

**SAN FRANCISCO  
HEALTH SERVICE SYSTEM**

Affordable, Quality Benefits & Well-Being

**Memorandum**

DATE: December 10, 2020

TO: Dr. Stephen Follansbee, President and Members of the Health Service Board

FROM: Larry Loo, Chief Financial Officer

RE: Audited Financial Statements – June 30, 2020 and 2019

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The audit of the Health Service System Trust Fund (Trust) for the fiscal year (FY) ending June 30, 2020 was issued by the independent auditing firm of Macias Gini & O’Connell LLP (MGO) on October 23, 2020. This was the first audit performed by MGO on the Trust as they replaced the previous auditing firm, KPMG. The audit consisted of an examination of the FY 2019-20 financial status, a comparison of the changes between FY 2019-20 and FY 2018-19, and an analysis of internal controls. No deficiencies in internal controls and no instances of noncompliance were identified by the auditor.

Hard copies are available at the SFHSS office (1145 Market, 3rd floor); during the COVID-19 shelter-in-place conditions, requests for copies can be made by email to [health.service.board@sfgov.org](mailto:health.service.board@sfgov.org). The statements are also posted on the public website at <https://sfhss.org>. The Comprehensive Annual Financial Report will contain a high-level summary of the Trust Fund.

**Summary**

The Trust ended FY 2019-20 with a balance of \$116.1 million in net assets (also known as net position). This was an increase of \$24.0 million from the balance of \$92.1 million as of June 30, 2019.

|                      | <b>Net Assets (in Millions)</b> |
|----------------------|---------------------------------|
| Balance 6/30/2019    | \$92.1                          |
| Change in Net Assets | <u>24.0</u>                     |
| Balance 6/30/2020    | \$116.1                         |

**Changes in Net Assets**

The \$24.0 million increase in net assets is primarily due to the following:

- \$0.3 million increase in the United Health Care (UHC) PPO net position primarily due to pharmacy rebates.
- \$10.6 million increase in the Blue Shield flex-funded plan (Access+ and Trio) net position was due to excess premium equivalents over claim costs of \$1.4 million, pharmacy rebates of \$6.7 million, and use of claim stabilization funding, per HSB approved policy, of \$2.5 million.

- \$8.2 million increase in the dental plans net position was due to excess premium equivalents over claim costs of \$13.8 million offset by claim stabilization, per HSB approved policy, of \$5.6 million.
- \$0.2 million increase in Kaiser plan net position was based on pay calendars for the San Francisco Unified School District, and the San Francisco Community College District; contractual provisions governing the timing of premium payments; and members moving from active to retiree and from non-Medicare to Medicare status.
- \$0.2 million increase in administrative savings.
- \$1.4 million increase in flexible spending account employee contributions over claim reimbursements to participants.
- \$3.1 million increase in Trust Fund interest income, other investment earnings, performance guarantee penalties, and forfeitures.

### Future Obligations and Reserves

The Department worked with Aon Consulting to identify \$49.9 million in future obligations and reserves.

| <b>FY 2020-21 Reserves and Obligations</b>              |               |                        |
|---|---------------|------------------------|
|   | (in Millions) | Total<br>(in Millions) |
| Net Assets as of 6/30/2020                              |               | \$116.1                |
| Contingency Reserves <sup>1</sup>                       |               |                        |
| UHC PPO   | \$6.3         |                        |
| Blue Shield   | 14.2          |                        |
| Delta Dental  | \$2.9         | \$23.4                 |
| Stabilization reserves <sup>2</sup>                     |               |                        |
| <u>Blue Shield</u>                                      |               |                        |
| Rate Stabilization January – June 2021                  | \$1.3         |                        |
| Rate Stabilization July 2021 and beyond                 | \$6.4         | \$7.7                  |
| <u>Delta Dental</u>                                     |               |                        |
| Rate Stabilization July – December 2020                 | \$3.5         |                        |
| Rate Stabilization January – June 2021                  | 2.8           |                        |
| Rate Stabilization July 2021 and beyond                 | \$8.5         | \$14.8                 |
| Healthcare Sustainability Fund                          |               | \$2.8                  |
| Performance Guarantees – Adoption and Surrogacy Program |               |                        |
| 2021  | \$0.3         |                        |
| 2022 – 2024   | \$0.9         | \$1.2                  |

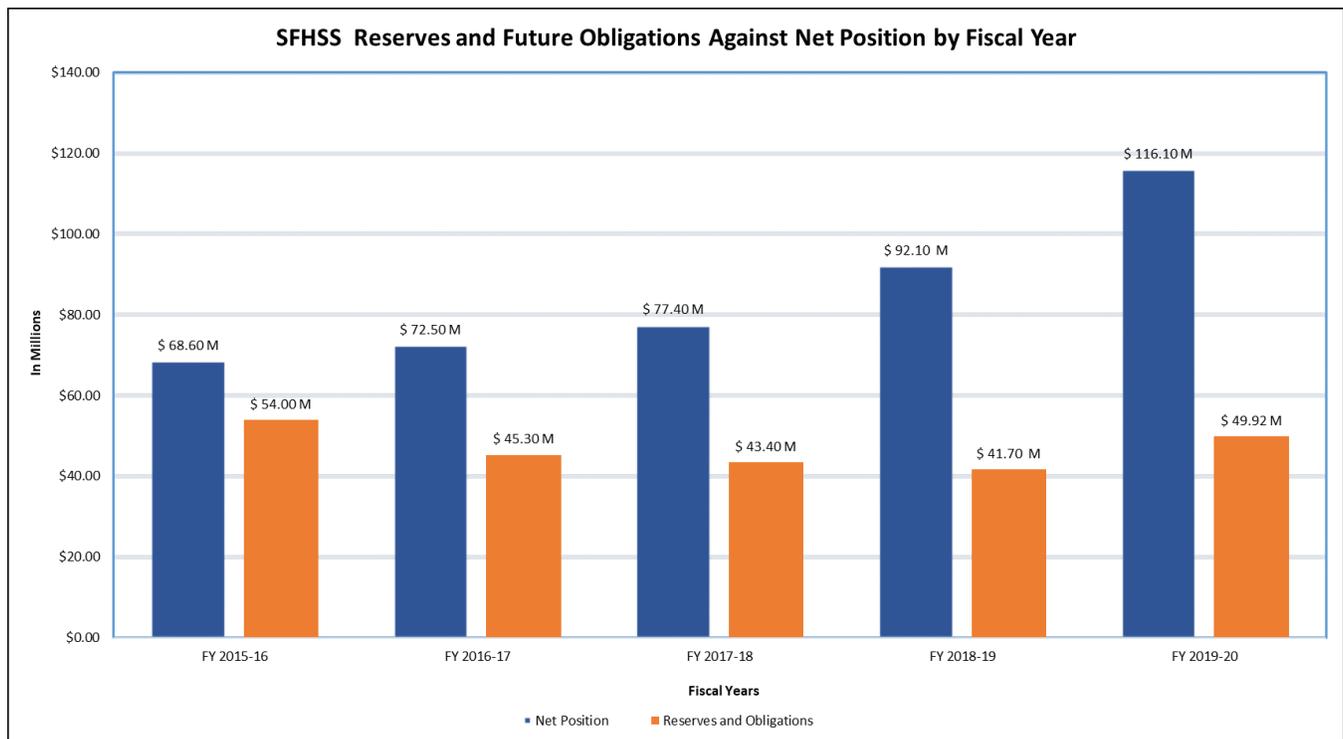
<sup>1</sup> Contingency reserves absorb the risk of claims in excess of expected claims targets.

<sup>2</sup> Stabilization reserves are based on financial gain or loss for Self-Funded and Flex-Funded plans amortized over a three (3) year rating period, for stabilization of rates. UHC PPO is currently in negative Stabilization Reserve positions, and therefore not shown above. For Blue Shield, the Stabilization Reserves changed from a deficit to surplus position and applied to the 2021 rates.

|  |  |               |
|--|--|---------------|
| Total Obligations and Reserves                               |  | <u>\$49.9</u> |
| Net Assets Remaining After the 2021 Reserves and Obligations |  | <u>\$66.2</u> |

### Historical View of Reserves and Future Obligations Against Year-end Net Position

The following graph compares the net position at the end of each fiscal year and the reserves and obligations against it. For example, the net position at the end of FY 2019-20 is \$116.1 million and the reserves and future obligations against the \$116.1 million are \$49.9 million.



The \$24.0 million increase in the net position in the Trust Fund, from \$92.1 million in FY 2018-19 to \$116.1 million in FY 2019-20, is mainly due to replenishment of the Blue Shield Stabilization Reserve (+\$10.6 million including \$6.7 million for pharmacy rebates), the dental plan premium exceeding claims cost (+\$8.2 million) and the performance of other revenue such as interest income, pooled investments, forfeitures and performance guarantees (\$+3.1 million). The plan performance for 2020 will be evaluated during the Rates and Benefits Setting process for plan year 2022. The value of the reserves and future obligations were increased 13% from the net position in FY 2019-20.

### Year End Information for Stabilization Reserves, Investment Earnings, Performance Guarantees and Adoption and Surrogacy Assistance Plan

#### Disposition of Stabilization Reserves

Based on the Health Service Board (Board) approved policy to stabilize annual rate actions on the self-funded and flex-funded plans, underwriting gains and losses are allocated over a three-year period. As of December 31, 2019, the Blue Shield and Delta Dental stabilization reserves were in a surplus position whereas UHC was in a deficit position.

The Blue Shield Stabilization Reserves were at \$7.7 million at the end of 2019. The Board authorized the use of \$2.56 million or 1/3 of the reserve, to be applied to the 2021 Rates and Benefits.

The Delta Dental Stabilization Reserves were at \$11.3 million at the end of 2019. The Board authorized the use of 50% or \$5.66 million to be applied to the 2021 Rates and Benefits.

Aon Consulting will reevaluate the reserves at the beginning of the 2021 Rates and Benefit process during which the 2022 rates will be determined.

Since the Stabilization Reserves for the UHC PPO is in a deficit position, it is not reported in the table on the following page. The rates for these plans were set to replenish the respective reserves.

| <b>Disposition of Stabilization Reserves as of 12/31/2019 (in millions)</b> |                      |                                    |  |
|---|----------------------|------------------------------------|--|
| <b>Plan</b>   | <b>Total Reserve</b> | <b>Amounts used for 2021 rates</b> | <b>Balance to be used for future years</b> |
| Blue Shield   | \$7.69               | \$2.56                             | \$5.12                                     |
| Delta Dental  | <u>\$11.33</u>       | <u>\$5.66</u>                      | <u>\$5.66</u>                              |
|   | \$19.01              | \$8.23                             | \$10.79                                    |

#### Investment Earnings and Performance Guarantees

The following table provides a high-level comparison of the investment earnings and performance guarantees for FY 2017-18 and FY 2016-17.

| <b>Investment Earnings and Performance Guarantees</b> |                   |                   |
|---|-------------------|-------------------|
| <b>Category</b>                                       | <b>FY 2019-20</b> | <b>FY 2018-19</b> |
| Net Change in Fair Value of Investments               | \$604,625         | \$887,475         |
| Investment Earnings                                   | 2,266,367         | 2,030,885         |
| Performance Guarantees                                | <u>\$318,747</u>  | <u>\$510,701</u>  |
| Total   | \$3,189,739       | \$3,429,061       |

#### Investment Earnings

There are two categories of Investment Earnings on the Statement of Changes in Net Position - net increase (decrease) in fair value of investments and interest income. The FY 2018-19 Statement of Changes in Net Position shows:

| <b>Investment Earnings</b> |                   |
|----------------------------|-------------------|
| <b>Category</b>            | <b>FY 2019-20</b> |

|   |                  |
|---|------------------|
| Net increase in fair value of investments | \$604,625        |
| Interest Income                           | <u>2,266,367</u> |
| Total investment earnings as of 6/30/2020 | \$2,870,992      |

In accordance with General Accounting Standards Board (GASB) Statement Number 31, Accounting and Financial Reporting for Certain Investments and External Investment Pools, the City must report, at the end of each fiscal year, certain investments at fair value in the Financial Statement. The City must also report the change in fair value of investments in the year in which the change occurred. In other words, the City is required to report the fair value of the Trust investments under the assumption that the City would stop doing business on June 30, 2020 and therefore would have to sell all the assets. As a practical matter, the City did not stop doing business on June 30, 2020. As such, the change in the fair value of investments should not be considered as an increase in the investment earnings.

Performance Guarantee Penalties

SFHSS has Performance Guarantees in the agreements with the benefits plan partners. These Performance Guarantees are set to ensure that administrative, service, and clinical standards are achieved and maintained. Measurements and reporting of the measures occur on a calendar year basis and certain measures such as clinical measures require some time to elapse before they are reportable. The full reporting of measures may take up to two years from the benefit plan year to be completed. When the standards are not met, penalties are paid into the trust. The following table shows the performance guarantee penalties received in FY 2019-20 and FY 2018-19.

| <b>Performance Guarantees</b> |                   |                   |
|-------------------------------|-------------------|-------------------|
| <u>Plan Year</u>              | <u>FY 2019-20</u> | <u>FY 2018-19</u> |
| 2019                          | \$464             |                   |
| 2018                          | \$318,283         | \$6,715           |
| 2017                          |                   | 311,951           |
| 2016                          |                   | 192,035           |
| Total                         | \$318,747         | \$510,701         |

Adoption and Surrogacy Assistance Plan

Adoption and Surrogacy Assistance Plan was introduced in January 2017 funded through performance guarantee penalties. As of 6/30/2020 a total of \$260,726 has been used to fund thirteen (13) adoptions and five (5) surrogacies.