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Fund's deficit raises questions

Sources: Probes focus on investments by teachers union

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The FBI and Indiana secretary of state are investigating the handling of high-risk investments by the state teachers union that have left its insurance fund teetering on the brink of bankruptcy, sources close to the investigations said.

The Indiana State Teachers Association's Insurance Trust is facing a potential $67 million deficit. The trust pays for long-term disability benefits to teachers in 90 of the state's nearly 300 school corporations and health insurance in 30 districts.

Dan Clark, ISTA's deputy director, told The Indianapolis Star on Thursday that the Securities Division of Secretary of State Todd Rokita's office last week issued subpoenas to the eight trustees who oversee the insurance fund.

He said subpoenas also were served to ISTA Executive Director Warren L. Williams, who sent an e-mail to board members announcing his immediate resignation Thursday, and Robert Frankel, the former executive director of the ISTA Insurance Trust, who resigned May 1.

The FBI also began a probe earlier this month centered on the fund's investments, according to a source close to the investigation.

Specific targets of both investigations were unclear, but sources said they could include Williams' and Frankel's administration of the fund.

Scrutiny also is likely to be focused on the actions of the outside money managers, whose identity could not be determined Thursday, and whether information about the fund's investments was properly shared with board members, the sources said.

Williams declined to comment Thursday.

Clark said Williams was planning to retire in December, and it was unclear whether his decision to leave early was related to any ongoing investigations. ISTA will pay Williams' salary through the end of the year, as required under his contract, Clark said.

Frankel and ISTA President Nathan Schnellenberger could not be reached for comment, and all members of the fund's Board of Trustees either declined to comment or could not be reached Thursday.

Rokita's office and the FBI would neither confirm nor deny whether they were conducting investigations.

Most affected by the fund's financial troubles are 650 former teachers and other school employees who receive long-term disability through ISTA. Benefits for teachers enrolled in ISTA's health insurance program are less likely to be affected, because the union is close to reaching a deal to shift that business over to a new provider.

Although state regulators and ISTA officials said it is unlikely the fund would fall into bankruptcy this year, they said the trust does not have nearly enough money to cover the disability payments it would have to make over the long term.

The fund is self-insured by ISTA, so if it collapses, individual school districts -- and thus, taxpayers -- would be obligated to pick up the tab.

"There is no guarantee, no backstop, no bailout option for these folks," said Jim Atterholt, commissioner of the Indiana Department of Insurance, which first raised concerns about the fund.

"If the fund fails, it goes back to the individual school districts to bear the burden, which could be dramatic."

Sen. Teresa Lubbers, R-Indianapolis, who chairs the Senate Education Committee, said her "overriding concern is for teachers and taxpayers at this point, both of whom appear to be at risk with this."

"This is a serious problem," she said, "and one that has huge ramifications."

The trouble begins

Signs of the Insurance Trust's troubles cropped up this year when ISTA decided to allow the Department of Insurance to regulate its troubled health insurance program after years of debate over whether the state should have oversight.

The health program was losing money and cashing in its investments to keep up with claims payments. As a result, Atterholt's department helped broker a tentative deal with United Healthcare, which is expected to take over the health insurance program July 1.

In the process, however, state regulators say what they found was startling: more than a dozen, high-risk investments in hedge funds and private equities accounting for 88 percent of the trust's $19 million in assets.

Compounding the problem: Most of the remaining money can't be liquidated to help pay for insurance claims because it is tied up in long-term, high-risk obligations, said Randy Lamberjack, a consultant hired by the state to analyze the fund and help secure the new health insurance deal.

"They got into some real, real sophisticated investments for this type of fund," said Lamberjack, president of Indianapolis-based Noble Consulting Services. "When you have this kind of money and you have insurance liability, you should be dealing in cash, money markets and government-backed bonds. There is no room for risk. It should have been much more conservative."

No more than 10 percent of the trust's funds should have been invested in stocks, Lamberjack said.

Williams, he said, justified the Insurance Trust's risky investments, telling him the returns they generated before the economic recession allowed ISTA to keep insurance premiums from rising.

When the economy went south, so did those capital gains, and Lamberjack said Williams acknowledged ISTA liquidated most of its bonds, stocks and some of its private-equity investments -- on which it could recover only about 50 percent of their value -- to help pay claims.

Atterholt said he has so far received only limited information from the trust.

"They need to open their books," he said. "We don't think ISTA membership is aware of how serious the situation is, and we don't even know how well-informed their board is."

Two sides of the story

Richard J. Darko, the interim director of the fund who replaced Frankel, also declined to comment Thursday.

However, Darko issued a memo April 28 urging members in ISTA's long-term disability plan to remain with the plan, saying it has been "one of the least expensive, best administered long-term disability products in the country."

Darko also said a planned 20 percent increase in plan premiums was going to be rescinded.

His memo also implored school leaders not to switch insurance carriers for at least the next 30 days. Clark said that request was made because ISTA is in talks with a new provider to take over the long-term disability insurance program.

"It's a Catch-22. If we don't increase premiums, we don't have the revenues we need. If we do, we jeopardize our customers," Clark said. "(The memo) is an attempt to deal with market pressures of adjusting rates and retaining customers. That's hard to do."

Atterholt said he and his consultants were unable to project specifically when the fund could run out of money, but said the concern is real -- particularly when ISTA is issuing memos touting the health of its long-term disability insurance.

"How can you decide not to increase your premiums when your program has been drastically under priced and is under financial duress?" Atterholt said. "What's equally as troublesome is that they are running around and pressuring their membership to stay in this plan that they've not disclosed at all as even being in any trouble.

"That, to me, is unconscionable."

Even with a new carrier taking over, the ISTA fund still would be responsible for paying benefits of the 650 disabled teachers it already covers.

According to the Department of Insurance, ISTA also would remain liable for $21 million in health insurance credits it owes to the 30 districts enrolled in that plan. School corporations accumulate those credits when their claims do not add up to what they have paid into the program.

"If all those districts leave today," Clark said, "we don't have the money."

Only the beginning

ISTA's liability for the long-term disability benefits, however, provides an even greater problem, contributing to most of the anticipated $67 million deficit.

With few investments to cash out, a large deficit and no way to raise premiums once a new company takes over, ISTA will have few options to plug its finances.

The hope, Clark said, is that ISTA's investments in the fund generate better returns or that its other insurance products, such as life and dental, produce enough revenue to cover the shortfall in the long-term disability fund.

The other likely option, Clark said, would be deep cuts in the ISTA staff that runs the fund.

ISTA, however, stressed that the fund is not in immediate danger.

"It's not imminent. These 650 people are collecting benefits now, and the only thing we're currently liable for is next month's payments. That's the cash we have to have," he said. "I think it's probably a few years before all the investments would have been completely exhausted and nothing is left."

Should the fund go bankrupt, 90 school districts across the state would be affected.

They likely would have to spend taxpayer dollars that otherwise would be directed to the classroom to cover their obligations to teachers on disability.

A list of the districts that participate in the long-term disability plan was unavailable. Superintendents of two Central Indiana districts that use the insurance program -- Washington Township and Center Grove -- could not be reached for comment Thursday.

ISTA's total long-term disability claims payment averages $8 million to $9 million per year, Clark said. Under the plan, the disabled school employees, he said, receive an average of $1,300 per month in benefits for an average of 15 years.

Additional Facts

ABOUT ISTA

» What is it? The Indiana State Teachers Association is a union of dues-paying educators. It advocates for teachers in contract negotiations and has a lobbying arm. In this year's legislative session, it fought for more money for Indiana's public schools.

The ISTA Insurance Trust is a separate arm that oversees the administration of the union's insurance funds.

» How big is it? ISTA has slightly more than 50,000 members in Indiana's 92 counties.

» What is its stated mission?: "To provide the resources necessary to enable local affiliates to effectively advocate for members, children and for public education."

» President: Nathan Schnellenberger.

» Executive Director: Warren L. Williams, who has resigned.

» How many are covered by its health insurance plans? About 7,000 members and their dependents.