayment				**$ 462**	

When a Big Six plan is involved in a refund, the situation becomes more complicated because both the government and the enrollees overpaid. Unlike the prior example, the government's contribution will not remain the same. The government's contribution is determined using premiums of the Big Six plans. If these premiums are adjusted, the government's contribution would also need to be adjusted to correct for the pricing changes from the refund. Our second example illustrates this situation using Blue Cross/Blue Shield high option family coverage.

Blue Cross/Blue Shield established an initial 1985 premium of $3,143 and proposed a refund of $734, establishing a final premium of $2,409. The higher premium figure was used in calculating the government contribution; the lower figure is the actual annual premium that will be paid. Two other Big Six plans (Aetna and GEHA) also offered refunds in 1985. Clearly, the government's contribution was too high because three of the Big Six plans' premiums were too high. What should the government have paid for family coverage in 1985? The accurate government contribution should be computed using the Big-Six plans' final premiums in the Big Six formula. Appendix III shows this computation.

Based on the price adjustments made by the three Big Six plans, the government's contribution should have been lowered from $1,387 to $1,216. The threshold would also be lowered from $1,850 to $1,621. The Blue Cross/Blue Shield high option family contract had an original premium higher than the original threshold and a final premium higher than the recalculated threshold. As a result, both premiums qualified for the maximum government contribution, and the government overpaid

$171 for nonpostal enrollees in this plan.[2] Contrasting the premium overpayments with the pro-rata refund shows that the enrollees do not receive the full amount of their premium overpayment from the pro-rata refund method. Nonpostal enrollees in this plan are shortchanged $153. Table 3 summarizes the results of the 1985 proposed Blue Cross/Blue Shield refund compared to premium overpayment.

Table 3: 1985 Example: Big Six Plan Offers a Refund (Blue Cross/Blue Shield 1985 High Option Family) (Nonpostal)

	Annual premiums				
	Total	**Government amount**	**Percent**	**Enrollee amount**	**Percent**
Original	$3,143	$1,387	44	$1,756	56
Final	2,409	1,216	50	1,193	50
Premium overpayment	**734**	**171**	**23**	**563**	**77**
Proposed pro-rata refund	734	324	44	410	56
Refund error:					
Overpayment		**$ 153**			
Underpayment				**$ 153**	

As both of these examples illustrate, OPM's pro-rata method does not return to the government and the enrollee their respective premium overpayments.

Because the pro-rata refund does not return premium overpayments accurately, it damages the parity of federal health benefits. Generally, each enrollee in the program benefits from the same government contribution, no matter which plan he or she joins. For example, a federal nonpostal worker choosing family coverage would have qualified for the lesser of $1,387 or 75 percent of the total premium of the plan chosen as a government contribution for 1985. Effectively, the proposed pro-rata refund would retrospectively alter this government payment and make it different for each plan. After the proposed refund, the government's contribution would vary from $878 to $1,336 among the 11 plans. For nonpostal family plans above the premium threshold of $1,621, the government contribution would vary from $925 to $1,336. These plans should receive a government contribution of $1,216 for nonpostal family enrollees, but their actual contribution ranges from 24 percent below to 10 percent above this amount. Appendix IV illustrates three different nonpostal government contributions for the 11 refunding plans—(1) the

[2]If any plan's recalculated premium falls below $1,621, the government's payment for this plan should be limited to 75 percent of the recalculated premium. In these cases (e.g., Blue Cross/Blue Shield standard family and GEHA family), the government overpaid more than $171 and receives more of a refund under our method.

original government contribution, (2) the government contribution that results after the government receives its share of the pro-rata refund, and (3) the recalculated government contribution resulting from our method. The original ($1,387) and the recalculated ($1,216) government contributions are uniform from plan to plan; the government contribution that results from the pro-rata refund varies widely.

What difference do these inequities make to the program? For FEHBP enrollees expecting refunds, OPM's pro-rata refund returns

- too little money to high option enrollees of Blue Cross/Blue Shield, Aetna, GEHA, Foreign Service, Medical Service Bureau and Washington Physicians Service (WPS), and standard option family enrollees of Blue Cross/Blue Shield (ranging from $291 to $2 depending on the plan);
- too much money to enrollees in plans sponsored by the American Federation of Government Employees (AFGE), the National Association of Letter Carriers (NALC), the Government Employees Benefit Association (GEBA), and Kitsap (ranging from $82 to $19 depending on the plan); and
- the correct amount of money for enrollees of SSS[3] and the standard option plans of Aetna (family and self) and Blue Cross/Blue Shield (self).

The differences can be substantial. For example, the proposed refund shortchanges high option family enrollees of Blue Cross/Blue Shield by $153 and Aetna by $173. Appendix V shows the nonpostal refunds proposed by OPM for the government and enrollees compared to our method.

Viewing the comparison from an overall FEHBP perspective shows the magnitude of the problem for refund plans. Enrollees in refund plans should receive $98 million more of the refund than has been proposed. While the total contributions to the health plans remain the same, the cost sharing under a pro-rata refund is substantially different from a refund based on premium overpayments. Table 4 shows the program costs in 1985 under the two refund methods in total for the 11 refund plans. Appendix VI compares the two refund methods for each of the 11 plans.

[3]Seguros de Servicio de Salud (Puerto Rico).

Table 4: Estimated FEHBP 1985 Program Costs for 11 Refund Plans

Dollars in millions

	Government	Enrollee	Total
Refunding money using OPM's pro-rata method	$1,986	$1,274	$3,260
GAO's premium recalculation method	2,084	1,176	3,260
Difference	**$(98)**	**$ 98**	**$ 0**

In summary, to divide a refund equitably, the same three steps used to divide premiums between the government and enrollees would be followed.

1. First, a recalculated premium should be computed for each plan offering a refund. This recalculated premium is the original premium less the proposed total refund—in effect the total premium that will be paid in the refund year for this plan.

2. Second, the recalculated government contribution should be computed. Only Big Six plans' premiums are used to compute the government's contribution. Therefore, those plans' recalculated premiums (lowered by the refunds) should lower the government contribution. If no Big Six plan refunds money, the government contribution remains the same.

3. Finally, the enrollees' share of the recalculated premium should be the difference between the recalculated total premium and the recalculated government contribution. The refund would be divided so that the government receives its premium overpayment—that is, the difference between its original and recalculated premium contribution. The enrollees would receive their premium overpayments as refunds—that is, the difference between their original and recalculated premium amounts.

Compared to OPM's refund method, our method

- refunds to both enrollees and the government not an arbitrary amount, but rather their respective premium overpayments and
- keeps the government's contribution consistent for each refund plan.

Conclusions

Under the method endorsed by OPM for allocating the FEHBP refunds, enrollees of some plans would be shortchanged because the government would receive part of their premium overpayments. Enrollees of other plans would benefit by receiving some of the government's premium overpayment. In addition, OPM's method would result in unequal government contributions for enrollee health benefits. To be equitable, the refund should be divided to recoup exactly the government's and the enrollees' premium overpayments.

Recommendation

We recommend that the Director of OPM divide the refund so that the government and the enrollees receive their respective premium overpayments. OPM should use the method described in this report to allocate the FEHBP refunds.

Agency Comments and Our Response

OPM does not agree that our method, which we believe returns the premium overpayments to the parties that made them, is better than the pro-rata method. (See app. VII.) In discussing their formal comments with us, OPM officials said that there are so many problems with the refund that the added inequities resulting from the choice of allocation method are inconsequential. They argue that our logic is faulty because (1) they have never recalculated premiums in the past despite similar estimating errors; (2) we did not adjust the premiums using the total amount of excess reserves, just the amount to be refunded; and (3) enrollees did in fact receive an equivalent government contribution in 1985. OPM says it did a responsible job of negotiating 1985 premiums and that it is impossible to undo the past by adjusting premiums. According to OPM, "common sense" dictates that the pro-rata method should be used to divide the refund.

Each objection to our refund method that OPM makes applies more directly to its actions and its pro-rata method.

- First, OPM's pro-rata method returns excess reserves to the government and enrollees inconsistently with past practices, while our method is consistent with the traditional practice of subsidizing premiums.
- Second, our method deals only with certain reserves because OPM permitted only a portion of the total reserves to be refunded.
- Finally, OPM's method results in varying government contributions for refunding plans in 1985. Our method sets equal government contributions for refunding plans.

The following sections detail OPM's specific comments and our responses on each of these three issues.

OPM's first objection to our method is that we are proposing a new policy for handling excess reserves resulting from premium estimating errors. OPM points out that FEHBP premiums are never perfect and that despite premium estimating errors in the past, it has never recalculated premiums. According to OPM, the original 1985 premiums were established in good faith and are the only premiums for 1985. OPM's position is that this year's premium errors were analogous to past years' overestimates or underestimates. They object to recalculating premiums and "re-running the past" now when it has never been done before in the program. OPM calls our recalculated premiums "a fanciful creation of 'what might-have-been.'"

Contrary to OPM's assertion, we are recommending a refund method consistent with its past practices. We analyzed how excess reserves would have been shared between the government and the enrollees under a traditional premium subsidy. Typically, under such a subsidy, OPM has lowered future premiums to spend excess reserves. If the government and enrollees overpaid one year, they could generally expect to recoup the overpayments in the future.

How would the excess reserves have been shared under a premium subsidy? Not on a pro-rata basis because this would result in different government contributions from plan to plan and would be illegal. Instead, the government would pay a uniform but lower contribution because the Big Six premiums would be lower. This is exactly how we are proposing the refund be handled.

We believe a plan's excess reserves should benefit the government and the enrollees the same no matter whether the plan chooses to lower past premiums through a refund or to lower future premiums through a subsidy. Both are premium adjustments; one is retrospective, the other is prospective. OPM has permitted some plans to refund excess reserves using its pro-rata method and others to subsidize 1986 premiums using a method consistent with ours. We do not believe, however, that OPM should allow plans to return different amounts to enrollees simply because a refund rather than a premium subsidy was chosen. OPM could distribute the refund to mirror a premium subsidy if it used our method.

The government contribution must be recalculated annually to account for prospective rate changes resulting from negotiations, but the law does not specify how retrospective premium changes like refunds should be handled. OPM acted lawfully when it established the 1985 premiums and the government contribution according to the cost-sharing principles. We believe fairness demands that OPM follow the same principles when it adjusts 1985 rates retrospectively through a refund.

Finally, we disagree that the only 1985 premiums in FEHBP were the original premiums. The final adjustments to the 1985 original rates will be executed by contract modifications when the refund distribution is approved. Therefore, our recalculated premiums, not the original premiums, will be the amount finally paid to the plans for health insurance in 1985.

OPM's second rebuttal to our refund approach is to point out what it perceives as a shortcoming—our failure to quantify and measure the total excess reserves, including those of one Big Six plan not offering a refund. Our report omits these reserves because including them in our analysis would result in double-counting the savings to the government and the enrollees. The excess reserves not intended to be refunded will be spent through either premium adjustments or benefit increases in 1986. Had the plans and OPM chosen instead to refund these reserves, we would have included them in our analysis.

OPM's final rebuttal is that every enrollee, whether in a refunding or a nonrefunding plan, has received an equivalent government contribution for 1985. OPM argues that it is the carriers' different experiences and their marketing decision to offer refunds that causes the refund shares to differ.

We agree that a plan's experience and choice of method to reduce excess reserves affect its total refund, but this experience should not affect the way the refund is divided between the government and the enrollees. How FEHBP costs are shared is a matter of law, not of plan experience or marketing strategy.

OPM's position that all enrollees received an equivalent government contribution for 1985 is correct only if refunds are ignored. The government originally contributed $1,387 for all nonpostal enrollees qualifying for the maximum family contribution. However, the government will receive part of its contribution back from refunding plans, causing the government contribution to differ between refunding and nonrefunding plans. By allowing a refund, OPM approved the inequities inherent in such an approach—that one group of enrollees receives a larger government contribution than another. If OPM uses its pro-rata method, the government contribution will also vary among refund plans—an added inequity. Our method is an improvement over OPM's because it keeps the government contribution uniform for refunding plans with premiums above the recalculated threshold. (See app. IV.)

In summary, we believe that if OPM and the plans follow the pro-rata method of distributing refunds, there will be program inequities. In some plans, enrollees will overpay for their health care coverage because the government receives too much of the refund. In other plans, enrollees will underpay for their coverage because the government receives too little. To be fair, the refund should be divided so that each party pays the same share of the after-refund premium that they would have paid had this premium been established during 1985 negotiations. To do otherwise is inconsistent with FEHBP cost-sharing principles. We remain convinced that returning the refund to the party that overpaid premiums is more equitable than the pro-rata method.

As arranged with your office, we are sending copies of this report to the Director of the Office of Personnel Management; the Senate Subcommittee on Civil Service, Post Office and General Services; and the plans proposing refunds. Copies will also be available to others upon request.

Sincerely yours,

Richard L. Fogel

Richard L. Fogel
Director

Contents

Abbreviations

AFGE	American Federation of Government Employees
FEHBP	Federal Employees Health Benefits Program
GEBA	Government Employees Benefit Association
GEHA	Government Employees Hospital Association
NALC	National Association of Letter Carriers
OPM	Office of Personnel Management
SSS	Seguros de Servicio de Salud
WPS	Washington Physicians Service

1985 Refunds Proposed by FEHBP Plans

Plan name	Option	Refund
Blue Cross and Blue Shield Association (Blue Cross/Blue Shield)	High Standard	$ 370,000,000 414,000,000
Aetna	High Standard	90,000,000 37,000,000
American Federation of Government Employees (AFGE)	High	2,296,000[a]
Foreign Service	High	5,000,000
Government Employees Benefit Association (GEBA)	High	342,000[a]
Government Employees Hospital Association (GEHA)	High	100,000,000
National Association of Letter Carriers (NALC)	High	40,000,000
Kitsap Physicians Service (Kitsap)		500,000[a]
Medical Service Bureau (North Idaho)		508,000
Washington Physicians Service (WPS)		4,700,000
Seguros de Servicio de Salud (SSS) (Puerto Rico)		4,000,000
Total refund		**$1,068,346,000**

[a]No refund was allocated to plans' standard options because of very low enrollments in 1985 for these options.

Objectives, Scope, and Methodology

The refund should return to both the government and the enrollees the amount they overpaid in 1985. Our objective was to evaluate what effect the pro-rata refund would have on the government and enrollee contributions for FEHBP—that is, whether premium overpayments were being returned appropriately.

To determine the government's and the enrollees' share of the proposed refund, we assumed that

- point estimates of enrollment (generally as of March 1985) could be used together with 1985 premium information to estimate plan income and enrollment for the full year;
- each plan's total refund (app. I) would be distributed among postal and nonpostal, family and self options based on each option's dollar volume of income;
- each option's refund would be pro-rated based on the premium split between the government and enrollee;
- annuitants would receive part of the refund; and
- premiums would not change for plans not offering refunds although a number of these plans had excess reserves.

Using these assumptions, we developed refund amounts for each contract (nonpostal family high, postal self high, etc.) of the 11 plans offering refunds. Because all refunding plans had not announced their refund proposal before our analysis was undertaken, we expect our estimates will vary slightly from the final proposals. For example, one plan intends to use July rather than March enrollment data to distribute its refund. Other plans may use claims expenses rather than premium income to divide the refund among family and self, postal and nonpostal contracts. We expect that these differences will cause minor variations between the plan's refund estimates and ours. As plans' refunds have been announced, we have verified their proposals against our distribution and found our assumptions gave valid refund estimates.

To calculate the premium overpayments made by enrollees and by the government, we reduced each 1985 contract total premium by the proposed 1985 refund for this contract. Our rationale was that the most accurate 1985 premium to avoid reserve buildup was the actual 1985 premium less the refund amount. Once we developed recalculated premiums, we computed what the government's contribution would have been in 1985.

The Big Six calculation had already been established for 1985. Our analysis required revising the government's contribution using the recalculated 1985 premiums. The enrollee's share of the 1985 overpayment is simply the recalculated premium less the recalculated government contribution. Had these recalculated premiums been established at the outset of 1985, the refunds would not have been necessary.

Our final step was to compare the premium contributions under the pro-rata refund with the recalculated premium contributions. This comparison allowed us to measure the effect of the proposed refund on both the government and the enrollee contributions.

We discussed our assumptions and our approach with OPM's principal actuary responsible for health benefits and a former chief actuary of OPM. They agreed that our analysis accurately represented the pro-rata method and the effect of reducing premiums of refunding plans by an amount equal to the declared refunds.[1]

Our review was conducted between August and November 1985 in accordance with generally accepted government audit standards.

[1] In our draft version of this report, OPM objected to a statement that its health actuary agreed with our approach. The above statement more clearly represents OPM's position. OPM's former chief actuary also reviewed this report in draft and said he agreed not only with our approach, but also with our conclusions and recommendations.

Calculation of Annual Government Contribution

	High option family contracts			High option self contracts		
	Original premium (A)	Refund (B)	1985 Recalculated premium (A)-(B)	Original premium (C)	Refund (D)	1985 Recalculated premium (C)-(D)
Blue Cross/Blue Shield	$ 3,143	$ 734	$ 2,409	$1,436	$335	$1,101
Aetna	2,501	621	1,880	1,342	333	1,009
GEHA	1,852	360	1,492	880	171	709
Mail Handlers	1,875	0	1,875	726	0	726
Kaiser—Northern CA	2,057	0	2,057	865	0	865
Kaiser—Southern CA	2,446	0	2,446	971	0	971
Total	**$13,874**	**$1,715**	**$12,159**	**$6,220**	**$839**	**$5,381**
Average	$ 2,312	$ 286	$ 2,026	$1,037	$140	$ 897
Government contribution						
Nonpostal[a]						
Original	$ 1,387			$ 622		
Overpayment[b]		$ 171			$ 84	
Recalculated			$ 1,216			$ 538
Postal[c]						
Original	$ 1,734			$ 778		
Overpayment[b]		$ 214			$105	
Recalculated			$1,520			$ 673

[a]60 percent of average.

[b]Represents the government's 1985 premium overpayment for enrollees in plans qualifying for the maximum government contribution.

[c]75 percent of average.

Comparison of Annual Government Contributions for 1985 Originally, After Refund, and Using Recalculated Premiums

(Nonpostal Family Options)

Refunding plans	Original 1985 government contribution (A)	With pro-rata refund: Government portion of refund (B)	With pro-rata refund: Effective annual government contribution (A)-(B)	Recalculated government contribution
GEBA	$1,387	$ 51	$1,336	$1,216
AFGE	1,387	53	1,334	1,216
Kitsap	1,387	89	1,298	1,216
NALC	1,387	133	1,254	1,216
GEHA	1,387	270	1,117	1,119[a]
WPS	1,387	287	1,100	1,216
Blue Cross/Blue Shield (High)	1,387	324	1,063	1,216
Aetna (High)	1,387	344	1,043	1,216
Foreign Service	1,387	365	1,022	1,216
Aetna (Standard)	1,246[a]	254	992	992[a]
SSS	1,217[a]	267	950	951[a]
Medical Service	1,387	462	925	1,216
Blue Cross/Blue Shield (Standard)	1,387	509	878	889[a]

[a]Capped premium where government contribution is limited to 75 percent of total premium.

Comparison of OPM and GAO Refund Methods

(Nonpostal Contracts)

Refunding plans	Plan option	Total refund amount	Enrollee OPM	Enrollee GAO	Enrollee Difference	Government OPM	Government GAO	Government Difference
OPM Method Returns Too Little to Enrollees:								
Medical Service	Hi-Self	$ 447	$240	$363	$(123)	$207	$ 84	$ 123
	Hi-Family	1,123	661	952	(291)	462	171	291
Aetna	Hi-Self	333	179	249	(70)	154	84	70
	Hi-Family	621	277	450	(173)	344	171	173
Foreign Service	Hi-Self	238	75	117	(42)	163	121	42
	Hi-Family	617	252	446	(194)	365	171	194
Blue Cross/Blue Shield	Hi-Self	335	190	251	(61)	145	84	61
	Hi-Family	734	410	563	(153)	324	171	153
	Std-Family	687	178	189	(11)	509	498	11
WPS	Hi-Self	252	124	168	(44)	128	84	44
	Hi-Family	552	265	381	(116)	287	171	116
GEHA	Hi-Self	171	50	81	(31)	121	90	31
	Hi-Family	360	90	92	(2)	270	268	2
OPM Method Returns Too Much to Enrollees:								
Kitsap[a]	Hi-Self	96	56	12	44	40	84	(44)
	Hi-Family	205	116	34	82	89	171	(82)
GEBA[a]	Hi-Self	42	19	0	19	23	42	(19)
	Hi-Family	103	52	0	52	51	103	(52)
AFGE[a]	Hi-Self	47	23	0	23	24	47	(23)
	Hi-Family	100	47	0	47	53	100	(47)
NALC	Hi-Self	108	48	24	24	60	84	(24)
	Hi-Family	216	83	45	38	133	171	(38)
OPM and GAO Method Return the Same:								
Aetna	Std-Self	159	40	40	0	119	119	0
	Std-Family	339	85	85	0	254	254	0
SSS	Hi-Self	111	28	28	0	83	83	0
	Hi-Family	356	89	89	0	267	267	0
Blue Cross/Blue Shield	Std-Self	288	72	72	0	216	216	0

[a]No refund was allocated to these plans' standard options because of very low enrollments in 1985.

Comparison of Aggregate Refunds to the Government and Enrollees Under the Two Refund Methods

Dollars in thousands

	OPM method		GAO method		Difference	
Refunding plans	Government (A)	Enrollee (B)	Government (C)	Enrollee (D)	Government (A) - (C)	Enrollee (B) - (D)
Blue Cross/ Blue Shield	$478,634	$305,366	$397,894	$386,106	$80,740	$(80,740)
Aetna	76,205	50,795	52,567	74,433	23,638	(23,638)
GEHA	77,289	22,711	74,862	25,138	2,427	(2,427)
Foreign Service	3,045	1,955	1,604	3,396	1,441	(1,441)
Medical Service	221	287	84	424	137	(137)
WPS	2,545	2,155	1,552	3,148	993	(993)
SSS	3,164	836	3,164	836	0	0
AFGE[a]	1,204	1,092	4,182	(1,886)	(2,978)	2,978
NALC	27,375	12,625	35,537	4,463	(8,162)	8,162
GEBA[a]	176	166	628	(286)	(452)	452
Kitsap	215	285	455	45	(240)	240
Total	**$670,073**	**$398,273**	**$572,529**	**$495,817**	**$97,544**	**$(97,544)**

[a]For both AFGE and GEBA, the refund is too little to recoup the government's overpayment. These plans lowered their respective premiums through refunds, but the recalculated Big Six average lowers the government contribution even more. As a result, even though these plans' total premiums were too high, only the government overpaid. The enrollees paid less than they should have. Our table shows the theoretical amount of the refund the government and enrollees should receive using the FEHBP cost-sharing rules. The negative numbers in the enrollee column under the GAO method (column D) indicate that the enrollees should have paid more of the final after-refund premium. As a result, the enrollees should receive none of the refund under GAO's method.

Advance Comments From the Office of Personnel Management

United States
Office of Personnel Management
Washington, D.C. 20415

In Reply Refer To: Your Reference

DEC 18 1985

Mr. William J. Anderson, Director
General Government Division
U.S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

We have reviewed your draft report entitled Insurance Refunds: Allocation Inequities in the Federal Employees Health Benefits Program and have the following comments.

The draft report concludes that the enrollee and Government shares of the proposed health insurance refunds should be based on a recalculation of the contract year 1985 premium rates, including a recalculation of the Government contribution using hindsight and part (but not all) of the information currently available on 1985 experience. This conclusion is based on the notion that excess reserves accumulated because enrollees "overpaid" for their health insurance in 1985 and an "equitable" distribution of the excess demands that we re-run the year to see what would have happened had the "right" premiums been charged. We believe this notion is fundamentally inconsistent with the operation of the Federal Employees Health Benefits (FEHB) program, creates as many inequities as it cures and depends upon a fanciful creation of "what might-have-been."

FEHB premiums are set as much as six months in advance of the contract year they govern and are based on experience from the previous year, plus the first quarter of the current year. In the highly volatile field of health care economics, forecasting the future under these conditions is necessarily an imperfect business. If enrollees "overpaid" in 1985, then they have either overpaid or underpaid in virtually every year since the program's inception in 1959, yet we have never recalculated a premium after the fact. Refunds are nothing more than an alternative to prospective rate reductions or benefit increases for drawing down excess reserves, and they do not require, any more than the other methods, that we re-run the past. The 1985 premiums were established by proper authority negotiating in good faith and in accordance with law and regulation. They were, and are, the only premiums we have for 1985.

Once the contractual premiums are forsaken for purposes of calculating the Government contribution, then any number of variations on premium can be selected, as evidenced by your methodology. You would have us factor in only that money that carriers have volunteered to refund and ignore that portion of the excess they have opted to use to reduce 1986 rates. Further, you would have us ignore completely the premiums of one of the Big Six carriers that drive the Government contribution because that carrier eschewed the notion of refunds and opted instead for a dramatic reduction in the 1986 premiums. There is nothing necessary or intrinsically "right" about these carrier decisions; they merely reflect the relative positions and marketing strategies of the plans going into 1986. Even if one subscribes to the fallacious notion that correction is required, surely one would have to "correct" all the 1985 premiums and not merely those of carriers that decided long after the fact to refund a portion of their excess reserves. Your selective recalculation of premiums not only ignores what did happen in the program, but sets forth an arbitrary, groundless version of what "should have happened."

Finally, the draft report advances your position in the name of equity. It is deemed more equitable for enrollees to receive refunds based on a premium that never was in effect than to get back a pro-rata share of the amounts they actually paid. Your draft report argues that this is the only way the principle that all enrollees should receive an equivalent Government contribution can be maintained. The fact is that all enrollees <u>did</u> receive an equivalent contribution in 1985. Their pro-rata shares of the refunds differ because the experience of the plans they were enrolled in differed and because these plans made various decisions about how much of their excess reserves they would draw down via refunds. Your methodology requires that we pretend the Government contribution was lower for this group of people than it actually was for them and than it was for <u>all those enrolled in non-refunding plans</u>. In the name of equity, should your report not request that the latter group of enrollees return to the program the difference between what the Government actually paid and what your report pretends it paid?

By a tortuous path of selectively recalculating premiums after the fact using only portions of the excess reserves available in the program, your report arrives at the conclusion that Federal enrollees are due an additional $98 million in refunds. Common sense tells us how a refund should be distributed; it should be returned to the contributing parties in proportion to the contributions they made. It is not possible to undo the past. Your version of what might have been is only one of the many possible scenarios and it clearly

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serves only one set of interests. The premiums for 1985 and the agency withholdings and employee contributions are a matter of record, and that is the ground on which we must proceed.

Aside from the substantive deficiencies in your report, we note that it misrepresents the view of OPM's current principal health insurance actuary who did not agree with your approach. (Please see page 16.)

Now on p. 18.

I thank you for the opportunity to comment on your draft report and respectfully request that the full text of our views be printed in your final version.

Sincerely,

James W. Morrison, Jr.
Associate Director
for Compensation

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