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Trends in Employee Benefits

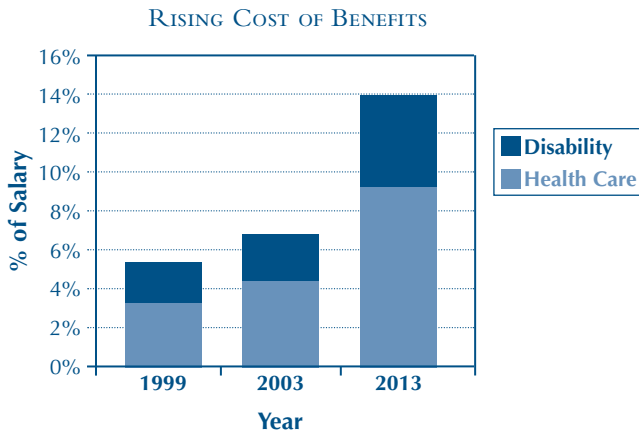
In this issue, we highlight the major trends in employer-provided group benefits (other than pension). This high level overview should be of particular interest to readers who are responsible for the design or cost of the benefits program for their organization.

Certainly, the broad themes are well known, including rising health costs, a shrinking insurance industry and continued government offloading of responsibility. The question is, what can organizations do? We are pleased to offer a few ideas.

RISING BENEFITS COSTS

It is no surprise that the rising cost of benefits is the number one HR concern for organizations. This was identified as a major issue by 57% of the respondents to our *2004 Compensation Trends and Projections Survey*. In addition, 95% of the respondents to our *60 Second Survey* from May 2004 expressed a medium or high level of concern about rising pension and benefits costs.

As the chart below shows, costs for employer-sponsored benefits programs are expected to continue rising steeply over the next decade.



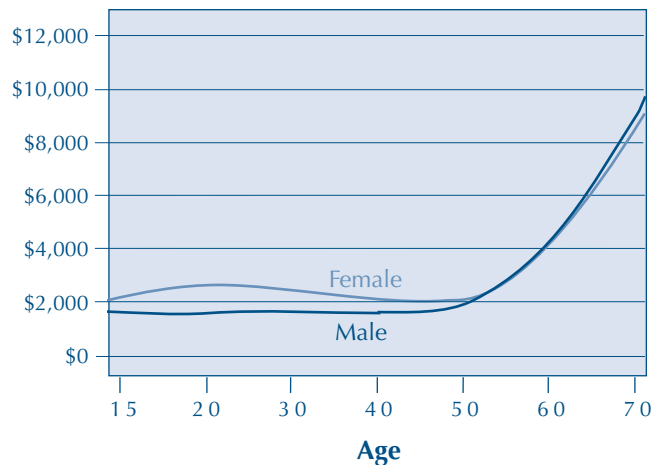
Employers can take a number of actions to keep their own costs in check. Before we get to them, let's begin by outlining the reasons for the trend:

- **Aging population** – Health care costs tend to be fairly steady until age 50, at which point they start rising steeply with age. The chart on your right shows the costs by age for employer-sponsored health, disability and dental benefits. In the next ten years, most organizations will have a higher proportion of employees in the 50+ category. One reason is because organizations will try to entice more of their older employees to stay in the workforce, if and when baby-boomer induced labour shortages start to materialize. Second, the trend to

defined contribution pension arrangements will cause workers to delay retirement. Indeed, U.S. statistics show that the average retirement age stopped declining around 1985, about the time that 401(k) plans started to become popular.

- **Surge in stress-related disability** – A decade ago, mental and nervous conditions were a primary or secondary factor in about 25% of all disability illness. Today, that figure is 55%. One might wonder what sudden and adverse change in the work environment was responsible for such an increase. More likely, a problem that always existed has now been given a label, and this has led to increased claims. Either way, it is a real problem and comes with a hefty price tag.
- **Drug use** – Total expenditures on drugs have been rising rapidly. This has little to do with cost increases for existing patented drugs, which have been rising more slowly than general inflation, but a great deal to do with greater utilization of drugs by a growing and aging population. In addition, more illnesses (e.g. HIV/AIDS) are being successfully treated by drugs. Rising drug expenditures by themselves are not necessarily bad news, provided that the increased costs are offset by reductions in the cost of surgery and hospital stays and less absenteeism.

HEALTH COSTS PER INDIVIDUAL



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- **Government offloading** – Governments have put an increased share (over 30%) of total healthcare costs onto the private sector. Apparently, it is not over. The recent Ontario budget continued this trend as Ontario partly or fully delisted services related to chiropractics, physiotherapy and optometry.
 - **Post-employment benefits coverage** – The cost attributed to post-employment benefits has soared in recent years, not because true costs suddenly rose dramatically but because accountants now measure costs differently. Thanks to the adoption of CICA section 3461 in Canada and FAS 106 in the U.S., what would have been a financial time bomb many years from now has simply been brought forward.
 - **Insufficient corporate governance** – While governance has received a lot of press in recent years, most of it has revolved around pension plans. The oversight of non-pension benefits has not received the same level of scrutiny, which is a problem now that benefits are having a greater financial impact.
- (See the sidebar *Cost-sharing Ideas*.) Before making any changes, an employer will probably want to benchmark current practices against their peer group.
- **Better governance** – More diligent oversight of the benefits program is likely to reap some savings. A good place to start is with a claims audit. Some findings from past audits have uncovered unauthorized expenditures such as:
 - Co-ordination with Medicare being ignored for retirees, hence the employer plan paying for benefits that should have been covered by government.
 - Paramedical limitations not coded into the system.
 - Out-of-pocket maximums being ignored resulting in the employer's plan paying more than promised.
 - Reimbursement for drugs not eligible for coverage under the plan.
 - Reimbursement of eye glasses that were not an eligible expense.

WHAT ORGANIZATIONS CAN DO

- **Take a future snapshot** – For starters, employers should get a better handle on how their own costs are expected to change in the next few years. This is not as difficult as it sounds since rising costs depend largely on demographic changes, which can be predicted with a high degree of confidence. By reviewing data on new hires and turnover, an actuary can project the future demographics of an organization's workforce and use it to estimate future costs. This knowledge can help prepare employers for what to expect and to plan accordingly.
- **Change the cost-sharing equation** – No one likes to pay more, but surveys show that employees are fairly open to increasing their share of benefits costs if this is what it takes to maintain health coverage.
- **Review rationale for providing post-retirement life, health and dental coverage** – Many organizations committed to providing post-retirement benefits when they thought the cost was minimal (pre-CICA 3461). As the cost has become better understood, post-retirement benefits coverage has been declining. Our 2004 Trends and Projections survey showed that 37% of respondents provided post-retirement health coverage, a drop of about 5% over two years. The one hurdle preventing an even more rapid decline is that the courts consider post-retirement benefits to be vested at the point of retirement. Hence, they cannot be easily taken away from retirees. Post-retirement benefits are similar to defined benefit pension plans in that both take many years to phase out and few organizations are launching new plans.

Cost-sharing Ideas

There are a number of ways that employers can share benefits costs with employees. The first approach, premium cost-sharing, is relatively straightforward. Through payroll deductions, employees would pay either a percentage of the total premium or some fixed dollar amount. The drawback to this approach is that employees will tend to view their premium as an “investment”. It subtly encourages them to get more back in reimbursed claims than they spent in premiums.

The second approach involves some form of participation in the actual cost of an expense. There are a number of methods used, as follows:

Coinsurance: As the word infers, two parties (the employer and the employees) share in the cost of an item. For example, under a prescription drug plan, an eligible drug may be 80% reimbursed through the plan, with the remaining 20% paid by the employee. This would be referred to as “80% coinsurance for drugs”.

Deductibles: A deductible is the threshold level before the employee’s benefits expenses are reimbursed. Typically, the deductible will be lower for employees with single coverage versus those with family coverage, such as \$50 (annual) single, \$100 family. A deductible could be combined with coinsurance (on the portion over the deductible). While a deductible is typically expressed as an annual amount, the term might also be used to describe recurring “co-pay”. A co-pay is often related to a pay-direct drug card expense and would often be described as \$5.00 per prescription.

Maximums and caps: Another form of cost-sharing, suited to budgetable expenses, are periodic maximums. These could be bi-annual maximums (typically found in a vision care plan), annual maximums (common for paramedical expenses), and lifetime maximums (associated with orthodontic plans).

Prescription drug dispensing fee caps could also be considered a form of cost-sharing. With the advent of mail-order pharmacy in Canada in the early 1990’s and a poor economy in general, pharmacist dispensing fees came under increased scrutiny. As a result, many plans capped the amount they would pay for a dispensing fee – or in some cases – not pay for the dispensing fee at all. There are still many of these plans in existence today.

- **Focus on wellness** – The traditional emphasis of the medical system and by extension of employer-sponsored benefits programs has been on diagnosing and treating illness, not on prevention. This is changing. A growing number of employers have implemented wellness programs. Our data indicates that 33% of organizations have an employee wellness program, up from 24% just two years earlier. Another 14% of those who don’t have a program indicate they are likely to add one in the next year. Most practitioners are convinced that wellness programs can improve the health of the workforce and hence improve productivity. The challenge is to quantify it. Doing so is critical since this is one of the few benefits areas where intervention might significantly reduce claims without cutting back on benefits or increasing costs. This area is sure to evolve rapidly in the next few years.
- **Partner with employees** – Consider having employee representatives on an advisory committee to deal with benefits issues. This may be the best way to get employees to buy in to remedies that may involve cut-backs in coverage or increasing cost-sharing on the employees’ part.
- **Consider a DC approach** – Just as defined contribution pension plans can help employers contain costs while giving employees more choice, the same is true with benefits, but only to a degree. This is discussed below.

THE RISE OF “DEFINED CONTRIBUTION” BENEFITS

The concept of defined contribution as it applies to pension arrangements is quite well known. From an employee perspective, DC pensions can be attractive since they suggest greater empowerment and transparency. The main advantage for the employer is reduced cost volatility. The same principle can apply to benefits as well, but only in the case of benefits where incidence is fairly high and the financial implications to the individual are manageable. This is

especially true if utilization has a discretionary element to it. In the case of DC benefits, the employee would accept some or all of the cost. Catastrophic benefits coverage – where incidence is low and the financial implications are major is almost always offered as a defined benefit.

The following chart indicates when a DC approach makes the most sense:

Benefits usually offered in DB form	Benefits that can be in DC form
Long-term disability	Routine dental
Life Insurance	Vision
Catastrophic drug coverage	Orthodontia
All extended health and dental expenses over a pre-determined dollar threshold	All extended health and dental expenses under a pre-determined dollar threshold
Nursing care	
Out-of-Canada coverage	

Even though employees would be taking on more risk under this approach, they would continue to be protected against catastrophic expenses. Employees could manage their share of the risk by adjusting future contribution and coverage levels to match their personal situation.

There is one big difference between the DC concept in benefits versus pensions. With pensions, an employer can maintain a fixed contribution rate for decades. If that rate proves to be inadequate, it does not become apparent until retirement. (This suggests DC pensions could be a ticking time bomb, but that is another topic.) In a DC benefit program, however, the inadequacy of a given contribution rate is felt immediately, for instance when a dental fee guide changes. The employer is, therefore, under constant pressure to increase the contribution rate, which limits the effectiveness of DC arrangements for benefits as a cost-containment tool. This is not to say that the DC concept is totally ineffective. DC gives

employers some cost control, though not as much as might be hoped.

CONSOLIDATION OF SERVICE-PROVIDERS

The number of players in the insurance industry has been shrinking rapidly (see the table in the centre of this issue). Among the surviving major insurers, the price gap is narrowing. This begs the question of whether there is still any point to conducting a market survey. Historically the main reason for a market survey was to reduce premiums and/or expense factors. While this is still a consideration, the bigger reason to initiate a market survey now is to ensure a good fit with your insurer. For instance, the insurer you selected five years ago may have since changed ownership and its focus may have changed or service may have deteriorated. Another reason to canvas the market is because technology and employee self-service options have become more important and service offerings vary from one insurer to the next.

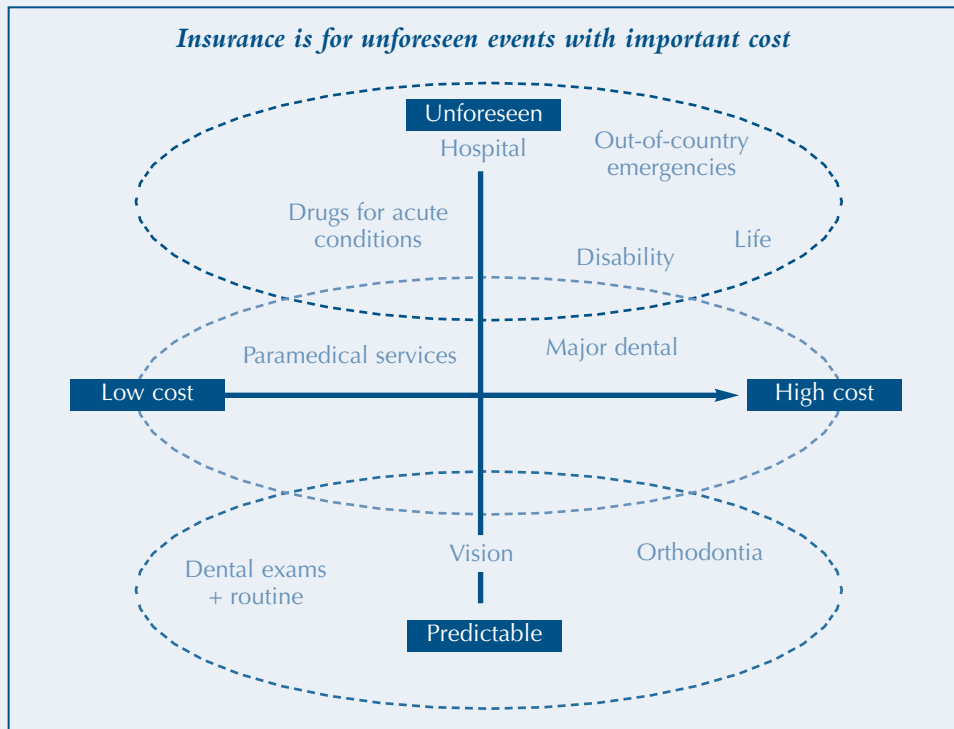
ONGOING EVOLUTION

Pension plans seem to go through a major overhaul every five to ten years because of external events such as provincial pension reform in the late 1980s and tax reform in the early 1990s. In the case of benefits programs, changes tend to be less dramatic but occur more frequently, so change is almost certain to be a constant. Here are some reasons why organizations will constantly need to review their benefits programs:

- **Government downloading of costs** – As governments pass along the responsibility for certain benefits, employers need to be diligent in managing the impact on their own plans. The default can be an automatic increase in employer costs that could have been avoided. The most recent Ontario budget, for instance, introduced individual healthcare “premiums”. In some cases, employers may be

INSURANCE IS FOR UNFORESEEN EVENTS WITH HIGH COST . . .

Given that Canadians have universal access to healthcare, the highest priority for an employer-provided benefits program is to protect employees from significant financial hardship due to illness, disability or death. When cost is a constraint, this suggests a benefits program needs first and foremost to protect big-ticket items like long-term disability and perhaps compromise on other benefits where the cost to the employee is both more predictable and more affordable. This is the basis of the following diagram:



Provide for catastrophic coverage.

Besides life insurance and disability benefits, the benefits that fall into this category include out-of-country emergency medical care, drugs for serious health conditions, and some form of accidental dental (extensive dental coverage required as the result of an accident) plus hospital coverage beyond what the province provides. The employer may want to cover up to 100% of these types of expenses.

Incorporate flexibility with some tax-preferred compensation.

Dental care and vision benefits are very popular with employees and typically included in defined benefit form. Since these types of expenses tend to be fairly predictable, you may wish to provide coverage in defined contribution form instead, in the form of a health spending account. This puts a cap on the employer's share of the cost, provides employees with flexibility in what they choose to cover and is extremely tax effective.

Some sharing of other high expenses.

The cost of certain services falls between the "catastrophic" and the readily affordable. Services in this category include chiropractors, physiotherapists, drugs for chronic conditions, and the more expensive dental treatments like crowns, dentures and bridges. Sharing these expenses with employees should help to motivate responsible purchasing behaviour while mitigating employees' financial concerns.

What's Hot and What's Not - Trends in Employee Benefits

What's Hot:	What's Not:
<p>Disability Management (DM)</p> <p>Over 60% of respondents to our October 2003 <i>60-Second Survey</i> on DM indicate that they will be seeking assistance with short-term disability management in the next three years. Employers are realizing that disability is one of the few areas where active management can actually reduce costs.</p>	<p>Preferred Provider Networks</p> <p>Unlike the U.S., mail-order pharmacies, preferred providers, and capitation plans have not fared well in Canada.</p>
<p>Choice</p> <p>Offering some choice (be it full flex, an "opt-up", or even an "opt-out" of a plan) affords employees some degree of control over their benefits.</p>	<p>Routine Market Studies</p> <p>With cost differences narrowing in a shrinking insurance industry, market studies need to do more than test price competitiveness.</p>
<p>Alternate Therapies</p> <p>Recognizing that employees have differing attitudes toward the delivery of healthcare, the provision of healthcare spending accounts is allowing employees to seek alternative therapies or treatments.</p>	<p>Antiquated Deductibles and Coinsurance</p> <p>Minimal deductibles (as low as \$10 / \$20 for single / family employees, or a \$2.00 fee per prescription) do little to protect employers against unnecessary utilization of benefits coverage.</p>
<p>Plan Governance</p> <p>Employers are taking a closer look at many elements of their plan (i.e. design, funding, etc) to ensure they are aligned with corporate goals.</p>	<p>Retiree Benefits Coverage</p> <p>Because of cost, few employers are implementing new post employment benefits programs.</p>
<p>Total Compensation</p> <p>Employers increasingly are managing benefit and pension costs in the context of a "total compensation" or "total rewards" framework and are looking to communicate total compensation to their employees.</p>	<p>Vacation Day Selling</p> <p>Some feel that allowing employees to sell vacation days can result in overworked staff and increased absenteeism.</p>
<p>Flexible Executive Plans</p> <p>To attract and retain key individuals, many organizations are going the extra mile to provide competitive and flexible benefits to executives.</p>	<p>Sick Bank Accruals</p> <p>Sick banks are often viewed as another form of income. Given the cost, employers are implementing a "use-it-or-lose-it" approach.</p>
<p>Employee Self-service and Outsourcing</p> <p>"Self-service" allows employees the freedom to access information online, 24/7. This includes plan design information, making choices, account balance, claims history and claims submission. Self-service usually calls for outsourcing.</p>	<p>Paper-based Processing</p> <p>Benefits and pension elections and enrolments, claims reimbursement, and even claims submission are going paperless. Online processing is seen as more efficient and modern.</p>

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required to bear the cost because of inadvertent wording in their collective bargaining agreements dating back to the 1980s, when Ontario last had OHIP premiums.

- **Changing demographics** – The effect of demographic change on benefits programs is profound, but is masked by the fact it seems to occur at a glacial pace. Employers need to review their coverage in light of their changing demographics every five years or so.
- **New health problems** – Although they are not new problems, factors such as obesity, Type 2 diabetes, and stress-related health issues are becoming increasingly prominent. The prevalence of these conditions will trigger changes in coverage.
- **New treatments** – The emergence of employee health risk assessments and various wellness programs can assist employees in improving their own health outcomes. To be successful, employers need to be clear on their objectives when they introduce new programs.
- **New technology** – Access to the Internet (and employer Intranets) is now commonplace. Perhaps the biggest impact of technology in terms of benefits program design is that it facilitates flexible benefits programs and healthcare spending accounts. Online enrolment, for example, has proven to be much more effective than paper-based enrolment. Technology can also be effective in improving the communication of plan changes and wellness programs to employees.

AND NOW, THE GOOD NEWS

It is easy to see the gloom in the current situation. We have identified the rather daunting challenges employers face in delivering an effective benefits program to their employees at a manageable cost. There is, however, some good news.

The vast majority of Canadians believe we have an effective healthcare system. According to an Aveniris healthcare survey, 86% of Canadians would rate the quality of services in our healthcare system as good to excellent. This is a higher percentage than we have seen in years. In the same survey, 94% of plan members say their employer benefits program meets their needs either “somewhat well” or “extremely/very well”. Canadians are living longer than ever. There are fewer illnesses that cannot be treated effectively. And for some illnesses, new treatment (e.g. via drugs) is less invasive and more effective than it once was (e.g. surgery).

We need to celebrate our successes while continuing to seek improvements.

WHAT OUR CLIENTS ARE SAYING

We invited several of our clients to voice their opinions on benefits, and we thank the representatives for sharing their thoughts.

CHALLENGES AND OPPORTUNITIES IN THE BENEFITS ARENA

By Andrew Rickard

While the consolidation of the Canadian insurance business may have helped to enrich shareholders and company executives, it hasn't done much for some of their group benefit customers. "It's simply a question of poor service," says Cindy Hillaby, vice president of human resources for the Canadian Automobile Association (CAA). "As insurers try to merge systems and get their administrative processes in place, I think they've lost sight of their clients."

Just how far have things deteriorated? When the CAA conducted an employee survey in 2002, their group insurance provider was ranked as the number one area of satisfaction.

"If I asked that question today, I'd be surprised to see them ranked in the top ten," says Hillaby. She's clearly concerned about the diminishing number of options available to her. "I find the consolidation threatening. It's really coming down to three or four big players now".

Although there isn't much she can do about the state of the insurance industry, Hillaby certainly is taking steps to manage her company's insurance costs through increased employee communication. With the help of Morneau Sobeco, CAA was able to provide staff with a listing of drug stores and their current dispensing fees.

"We were able to educate employees about how prescriptions are filled, showing that they don't have to pay a \$15 charge when they can go to NoFrills for \$4.99," says Hillaby, who points out that this one

project has already had a positive effect on the company's bottom line. CAA has launched a similar campaign to encourage employees to ask their doctors for more cost-effective, generic drugs whenever possible. "We're really trying to educate them about the expenses related to their plans," she says.

Hillaby isn't the only human resources professional who's worried about educating employees and managing expenses. Norampac, Canada's largest containerboard producer, has seen their benefit costs increase by more than 300 per cent over just five years.

Human resources director Valérie Miron estimates that in 1999 it cost Norampac about \$600 to provide each of its employees with insurance benefits. By 2003, that number had increased to about \$2000 per person. With more than 4500 employees, the expense was significant. "It was awful," she says "and a major problem for the company."

Last year, Miron sat down with her colleagues to conduct a review of the company's benefits package. They wanted to overhaul the plan and create something that was competitive and met the employees' needs, but was also designed in such a way that it would allow Norampac to better control costs. The result was a cafeteria style benefits plan that gives employees a specific number of credits that they may spend on the features that they consider to be of greatest value.

When the proposed plan was shown to the company's non-unionised workers in series of focus groups, the result was positive. "Of course we cannot please everybody," says Miron. "But many employees were very open to the changes once they understood the purpose and saw the amount of flexibility available." The availability of newer products such as critical illness insurance appealed to some, but ultimately the Healthcare Savings Account emerged as the single most popular feature. Miron says that

employees really liked the idea of opting out of the benefits they didn't need and receiving funds they could spend elsewhere.

Presenting the same type of benefits plan to Norampac's unionised workers, however, may prove more difficult. Accustomed to having the employer pay the lion's share of benefit costs, many of the company's union members have been reluctant to accept the idea of flexible plans and cost sharing. That, however, may change with time.

"There's an educational role that I have to play because I represent the corporate stakes at the negotiation table," says Miron. Right now, many Norampac employees don't have any idea about the true, bottom line costs because they only pay a few dollars in order to have a prescription filled. Miron says that her number one priority is to increase awareness about costs so that employees will think carefully about how they use the plan in future. "It's a behaviour change we're looking for," she says.

To a certain extent, New Brunswick Power has already managed to bring about a change in their employees' behaviour. "We've been quite successful over the last few years in bucking industry trends," says Manager of Benefits Maurice Poirier "We're averaging 3 to 4 per cent increases [in premiums] where the industry is closer to 15 per cent." Asked for his secret, Poirier answers with one word: wellness.

"We discovered years ago that the only way we were going to address increases in health care and disability insurance costs was through wellness," he says. "We went through redesigning the plan and putting in deductibles on prescription drugs, but the fundamental concern is the lifestyle people lead these days. People are really not looking after themselves."

Poirier says that NB Power has been taking a pre-emptive approach to managing health care expenses. They put a great deal of time and effort into

educating employees about the personal and corporate benefits of leading healthier, more active lives. As he points out, it's a win-win proposition; when an employee's physical and mental condition improves, so does the plan's claims experience.

Central to NB Power's benefits strategy are the company's regular health clinics, where employees can complete personal wellness profiles. These confidential, scientific questionnaires collect information about subjects such as diet and family history, ultimately revealing potential problem areas. Once the employees understand their own risk factors, they are in a better position to make appropriate lifestyle changes.

NB Power is currently undergoing a reorganisation, and there has been an increase in long-term disability claims as people try to cope with uncertainty. "But we're not just riding it out," says Poirier. "Through better communication and our early intervention program, we're trying to address the problem before it becomes serious."

When an employee does require time away because of an illness, they receive additional support from the company. Staff stay in touch with the employee throughout the period of disability and try to help them maintain a healthy state of mind. If possible, the employee is even encouraged to come into the workplace for purely social visits. "We want to keep them feeling part of the team," says Poirier. "We don't want them to start to feel disconnected or adrift, because depression might set in and we could lose them for an even longer period of time."

At the end of the day, Poirier seems fairly optimistic about the future. "We're struggling with demographics and we are faced with expenses that are age related," he says. "But with a flexible plan, at least employees have a better appreciation of the costs of benefits. They're more aware because it's coming out of their money."

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ABOUT MORNEAU SOBECO

Morneau Sobeco is a leading human resource consulting firm focusing on the design and delivery of compensation, retirement, and employee benefits programs. With over 950 professionals working in twelve cities across North America, it serves more than 3,000 clients. In addition to its in-depth consulting practice, Morneau Sobeco is recognized for its expertise in the provision of integrated administrative solutions and for its vision in terms of progressive employee self-service tools.

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