

City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 19, 2013

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: RASHAD M. YOUNG, CITY MANAGER *in for Rashad Young*

SUBJECT: BUDGET MEMO #26: HEALTH CARE PLAN DESIGN

The memo is a response to Mayor Euille and Councilman Wilson's request for information about the proposed health care plan design changes included in my FY 2014 Proposed budget.

BACKGROUND

By now City Council is aware that to present a balanced FY 2014 proposed budget, staff was required to close a \$30.5 million budget gap. One of the largest cost drivers contributing to this \$30.5 million deficit was a \$14.1 million projected cost increase (to maintain funding) for City employee compensation and benefits. In recent years the most significant cost driver to City personnel has been the rising cost of health insurance as evident by the nearly 40% cost increase that we have experienced in the past 3 years. Preliminary budget projections last fall indicated this trend would continue in FY 2014 and beyond if changes were not made.

Specifically, if the current health insurance benefits model continues unchanged in FY 2014 the anticipated total plan increase would be \$2.7 million or 9.5% over FY 2013. Since health care costs are split between the City and employees at a combined HMO and PPO ratio of approximately 70%/30% respectively, the projected increase would require \$2.1 million in new City funding and would increase employee costs by \$0.6 million in the form of higher premiums regardless of one's utilization of the plan.

Given the health care cost increases experienced to date and projected for FY 2014 and future years, it became apparent that the City needed to alter our current health care benefits.

Discussion about this policy change focused on three main goals:

1. Creating balanced and sustainable plans that are cost effective for both the City and employees in FY 2014 and in future years;
2. Rebalancing total compensation expenditures through revisions to health insurance plans thereby allowing the funding of pay initiatives such as merit-based step increases (\$3.4 million), one-time bonuses (\$0.6 million) and career ladders (\$0.9 million). The fiscal savings required within the budget for employee benefits to fund compensation initiatives was \$0.6 million from pension, \$0.3 million from the elimination of the sick leave bonus program, and \$1.6 million from within health insurance. Because health insurance costs are split between the City and employees, the actual health care plan savings needed was \$2.2 million, and;

3. Making those changes to health insurance benefits that could be analyzed, recommended and implemented within the confines of the budget process. Significant structural changes such as rebidding our current health insurance plans requires a greater amount of time that simply would not be feasible during the budget process.

To achieve these three goals, the FY 2014 Operating Budget proposal introduces a deductible provision and higher co-pays for certain health care services while significantly lowering premiums. The proposal represents a philosophical shift in the City's approach to sponsoring health care benefits by creating a user-driven model wherein employees experience costs based on the services they utilize and not simply through across-the-board premium payments. The final decision to introduce plan design changes to the City's health care plans was preceded by months of conversation amongst my senior management team and department heads. Staff was also assisted by experts from the health insurance industry who provided analysis of our current plans and the health care market. The process for altering health insurance plans is complex and required nearly four months (mid-December to mid-April) of staff time for discussion and negotiation. In general, the process consisted of four main components: 1) an analysis of market conditions and current plans, 2) negotiation and approval of changes by providers, 3) a benefits open enrollment period, and 4) an ability to effectively communicate proposed changes to healthcare plans to our workforce.

ANALYSIS

Analysis of Health Care Market and Current Plans

In mid-December when it became evident that we needed to explore changes to our health insurance plans, I directed staff to begin meeting with our contracted health insurance experts to discuss options for changing the current health insurance plan design. The City, in conjunction with our consultants, annually review the health care market to determine if changes to the health insurance plans are warranted. In recent years, our consultant has recommended and the City has implemented health care plan changes such as premium cost sharing adjustments and the implementation of the employee plus one tier option.

With an understanding of the City's budget situation and need to introduce a new health insurance model, staff considered a variety of plan design options that included combinations of increasing co-payments for certain services, using co-insurance models, and introducing deductibles. Various plan design changes were vetted through our consultant to verify both employee utilization and the fiscal assumptions inherent to each proposed plan design alternative. Ultimately I recommended a plan design that combined increased co-payments with new deductibles. The selected approach yields for the City a more sustainable model for health care benefits and, as previously noted, moves our healthcare system towards greater user accountability.

Options that were considered and the approximate savings to the health care plans are listed in the table below.

Plan Design Option	Included In City Manager's Proposal	Approximate Total Plan Savings
Deductibles (New)	✓	\$50 increments = \$200,000
Inpatient Hospital Co-pay (New)	✓	\$100 increments = \$30,000
Emergency Room Co-pay (Increase)	✓	\$75 increments = \$105,000
Prescription Drug Co-pay (Increase)	✓	\$5 increments = \$187,000
Coinsurance		10% increments = \$630,000

My proposed plan design changes utilize a combination of the alternatives above to achieve a total plan savings of \$2.2 million. The consensus of the leadership team was not to include coinsurance in the new plan design because with coinsurance employees can potentially experience even greater out-of-pocket costs for more expensive health care services such as emergency room or hospitalization visits. Instead, my recommendation includes introducing new deductibles and a co-payment for inpatient hospitalization as well as increasing co-payments for existing benefits such as emergency room visits and prescription drugs.

On April 16 staff concluded premium rate negotiations with both of our health care providers and as a result of the proposed plan design changes the FY 2014 premium rates are lower than FY 2013 levels. On a total plan basis the Kaiser rates are 5.5% lower than FY 2013 levels and UHC are lower by 1.8%. For HMO plans, employees can expect to experience premium decreases ranging from 16.5% to 19.7% as a result of final negotiated premiums and the City Manager's recent proposal to change the premium cost sharing ratio from 80%/20% to 83%/17%. The premium decrease for PPO plans is less since employees enrolled in those plans choose to pay a higher amount for the services provided in the plan.

The reduction in premiums translates into a positive impact on employees' take home pay since the deduction for monthly premiums will be less than the current year. On average, the annual savings to employees will range from \$235 for HMO individual plans to \$680 for family PPO plans. This is compared to an average premium increase of \$124 to \$793 if no plan design changes were made and premiums increased by 9.5% as projected.

<i>Employee Share Only Avg. Kaiser & United</i>			<i>9.5% Premium Increase No Plan Design Change</i>	<i>Final FY 2014 Premium Decrease Plan Design+Cost 83/17%</i>
Plan	Plan Type	Average Annual FY13 Premium	Average Annual \$ Change FY13-14	Average Annual \$ Change FY13-14
HMO	Individual	\$1,311.85	\$124.63	-\$235.86
	Employee + One	\$2,623.70	\$249.25	-\$471.73
	Family	\$3,359.28	\$319.13	-\$603.78
PPO	Individual	\$2,770.75	\$263.22	-\$256.34
	Employee + One	\$6,501.02	\$617.60	-\$529.79
	Family	\$8,356.22	\$793.84	-\$680.81

The annual savings shown above will be accrued over the course of the fiscal year as premiums are deducted on a bi-weekly basis. In total though these savings coupled with the Out-of-Pocket Assistance Program we discussed at the employee compensation work session which allows employees to convert up to \$200 in annual leave is equal to the deductibles employees in individual and family plans may experience in FY 2014.

Plan Design Approvals

Changes to plan design require approval from the City's two health insurance providers. This process typically can take several weeks to a few months to complete, depending on the provider. Because the City is self-insured with United Health Care, we have been able to gain approval from UHC for proposed plan design changes relatively quickly. In the case of Kaiser, our proposed plan design changes altered the standard Kaiser HMO model. As a result, the proposed plan changes required the approval of the State Bureau of Insurance. In the case of my proposed Kaiser HMO plan design changes, this additional level of authorization took in excess of two months to conclude. The City received final authorization for the proposed changes on April 16.

Employee Benefits Open Enrollment

Every year in May, Human Resources hosts benefits open enrollment, which is the period of time that current employees are allowed to amend their benefits selections. Open enrollment is scheduled months in advance given the considerable amount of staff time required to prepare for this multi-week event. This year open enrollment is scheduled for May 8 - May 24 and includes the annual Health Fair as well as 10 new open house sessions to provide employees and retirees enrolled in our healthcare plans the opportunity to interact directly with HR staff and the City's two health care providers. In addition to the scheduled events, open enrollment requires a substantial communications plan starting in mid-April to provide information to employees through multiple platforms. Finally, considerable staff work is required to process employee benefits selections into our HR information systems before the new plan year begins at the start of the first pay period of FY 2014.

Employee Concerns and Communication Efforts

Since I proposed my budget on February 26, there has been a considerable outreach effort made to employees to explain the changes to health insurance I have proposed and to answer questions and address concerns expressed by employees. Staff is routinely providing updates on AlexNet and is actively engaging with employees through the AlexNet forums, by email and phone, and in-person. I have personally hosted 6 town hall sessions and have met with employees and their labor representatives. Using these various communications platforms we have explained the budget process, the philosophical reasoning behind health care changes I proposed, and the details of how the plan design changes may impact employees.

Based on the feedback employees have provided to date, a top concern continues to be the potential impact the proposed deductibles may have on their net pay. It is important to note that employees will only experience a deductible if they utilize health care services. Low users of health care may experience little if any of the \$400 or \$800 deductible. In addition, all employees would be paying less in bi-weekly premiums, and those who perform satisfactory will

receive a merit raise under the proposed budget. Plus, employees will be able to cash-in \$200 in annual or compensatory leave to assist with deductible payments as needed. In total, this results in a positive impact on employees' take-home pay that would likely offset the \$400 or \$800 deductibles that may be experienced. Even with this information some employees still worry about the chance of incurring a substantial health care bill due to a serious health emergency/condition before their merit increase takes place or they can accrue the savings generated from lower premiums.

CONSIDERATION OF ALTERNATIVES

Since the approval process for plan design changes takes a minimum of two months, further plan design changes at this point in the budget process are limited. Any structural changes to the proposed plan design Council elects to make within the approved budget, such as lowering or eliminating deductibles or co-payments, would severely impact the process required to start the new plan year on July 1. Open enrollment season would need to be moved back as new benefits summaries would have to be produced by the providers. This would be compounded by the need to reschedule the Health Fair and 10 health insurance sessions that have already been scheduled. The time required for HR staff to input employees' new benefits selections would also have to be taken into consideration. A delay to the start of the plan year will have a fiscal impact because the City and employees would have to absorb the ongoing costs associated with staying in the FY 2013 plans.

Council still has the opportunity to consider changes to the employer/employee premium cost sharing ratio without requiring approval of the health insurance providers. The City has the ability to adjust the ratio and I recently recommended changing the minimum premium cost sharing ratio to 83%/17%. This recommendation resulted in shifting \$750,000 of City funding to employees in the form of lower health insurance premiums. Shifting the cost sharing ratio back to an 80%/20% split would provide \$750,000 that could be used to provide additional out-of-pocket assistance to address the concerns expressed by employees about potential deductible payments they may experience next year. Were Council to consider such a change during the add-delete process, it would be aligned with the suggestion made in the letter you recently received from representatives of the Fire, Police, Sheriff and General Schedule labor organizations.

If additional out-of-pocket assistance is something Council is open to considering, I recommend the following framework to guide such a program:

- The assistance is provided through a one-time pay supplement at the beginning of the fiscal year.
- The assistance program is only available to regular full and part-time employees who are enrolled in a City-sponsored health care plan on July 1, 2013.
- This one-time assistance program is limited to FY 2014 to help employees transition into the new user-driven plan design model.
- The one-time payment would be an amount equal to the difference in annual premium payments the employee would have experienced from the 80%/20% to 83%/17% cost sharing reduction. The savings would vary by the type of plan and tier the employee is enrolled in. The table below shows the savings by plan and tier using this methodology.

Plan Type and Tier	Difference in Annual Premiums from 80/20 to 83/17 cost sharing
HMO - (avg UHC & Kaiser Savings)	
Individual	\$196
EE+1	\$391
Family	\$501
PPO	
Individual	\$207
EE+1	\$414
Family	\$532

- Council may also want to consider a cost multiplier of 41% (to the dollar amounts in the table above) to cover the Federal and state tax burden employees incur when provided one-time pay supplements.

The fiscal impact of providing additional out-of-pocket assistance based on the framework above and current health insurance enrollment data is approximately \$776,000. The final cost will depend on final enrollment figures on July 1, 2013 and may be above or below this preliminary estimate.

I continue to believe it is important that the City focus on creating balanced and sustainable benefits programs that are cost effective for FY 2014 and beyond. This is best achieved if we begin to implement plan design measures that introduce user-driven principles into our benefits program.

Going forward I fully expect our health insurance program to continue to change as a result of federal health care reform and the evolving needs of our workforce. Employees will have a role in helping to guide these changes and their input is exceptionally valuable as we try and shape a future system that most closely meets the needs of our workforce. It is for this reason that I have established an Employee Health Care Advisory Group led by HR staff that will begin to meet following budget adoption in May.