Section 7
Organization and Staffing Issues

Employee Medical Program

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Government Services Management Consultants
for
North Carolina General Assembly
Government Performance Audit Committee
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Issue Statement

This paper evaluates alternative contribution strategies to increase the number of employees that elect dependent coverage and preserve the financial viability of the dependent medical program.

Background

KPMG Peat Marwick's Phase I initial analysis of the medical program identified a significant decrease of active employees electing dependent coverage. This trend was particularly disturbing for the indemnity plan. Without a reversal of this trend, it is unlikely that employees will be able to afford to cover their dependents.

Under current State statutes, active employees wishing to cover their dependents under the indemnity medical program must pay the full cost of their dependents coverage. The State pays the full cost of coverage for employees.

Employees may choose to cover their spouse and or family at one cost or only their children at lower cost. These costs are established each biennium to coincide with the State's budgetary cycle. Employees may also choose coverage from a Health Maintenance Organization (HMO). The HMO costs are calculated as a percentage of the indemnity plan's costs based on the employees relative risk.

Exhibit 1 shows that the employee's cost for dependent coverage under the indemnity plan has escalated more rapidly than the State's cost for employee coverage. Since 1985 the State's contributions have risen 126 percent while employee contributions rose 139 percent.

The percentage of employees covering dependents has steadily decreased as shown in Exhibit 2. Since 1985, the percentage of employees covering dependents has decreased from 33.8 percent to 29.1 percent.

The decrease in the number of employees covering dependents has created a situation where the employees are not paying the full cost of dependent coverage under the indemnity plan. (See Exhibit 3.) Since 1987, the State has contributed 15.6 percent of employee dependents' claims. The reason for this is that the good risks with dependents that will have claims significantly less than the required contributions leave the plan taking with them premiums used to subsidize poor risks' claims.

The loss of the good risks creates a "cost spiral" since those individuals leaving the program incur claims at a level less than their contributions. This spiral has created a situation where the cost of dependent coverage is not being fully funded by employee contributions. This shortfall is expected to continue unless the good risks are retained and brought back into the plan.

EXHIBIT 1

Active Employee and State Contributions

Year	State Cost Per Employee Per Month	Increase	Employee Cost to Cover Family Per Month	Increase	Employee Cost to Cover Children Per Month	Increase
1985	$63.82		$89.28		$38.30	
1987	93.82	47%	131.24	47%	56.30	47%
1989	107.90	15%	152.24	16%	65.30	16%
1991	144.60	34%	216.18	42%	90.12	38%

Source: 1991 State of North Carolina Enrollment Form
1989 State of North Carolina Enrollment Form
1987 State of North Carolina Enrollment Form
1985 State of North Carolina Enrollment Form

EXHIBIT 2

Employees Electing Dependent Coverage

Year	Total Number of Employees	Number of Employees Covering Dependents	Percentage of Employees Covering Dependents	Number Employees Under Indemnity Plan	Number of Employees Covering Dependents	Percentage of Employee Covering Dependents
1985	197,860	66,864	33.8%	197,860	66,864	33.8%
1987	200,585	67,867	33.8%	200,585	67,867	33.8%
1988	216,129	67,229	31.1%	197,375	61,218	31.0%
1989	221,712	67,780	30.6%	202,710	61,488	30.3%
1990	225,633	68,709	30.5%	209,135	63,251	30.2%
1991	227,550	66,328	29.1%	200,647	57,019	28.4%

Source: Analysis of Self Funded Plan & HMO Enrollment prepared by David Devries 2/20/92

EXHIBIT 3

State and Employee Contributions and Claims
(000 omitted)

Year	State Contributions	Employee Claims	Surplus/ (Deficit)	Employee Contributions	Dependent Claims	Surplus/ (Deficit)
1987	$122,092	$121,645	$447	$47,586	$60,022	$(12,436)
1988	165,180	123,984	41,196	60,120	64,893	(4,773)
1989	212,134	168,843	43,291	73,483	85,418	(11,935)
1990	252,807	226,401	26,406	86,795	96,444	(9,649)
1991	269,189	268,459	730	93,350	121,453	(28,103)
Totals	1,021,402	909,332	112,070	361,334	428,230	(66,896)
Surplus/(Deficit) As a Percentage Of Paid Claims		13%			(16%)	

Source: Fiscal Research Division's State of North Carolina Comprehensive Major Medical Plan for Teachers and State Employees Summary Analysis of Claims Cost - July 1991

Findings

Finding 1: ***The requested cost for family and child coverage will increase significantly starting in 1993, which will likely cause a further decrease in the number of employees electing dependent coverage.***

The indemnity program will establish new contribution rates to be effective November 1, 1993 to coincide with the next budget cycle. Employees wishing to provide coverage for their dependents will be required to cover the dependents' projected claims for fiscal years 1994 and 1995. The Plan Administrator has requested a 44 percent increase for each type of coverage as shown below:

	Current Cost Per Month	Plan Administrator's Request
State Contribution	$144	$207
Family Cost	216	311
Children Cost	90	130

This request assumes that there will be no plan changes. As a result of this large increase, more employees are likely to drop dependent coverage. The cost of the program as a percentage of pay is shown in Exhibit 4.

Finding 2: ***North Carolina is one of a small number of states that pays the full cost of employee coverage and none of the dependent coverage.***

KPMG Peat Marwick's report, Health Benefits in 1992, surveyed the following eleven states:

Alabama
Arkansas
Colorado
Iowa
Kansas
Massachusetts
Mississippi
New York
Oregon
South Carolina
Washington

The survey showed that on average these states required employees to contribute 9 percent of the cost for single coverage and only 35 percent of the cost for dependent coverage.

EXHIBIT 4

Employee Contributions As A Percent of Wages
Annual Gross Wages

	$20,000	$25,000	$30,000	$35,000
Percentage of Employees Earning This Amount or Less	48%	55%	72%	82%
Current Costs Percentage of Pay For Family Coverage	12.9%	10.4%	8.6%	7.4%
Percentage of Pay For Children Coverage	5.4%	4.3%	3.6%	3.1%
Plan Administrator's Request Percentage of Pay For Family Coverage	18.7%	14.9%	12.4%	10.7%
Percentage of Pay For Children Coverage	7.8%	6.2%	5.2%	4.5%

Source: KPMG Peat Marwick

Exhibit 5 and 6 show the State's contribution methodology in comparison to other Southeastern States.

Finding 3: ***Financial constraints are the main reason that employees do not cover their dependents.***

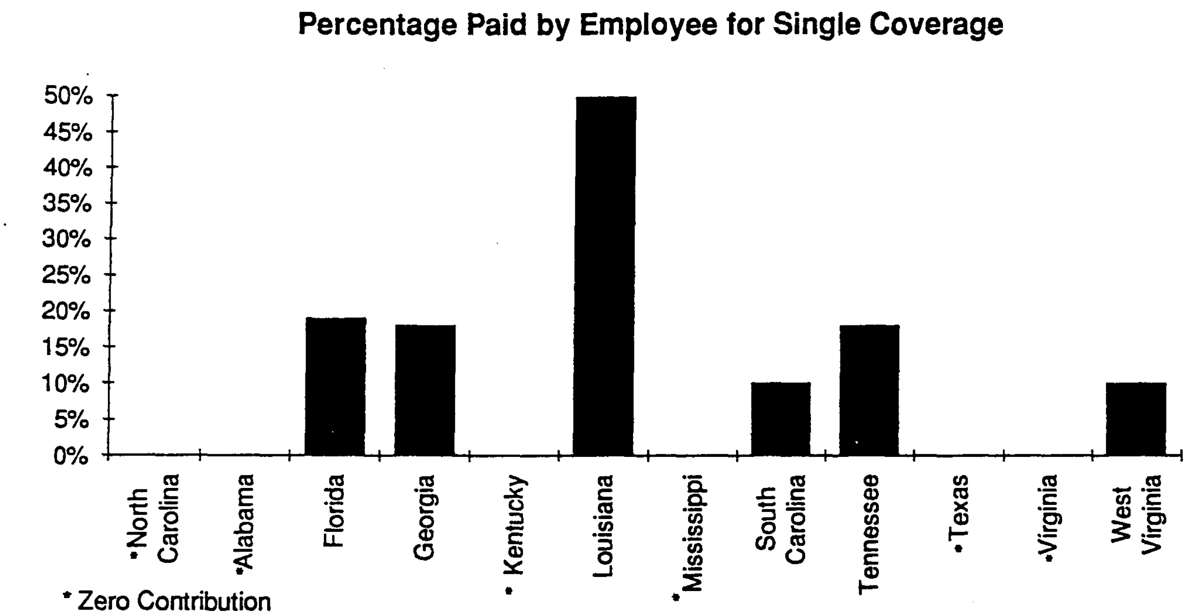
The current demographic characteristics of those State employees that cover dependents under the indemnity plan were analyzed to determine factors that influenced their coverage decision. Two key findings were identified. The first is that there is a correlation between the age of an employee and whether or not dependent coverage was chosen. This relationship is to be expected since younger employees are more likely to be single without any children. The second is that there is also a strong correlation between pay and whether or not dependents are covered. (See Exhibit 7.)

The State does not track the dependent status of each employee, thus we could not analyze the percentage of employees that have dependents that do not cover them under the State's plan. A comparison with national data from the 1991 Statistical Abstract published by the Census Bureau shows the following:

Age	Percentage of Adults Nationwide with a Family	Percentage of State Employees Covering Dependents
25-34	77	21
35-44	80	35
45-54	43	28
55-64	9	13

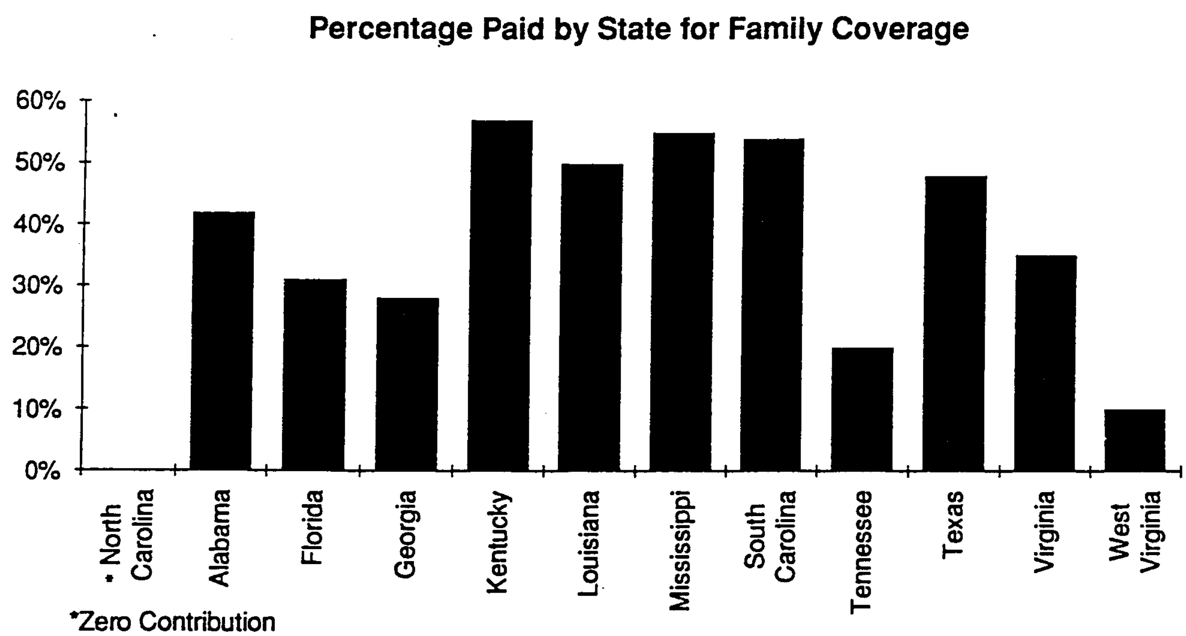
Source: 1991 Statistical Abstract of the United States

EXHIBIT 5



Source: State Employees Association of North Carolina (SEANC) 1990 Comparisons of Employee Basic Health Plans - Southeastern States

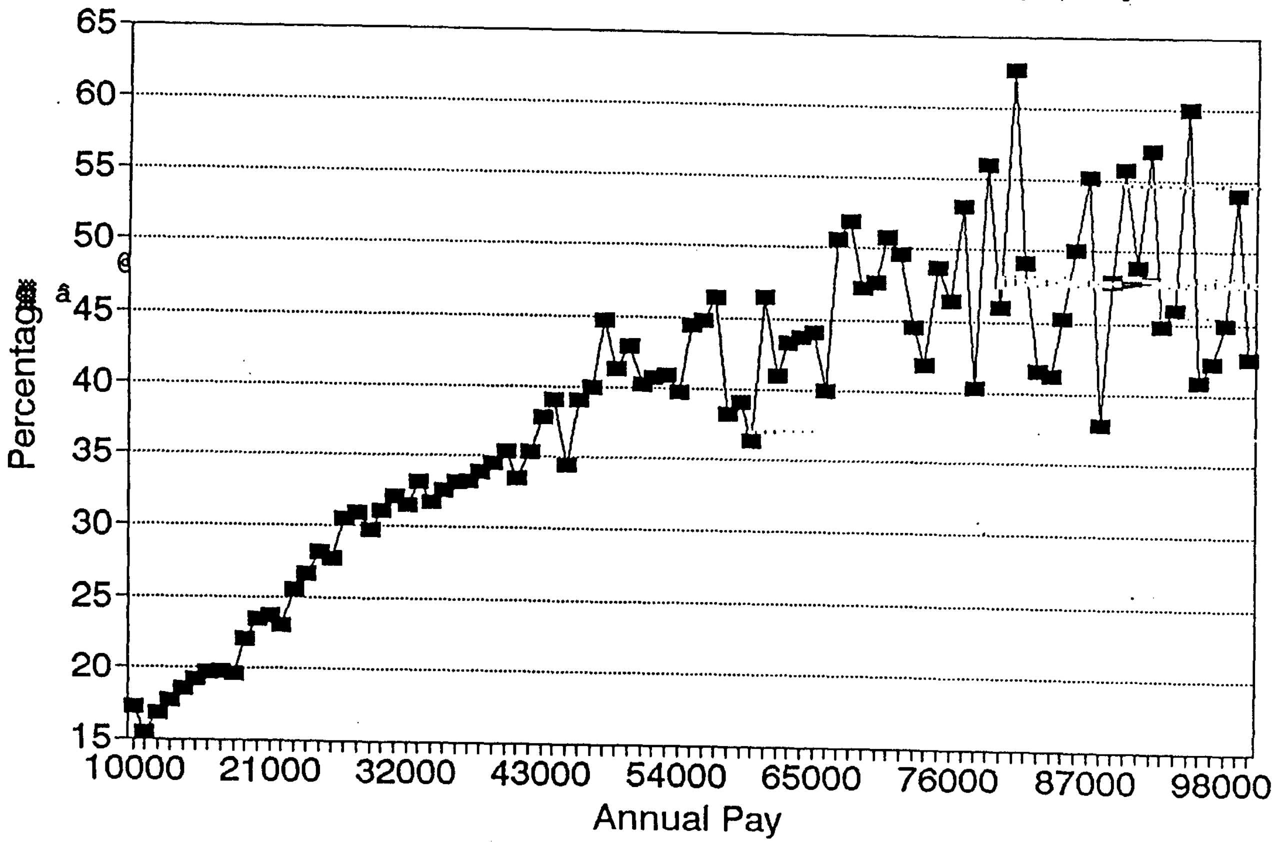
EXHIBIT 6



Source: State Employees Association of North Carolina (SEANC) 1990 Comparisons of Employee Basic Health Plans - Southeastern States

EXHIBIT 7

Percentage Covering Dependents by Pay



Source: Based on data obtained from Blue Cross Blue Shield and State Retirement System.

Recommendations

Recommendation 1:** **The State should retain its current spouse and children or children only coverage options.

Addition of a new coverage option such as spouse only would have a detrimental effect on the plan's enrollment. Spouse coverage is now part of family coverage. Segregating spouse coverage would require increasing the cost of family coverage in order to generate the same dollar amount of contributions. In short, those employees that currently only have a spouse and have enrolled for family coverage are subsidizing those employees with family coverage that have a spouse and children. Increasing the cost of family coverage will result in more employees dropping dependent coverage.

Recommendation 2:** **The State should require contributions for single coverage and should adopt a percentage of pay approach for employee contributions to dependent coverage.

Most employers as well as other states are requiring employees to contribute to the cost of single coverage. The reason for this is that the cost of medical coverage can no longer be viewed as a fringe benefit. Employees should be made aware of the cost of the medical benefits by sharing in the cost. The recommended contribution for single coverage is presented below.

It is clear that the cost of the dependent coverage will become prohibitive for the majority of active State employees. A further erosion of participation in the plan will cause even larger increases for dependent coverage in future years. In order to make dependent coverage more affordable for employees, the following percentage of pay-based contribution approach is recommended:

Category of Coverage	Recommended Contribution Level*
State Contribution	$173 per active employee per month
Active Single	.5% of pay with an annual minimum of $120 and an annual maximum of $1,200
Active Family	9.5% of pay with a $6,000 annual maximum
Active Child	5.5% of pay with a $6,000 annual maximum

* HMO contribution levels will also be a percentage of pay but adjusted for risk as is done curretly.

The benefits of the percentage of pay approach are that it:

- Helps stem the loss of good risk individuals from the indemnity plan

- Provides meaningful medical benefits to lower paid employees

- Establishes a consistent long-term contribution strategy that is sensitive to employees' ability to pay

The recommended contributions approach would be revenue neutral and would continue the State's contribution to dependent coverage.

Our recommendation is based upon the projected costs shown in Exhibit 9. Our projection is less than the request made by the Plan Administrator. The most significant reasons for this difference are:

- The Plan Administrator utilized an annual medical trend of 18 percent while we utilized a 10 percent annual medical trend. KPMG Peat Marwick's report, Health Benefits in 1992, shows that the national average increase was 11 percent. With the adoption of the PPO, implementation of the prescription drug program and continued slowing of inflation, the State should experience a medical trend less than the national average.

- The Plan Administrator's projection includes a continuation of the contribution made to dependent coverage as well as funding of the retiree coverage. Our projection is for active employees and their dependents only. The cost of retiree coverage is addressed in a separate issue paper.

- Our projection assumes that the new contribution method will stabilize the number of dependents covered under the plan. The Plan Administrator's projection assumes a continued decrease in the number of covered dependents.

By having contributions for the indemnity plan and HMOs as a percentage of pay, there should not be any more than normal migration to the HMOs. Employees will still have to choose between an HMO and the indemnity program based on the medical services provided and not on price. As an example, an individual earning $50,000 would contribute $396 per month for family coverage under the indemnity program and $406 per month for family coverage from PruCare of Charlotte.

The impact of this recommendation on individuals is shown in Exhibit 10.

EXHIBIT 9

Projection of 1993 and 1994 Claim Costs

Projection	
Total Claims Paid in 1992	$505,452,082
Percentage Paid to Active Employees and Their Dependents	76.80%
Active and Dependent Claims	$388,200,899

	Employee	Children	Family
Claims Paid in 1992	$267,280,837	$28,206,971	$92,713,091
Covered Units in 1992	201,026	30,204	27,025
Cost per Unit per Year in 1992	$1,330	$934	$3,431
Medical Trend Per Year	10%	10%	10%
Expected Cost Per Unit in 1994	$1,609	$1,130	$4,152
Expected Cost Per Unit in 1995	$2,142	$1,504	$5,526
Expected Covered Units In 1994	201,026	30,358	28,241
Expected Covered Units In 1995	201,026	30,520	29,519
Total	402,052	60,878	57,760
Projected Cost in 1994	$323,450,834	$34,304,540	$117,256,632
Projected Cost in 1995	$430,597,692	$45,902,080	$163,121,994
Net Administrative Costs	$24,000,000		
Total	$778,048,526	$80,206,620	$280,378,626
Needed Cost Per Unit Per Year	$1,935.19	$1,317.50	$4,854.20
Needed Cost Per Unit Per Month	$161.27	$109.79	$404.52

EXHIBIT 10

Impact of Recommended Contribution Levels
Individual Covering Children

Gross Wages	Current Cost	Monthly Health Plan Proposed Cost	Monthly Proposed Cost
$15,000	$90.12	$129.77	$69.00
20,000	90.12	129.77	92.00
25,000	90.12	129.77	115.00
30,000	90.12	129.77	138.00
35,000	90.12	129.77	161.00
40,000	90.12	129.77	183.00
45,000	90.12	129.77	206.00
50,000	90.12	129.77	229.00
55,000	90.12	129.77	252.00
60,000	90.12	129.77	275.00
65,000	90.12	129.77	298.00
70,000	90.12	129.77	321.00
75,000	90.12	129.77	344.00

EXHIBIT 10 (continued)

Impact of Recommended Contribution Levels
Individual Not Covering any Dependents

Gross Wages	Current Cost	Monthly Health Plan Proposed Cost	Monthly Proposed Cost
$15,000	$0	$0	$10.00
20,000	0	0	10.00
25,000	0	0	10.00
30,000	0	0	12.00
35,000	0	0	14.00
40,000	0	0	16.00
45,000	0	0	18.00
50,000	0	0	20.00
55,000	0	0	22.00
60,000	0	0	25.00
65,000	0	0	27.00
70,000	0	0	29.00
75,000	0	0	31.00

EXHIBIT 10 (continued)

Impact of Recommended Contribution Levels
Individual Covering Family

Gross Wages	Current Cost	Monthly Health Plan Proposed Cost	Monthly Proposed Cost
$15,000	$216.18	$311.30	$118.00
20,000	216.18	311.30	158.00
25,000	216.18	311.30	197.00
30,000	216.18	311.30	237.00
35,000	216.18	311.30	277.00
40,000	216.18	311.30	316.00
45,000	216.18	311.30	356.00
50,000	216.18	311.30	395.00
55,000	216.18	311.30	435.00
60,000	216.18	311.30	475.00
65,000	216.18	311.30	500.00
70,000	216.18	311.30	500.00
75,000	216.18	311.30	500.00

Implementation Considerations

There are two actions that must precede implementation of the recommendations. The first requirement is a modification of the current State Statutes. Currently, State Statute (135-40.2) requires the State to pay the full cost of medical coverage under the indemnity plan for employees and certain other individuals. The same Statute requires coverage of dependents to be fully contributory. Our recommendations would require modification of this Statute.

The second action will be a modification of the current payroll system. Based on interviews with Central Payroll, Payroll Programmers for the Community Colleges and SIPS, these changes appear feasible to implement. However, Central Payroll has a special programming need that dictates how our recommendations may be implemented.