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*Municipal Technical Advisory Service*

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# REDUCING HEALTH INSURANCE COSTS IN TENNESSEE CITIES

Don Darden, Municipal Management Consultant

October 2008

THE UNIVERSITY of TENNESSEE   
MUNICIPAL TECHNICAL ADVISORY SERVICE

*In cooperation with the Tennessee Municipal League*



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By sharing information, responding to client requests, and anticipating the ever-changing municipal government environment, MTAS promotes better local government and helps cities develop and sustain effective management and leadership.

MTAS offers assistance in areas such as accounting and finance, administration and personnel, fire, public works,

law, ordinance codification, and water and wastewater management. MTAS houses a comprehensive library and publishes scores of documents annually.

MTAS provides one copy of our publications free of charge to each Tennessee municipality, county and department of state and federal government. There is a \$10 charge for additional copies of "Reducing Health Insurance Costs in Tennessee Cities."

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# REDUCING HEALTH INSURANCE COSTS IN TENNESSEE CITIES

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## State of Health Care in Tennessee

Americans spend a great deal on health care. The U.S. Department of Health and Human Services reports that in 2003 Americans spent \$1.7 trillion on health care, and by 2008 that expense is estimated at \$2.4 trillion.

Most Americans have health insurance through their employer, but with skyrocketing health care prices, many of the nation's largest private firms are looking for ways to cut health insurance costs. The state of Tennessee's local government health plan (level 3 coverage) currently charges monthly premiums of \$621.53 for individual coverage and \$1,551.64 for family coverage. Family coverage is \$18,619.68 annually, which is 37 percent more than a minimum wage worker's annual pay. The state plan is rich in benefits. While this is relevant because so many cities turn to the state for their health plans, many cities and employees believe their coverage is the norm or middle of the road when, in fact, it is the filet mignon of health plans. These plans require minimal out-of-pocket expenditures for most services and may not promote wise or cost-effective choices.

The bottom line for city governments in Tennessee is that the cost of employee health insurance is fast becoming prohibitively high. As a result, many cities do not provide health insurance, and those that do are likely to limit the amount of public funds they are willing to spend. Smaller Tennessee cities, in

many instances, are financially unable to pay the cost of increased health insurance and, as a result, experience difficulty retaining good employees. **It is not a good management practice to reduce or eliminate health insurance coverage then spend as much or more of that avoided cost on additional training and equipment.** Many smaller cities say that they cannot afford health insurance for their police officers. This sometimes means that the small city serves as a training program for larger police agencies that do provide health insurance.

Tennessee is ranked as one of the unhealthiest states in the nation (ranking 47th out of 50). Tennessee has consistently ranked 1st and 2nd in prescription drug use, which is not a positive indicator of the state of our health care and explains, at least in large part, why we are facing a crisis. Tennessee is ranked number one in prescription drug use and is number two in prescription drug spending at \$1,192 per capita. Tennessee ranks 47th in health status of its citizens. Tennesseans use prescription drugs at the rate of 17.3 prescriptions per person compared to the U.S. average of 11.3 prescriptions per person. Tennessee also ranks 30th in children's health care.<sup>1</sup>

It is important to note that 30 percent of all health care is the result of poor quality care. Medical errors are the fifth leading cause of death in the United States. Almost 6,000 people die every year

<sup>1</sup> <http://nashville.bizjournals.com/nashville/stories/2008/05/daily16.html>.



as a result of prescription drug errors, and 98,000 thousand patients die every year as the result of medical errors in hospitals. More people die from preventable mistakes than from breast cancer.<sup>2</sup>

It is against this background that MTAS presents what it considers best practices for Tennessee cities to reduce health insurance cost.

### Best Practices for Reducing Health Insurance Costs

1. It is imperative that every city and every employee become as knowledgeable as possible concerning the quality of health care. Employees should ask questions, seek second opinions, and review consumer health guides that clearly show providers who are most likely to provide high quality health care.
2. Consider mandatory retirement at age 60 for public safety personnel who participate in the Tennessee Consolidated Retirement System (TCRS). General laws do not allow employees who are not participating in TCRS to be mandatorily retired at any age unless they are unable to perform the essential functions of the job.
3. For cities with fewer than 20 employees, make sure that the city is the secondary provider for those on Medicare. The city is the primary provider if it has 20 or more employees.
4. Require pre-employment physical for all new employees. A physical examination should determine if the prospective employee is able to perform the essential functions of the job, with or without accommodation.
5. Require annual physical examinations. In many Tennessee cities it is common practice for employees to be required to take pre-employment physicals then never take another physical examination for as long as they remain employed by the city.
6. Annual physical exams may identify problems before they become critical and costly for both the employee and the employer. Many health insurance programs provide for annual physical exams. **It is not a good management practice to assume that annual physical examinations cost more than prolonged neglect of a medical condition that may later result in costly treatments or major surgery, the cost of which determines, in large part, the city's increased health insurance costs**
7. Increase deductible and out-of-pocket expenses. Giving the employee a greater share of the cost of health insurance may discourage its abuse. Cities are cautioned, however, that raising deductibles too high may result in more uninsured workers and increased health care costs. Those managing health insurance costs should study trends and understand what medical components warrant the employee to pay a higher percentage of costs. For example, if the city increases the deductible without properly studying its employee and dependent population, it may result in higher copayments, deductibles, and out-of-pocket expenses in the WRONG area. In turn the city makes it less feasible for those with chronic conditions to continue to stay compliant with medication regimens and treatments. This often means making medicines for diabetes and cholesterol affordable, which can, in turn, lower the city's claim costs because the city saves on inpatient hospitalizations and other complications. For sick employees the city's aim should be for compliance; for healthy employees the aim is prevention; and for employees in the middle, the city looks at both while reducing overuse of the system.
8. Establish a flexible spending program. A flexible spending program allows the employee to spend pre-tax dollars for reimbursable medical

<sup>2</sup> 2006-2007 Tennessee Consumer Guide on Hospital Care, HealthCare 21 Business Coalition.



expenses. The employee is not required to pay income and Social Security taxes on dollars spent for qualified expenses. The employer is not required to match Social Security taxes for such expenses. This program, therefore, saves money for both the employee and the employer.

9. Offer a core health insurance plan for catastrophic illness and a supplemental policy for expenses up to the amount of the deductible. Options might include:
  - a. A catastrophic illness (for large claims) and supplemental policy (for small claims) at city expense;
  - b. A catastrophic illness policy at city expense and a supplemental policy with the employee paying 50 percent of the cost of supplemental coverage; or
  - c. A catastrophic illness policy at the city's expense and a supplemental policy with the employee paying 100 percent of the cost of supplemental coverage. Here the employer might offer the employee more than one level of supplemental policy.

This arrangement is similar to a high density health plan but does not include a separate trust account for payment of small claims.

10. Consider a partially self-funded health insurance program. This is a program in which the city pays for individual health insurance, usually with an employee contribution, and an insurance company pays for aggregate health insurance above a pre-determined level. In a partially self-funded health insurance program, there are two stop losses: individual and aggregate. The individual stop loss would be the amount of deductible and maximum out-of-pocket expense for the individual and the family. The city would pay, through a third-party administrator, claims up to the aggregate stop loss. This stop loss ensures that the city will not have to pay in excess of a pre-determined amount for its health insurance costs. Expenses above the aggregate stop loss are paid by traditional insurance, and the city can know for certain the amount to

budget for health insurance cost. As an example, a city estimating health insurance cost of \$300,000 would take out an insurance policy to pay all claims in excess of \$300,000.

11. Consider a health savings account plan. In a health savings plan, the employer provides a catastrophic coverage plan to pay for larger hospital and medical claims and establishes individual health savings accounts for its employees. An individual health savings account is in the name of the individual employee, and the account belongs to the employee. Small claims that are less than claims insured under the catastrophic coverage insurance are paid by the employee out of the health savings account. If the employee visits his doctor and pays a \$20 copay, the \$20 would be paid out of the health savings account. If the doctor prescribes medicine costing \$80, this would also be paid out of the account. Options that a city might provide include:
  - a. Deposit \$400 per month into the employee's health savings account and require the employee to deposit \$200 per month. Whatever money accumulates in the account belongs to the employee, and it may appreciate in value in the same manner as a traditional 401(k). A health savings account generally favors younger employees who, on average, have lower hospital and medical expenses;
  - b. Deposit \$200 per month into the employee's health savings account and require the employee to deposit \$200 per month; and
  - c. Other variations of shared expenses between the employer and employee.To initiate a health savings account plan, cities should contact a local insurance agency or bank.
12. Determine the maximum amount the city is willing to spend on health insurance and offer more than two options for employees. Using this strategy, the city would, for example, determine that it is willing to spend no more than \$800 per month for health insurance



coverage. The city would purchase a policy for \$800 per month that might have a deductible of \$1,000 and might also provide for basic coverage. This would be option one for the employee. Option two could be for the city to pay \$800 on a health insurance premium, and the employee would pay \$300 per month. The deductible might be \$500 with better than basic coverage. A third option would be for the city to provide \$800 per month for the health insurance premium and the employee to pay \$500 per month with, perhaps, a \$300 deductible and even better hospital and medical coverage possibly including dental and vision coverage. In the above examples, the city never pays more than \$800 per month but allows employees to purchase additional coverage at their own expense.

13. Establish a wellness program. Although most Tennessee cities do not offer wellness programs, such programs may represent an important means of reducing health care costs and should not be ignored. A wellness program is a program that seeks to maintain or improve health prior to serious problems arising. Such programs may be used to trim health care expenses, reduce absenteeism, and in some cases to actually increase productivity. Too often cities dismiss components of a wellness program as a costly expense that is not worthwhile. The U.S. Department of Health and Human Services reported in a recent study that for every \$1 spent on wellness programs there is a positive benefit of from \$1.49 to \$4.91. **The median benefit is \$3.14 saved for every \$1 spent.**

A wellness program must provide sufficient incentives for city employees to participate in and support the program. It is not sufficient simply to say that we have a wellness program and encourage every employee to participate. Incentives sufficient to gain the participation of employees is critical to the program's success. Examples of incentives include:

- a. Pay each employee \$1 for every mile they walk in a week or month;
- b. Provide a health assessment for each employee and pay a fixed amount to employees who visit the gymnasium and fulfill the requirements of a personalized training effort;
- c. Offer a reduction in the employee's share of health insurance premiums — 5 percent, 7.5 percent, 10 percent, or some other amount; and
- d. For obesity offer \$10 for every pound the employee loses.

There are many incentives in addition to these, and each city is encouraged to be creative in helping its employees move away from a sedentary lifestyle.



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