Department of the Treasury
Division of Pensions and Benefits
Group Life Insurance

July 1, 2002 to September 30, 2004
The Honorable Richard J. Codey  
Acting Governor of New Jersey

The Honorable Richard J. Codey  
President of the Senate

The Honorable Albio Sires  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the Department of the Treasury, Division of Pensions and Benefits, Group Life Insurance for the period July 1, 2002 to September 30, 2004. If you would like a personal briefing, please call me at (609) 292-3700.

December 20, 2004
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Department of the Treasury  
Division of Pensions and Benefits  
Group Life Insurance

Scope

We have completed an audit of the Department of the Treasury, Division of Pensions and Benefits, Group Life Insurance for the period July 1, 2002 to September 30, 2004. Our audit included financial activities accounted for in the Public Employees’ Retirement System (PERS), Police and Firemen’s Retirement System (PFRS), State Police Retirement System (SPRS), and Teachers’ Pension and Annuity Fund (TPAF).

Annual benefit payments and administrative costs of the group life insurance plans were $185 million. Some of the prime responsibilities of the division are the issuance of group life insurance policies, oversight of beneficiary designation, and processing of death claims. Life insurance benefits are paid through an insurance carrier.

Objectives

The objectives of our audit were to determine whether financial transactions were related to the division’s programs, were reasonable, and were recorded properly in the accounting system. We also tested for resolution of two significant conditions noted in our prior report.

This audit was conducted pursuant to the State Auditor’s responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the division.
Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also read the budget message, reviewed financial trends, and interviewed division personnel to obtain an understanding of the programs and the internal controls.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Sample populations were sorted and transactions were judgmentally selected for testing.

To ascertain the status of the two significant findings included in our prior report dated August 23, 2000, we identified corrective action, if any, taken by the division and walked through the system to determine if the corrective action was effective.

Conclusions

We found that the financial transactions included in our testing were related to the division’s programs, were reasonable, and were properly recorded in the accounting systems. In making this determination, we noted certain internal control weaknesses, matters of compliance with laws and regulations, and opportunities for cost-savings meriting management’s attention. We also found that the division has not resolved the significant issues noted in our prior report. The unresolved issues have been updated in this report.
Life Insurance Plan Administration

Upon the death of a retiree or active member, a group life insurance benefit is paid to the designated beneficiary through the state’s insurance carrier. The total amount of life insurance payments made to the insurance carrier, including premium and administrative costs, is $185 million annually. We identified issues involving the review of year-end billings, beneficiary payment options, bidding for services, and benefit reconciliations which are disclosed in the following paragraphs.

Insurance Carrier Billings

The division calculates the beneficiaries’ entitlements and notifies the insurance carrier of the amounts to be paid. Death benefit claims paid by the insurance carrier along with administrative costs are billed to the division on a monthly basis for reimbursement. At year-end, the insurance carrier analyzes actual costs and informs the division of the final payment or refund amount due. The division has no written procedures and may not have the level of expertise necessary to perform a detailed review of the year-end experience analysis provided by the insurance carrier. The information currently obtained from the insurance carrier is not sufficient for the division to verify that the final billing is accurate. The division relies on the insurance carrier for the accuracy of the bill.

Beneficiary Payment Options

Beneficiaries have the option of receiving one lump-sum payment, an annuity over a period of years, or a life annuity. Both lump-sum payments and annuities are funded by the state and administered by the insurance carrier. According to N.J.S.A. 43:16A-60 (PFRS) and 18A:66-81 (TPAF), the current interest rate to be used for annuities is 8.75 percent. Although not required by law, this rate is also being utilized by other pension systems. The current
annuity interest rate of 8.75 percent greatly exceeds the prevailing market rate and is therefore more costly to the pension funds. In addition, the cost of providing the annuity becomes part of the insurance carrier’s annual billing which further complicates the year-end experience analysis. An alternative could have beneficiaries dealing directly with the insurance carrier if an annuity is desired.

**Contract Bidding**

The same insurance carrier has been the sole provider of the group life insurance plans since the 1950's with automatic renewal and no competitive bids. Although the division is not required by law to seek competitive bids, this is a standard government procurement practice which could be beneficial in determining if the current group life insurance plans could be provided at a lower cost. In addition, the most recent study of group life insurance plans administered by the division was performed by an outside consultant in 1982. This type of study could analyze the current plans, describe the benefits of other plans available, and suggest which alternatives would be most beneficial. This information could be used by the division in selecting criteria to be utilized in awarding a contract.

**Benefit Reconciliations**

Our prior audit recommended the division reconcile death benefits initiated by the division to the monthly billings of death benefit claims paid by the insurance carrier. The division, in conjunction with the Office of Information and Technology and the insurance carrier, has developed an interface between the division’s Death Information Benefits System and the data transmitted by the insurance carrier. A report is generated which summarizes these individual payments and identifies any differences. We were informed that the division’s Financial Services personnel are to review this report and present any questionable items to the Claims Bureau.
for investigation. This computerized comparison has reached its operational stage but no standard procedures have yet been implemented to investigate any differences on a regular basis. The possibility of overpayment therefore still exists.

Recommendations

We recommend the division take the following actions.

- Develop written procedures and the level of expertise necessary to confirm the accuracy and propriety of insurance carrier billings.

- Review the propriety of the guaranteed annuity interest rate, propose legislation where necessary, and institute a practice whereby beneficiaries choosing the annuity option would deal directly with the insurance carrier at no additional cost to the pension plans.

- Conduct a study to determine the most beneficial means of providing group life insurance and, based on the results, contract with the insurance carrier(s) through a competitive bid process.

- Implement procedures which compare death claims processed to those the insurance carrier has claimed for reimbursement.
December 10, 2004

Mr. James B. Patterson  
Assistant State Auditor  
New Jersey State Legislature  
Office of Legislative Services  
125 South Warren Street  
Trenton, NJ 08625-0067

Dear Mr. Patterson:

Enclosed is our response to the auditor report of the Department of the Treasury, Pensions and Benefits Group Life Insurance.

Please include these comments in the formal report that will be issued.

Best regards,

[Signature]

John E. McCormac, CPA  
State Treasurer

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Insurance Carrier Billings

Since premium charges and administrative fees are based on incurred claims activity under the contributory and noncontributory policies, Division staff has the resources and the expertise to verify the accuracy of the year-end analysis report prepared by the insurance carrier. However, our current operating procedures have been confined to verifying that the fees incurred on noncontributory claims do not exceed the established rate, which was 5% of claim charges for the last policy year closed. We also verify for both the contributory and noncontributory policies that actual incurred claims are reasonable based on premium amounts billed during the policy year. The monthly premium charges are audited prior to payment against internal records. Over the last two years, we have also obtained from the insurance carrier a listing of those claimants receiving benefits as an annuity certain to verify the change in incurred but unpaid claims.

We have also had several meetings with the carrier in an effort to address rising administrative fees for the contributory policies, and a proposed increase in the administrative charge on noncontributory settlements from 5% to 6% of the insurance benefit amount. Through our discussions with the carrier, we recently implemented a policy amendment whereby administrative fees for the contributory and noncontributory policies would be capped at 6% of incurred benefit charges prior to providing any interest credit on reserves held by the carrier. This amendment should result in lower administrative fees being charged by the insurance carrier.

The Division plans to expand its procedures so a more thorough review of the year-end analysis report can be made. Specifically, we will require the insurance carrier to provide a separate accounting of conversion charges assessed. As part of the year-end settlement, we are also billed for the 8.75% interest paid to claimants who elect to receive benefits as an annuity. We will require a separate accounting of the interest charges so these charges can be verified. We will also require that a separate listing of the annuitants be included in the year-end analysis report along with an accounting of the reserves being held for these individuals. We will also develop written procedures for the review of the year-end analysis report as recommended in the audit.

Beneficiary Payment Options

The Division agrees with the audit recommendation that suggests a review of the guaranteed annuity interest rate payout option and supports legislation to either eliminate this option or permit the beneficiary to contract directly with the insurance carrier for annuity payouts. The Division advanced a similar cost savings suggestion during the FY2004 budget cycle that was not acted upon.
Contract Bidding

We concur with the recommendation and will initiate a study of the Group Life Insurance Plan.

Benefit Reconciliations

Procedures are in place to conduct and complete these reconciliations and investigate any differences. The reconciliations had temporarily stopped due to limited resources and the dedication of those limited resources to higher priorities. However, we have recently been able to reallocate resources and the process has started again. Reconciliations have been brought to current with no significant differences being identified.