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August 26, 2015

Senator Fletcher L. Hartsell, Jr., Co-Chair, Joint Legislative Program Evaluation Oversight Committee
Representative Craig Horn, Co-Chair, Joint Legislative Program Evaluation Oversight Committee

North Carolina General Assembly
Legislative Building
16 West Jones Street
Raleigh, NC 27601

Honorable Co-Chairs:

The 2013–15 Program Evaluation Division work plan directed the division to review supplemental post-tax benefits offered to state employees through employee insurance committees.

I am pleased to report that all agencies and institutions cooperated with us fully and were at all times courteous to our evaluators during the evaluation, particularly the Office of State Human Resources, Office of State Budget and Management, Office of the State Controller, Department of State Treasurer, and University of North Carolina General Administration.

Sincerely,

John W. Turcotte
Director

PROGRAM EVALUATION DIVISION
NORTH CAROLINA GENERAL ASSEMBLY

August 2015 Report No. 2015-07

North Carolina Should Centralize Management of State Employee Supplemental Insurance Benefits

Summary

In addition to offering standard benefits such as health insurance, North Carolina offers state employees the option of purchasing supplemental insurance plans, such as dental and life insurance. Currently, supplemental insurance is provided through two separate mechanisms: the NCFlex program, which is administered through the Office of State Human Resources and uniformly available to all eligible state employees, and employee insurance committees, which are housed within individual agencies and universities.

Employee insurance committees are ineffective and have failed to manage the selection of supplemental insurance products. Employee insurance committees are entrusted with selecting insurance products that best meet the needs of employees, but the majority of committees established at state agencies and universities either no longer exist or meet infrequently. In addition, many committees do not have contracts with vendors and could not demonstrate product offerings were competitively bid, putting employees at risk of overpaying for insurance products.

The separation of employee insurance committees and NCFlex results in overlapping and duplicative supplemental insurance offerings and makes product comparison and selection challenging for state employees. For example, some state employees were unaware they were simultaneously enrolled in two separate dental insurance plans, one administered by NCFlex and one through an employee insurance committee.

Weak oversight and management of supplemental insurance elections and payroll deductions by agencies and universities presents risks to employees and the State. Many agencies and universities do not have internal processes to ensure the accuracy of supplemental insurance payroll deductions, which can result in incorrect amounts being deducted from employees' pay. In one instance, weak oversight and controls resulted in employees paying insurance premiums for several years after an employee insurance committee had cancelled the employees' policies.

The General Assembly should centralize supplemental insurance benefits by creating a single committee that would oversee all supplemental insurance offerings, including the NCFlex program. Centralized management of all supplemental insurance products would improve oversight and administration, eliminate duplication of administrative functions, and create a more simplified and consistent supplemental insurance system. This single committee could manage all supplemental insurance procurement, using competitive bidding and large volume group purchasing to ensure state employees receive the best value.

Purpose and Scope

The Joint Legislative Program Evaluation Oversight Committee's 2013-15 Work Plan directed the Program Evaluation Division to review supplemental post-tax benefits offered to state employees through employee insurance committees.

This evaluation addressed three central research questions:

1. What supplemental insurance products are employee insurance committees selecting and how are agencies and universities administering these insurance offerings?
2. How do other states organize and administer supplemental insurance offerings?
3. How could North Carolina improve supplemental insurance product selection and administration?

The following data were collected to address these questions:

- payroll deduction data from the Office of the State Controller, UNC General Administration, North Carolina General Assembly, and other agency payroll systems;
- product information and billing data from vendors offering supplemental insurance to state employees;
- a review of state laws, rules, and policies related to supplemental insurance procurement and payroll deduction;
- administrative queries of employee insurance committees and agency and university staff administering payroll deduction for supplemental insurance;
- insurance product description and rate data from all state agencies and universities;
- contracts between employee insurance committees and supplemental insurance product vendors;
- interviews with other states in the southeast; and
- a survey of state employees newly enrolled in multiple dental plans concurrently.

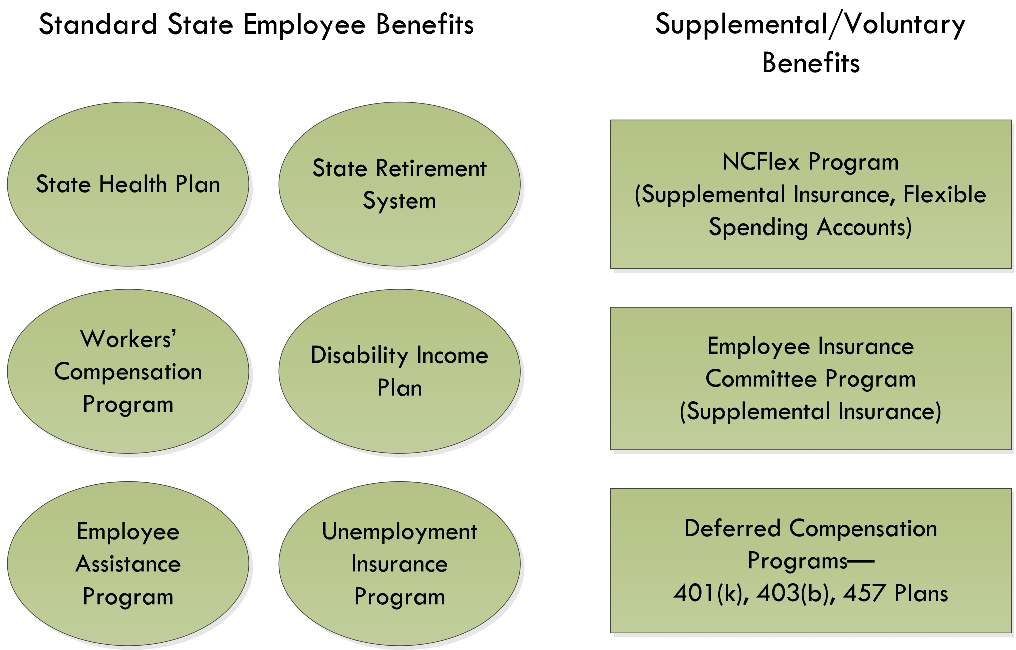
This study focuses specifically on supplemental insurance products offered to state employees and does not include other voluntary benefits offered to employees such as supplemental retirement savings plans or employee discount programs. The study also is limited to insurance offered through employee insurance committees and does not include insurance offered through non-state entities such as the State Employees Association of North Carolina or the State Employees' Credit Union. Finally, the scope of this study is limited to state agencies and universities and does not include employees of community colleges, local school districts, or local government.

Background

North Carolina offers several benefits to eligible employees including health coverage through the State Health Plan and participation in the Teachers' and State Employees' Retirement System. Employees also have the option of participating in voluntary insurance programs such as dental, critical illness, and life insurance. Employees voluntarily elect to participate in these offerings and pay the cost of the insurance through payroll deduction. These supplemental insurance offerings are an important part of the overall benefits package for state employees because they provide employees with options for additional types of insurance coverage that are not provided through standard benefits. Exhibit 1 lists benefit programs or plans available to eligible state employees.

Exhibit 1

North Carolina State Employee Benefit Programs and Plans for Eligible Employees



Source: Program Evaluation Division based on Inside State Government: A Handbook for State Employees.

In North Carolina, supplemental insurance products are offered to state employees through two different systems:

1) the NCFlex program, which is administered statewide by the Office of State Human Resources;[1] and
2) employee insurance committees, which select supplemental insurance offerings for employees at each agency or university.

Appendix A lists and defines the various types of supplemental insurance products offered to state employees through the NCFlex program or an employee insurance committee, though availability varies greatly by agency or university.

In 1985, the General Assembly established the system whereby employee insurance committees at agencies and universities select supplemental insurance products. State law requires the head of each state government employee payroll unit offering insurance products through payroll

[1] All permanent, probationary, and time-limited employees working at least 20 hours per week are eligible to participate in NCFlex.

deduction to appoint an employee insurance committee.[2,3] These committees, which are made up of between five and nine employees who spend state employee hours working on the committee, are responsible for

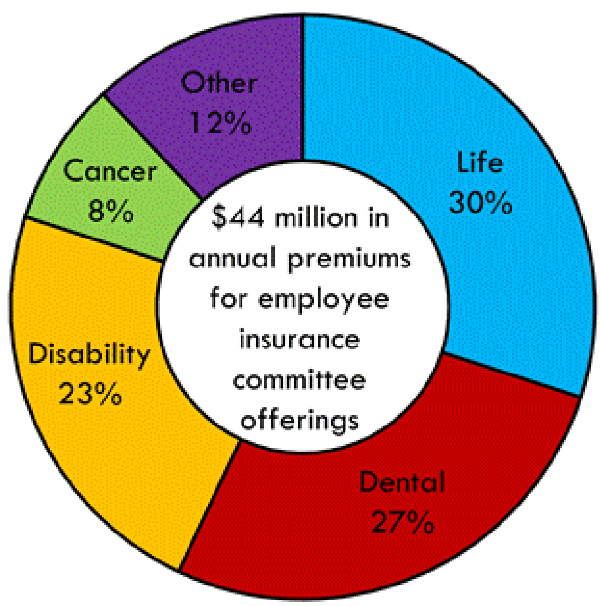
- reviewing insurance products currently offered to determine if those products meet the needs and desires of employees;
- selecting the types of insurance products that reflect the needs and desires of employees; and
- competitively selecting the best insurance products.

Whereas human resources and payroll staff at agencies and universities are responsible for administering the enrollment and payroll deduction process for employee insurance committee-selected products, the actual selection is not the function of agencies or universities but is instead strictly the role of employee insurance committees. The committees are considered autonomous entities for the purposes of selecting supplemental insurance products.

Employee insurance committees can offer various types of insurance products that range from life insurance and dental insurance to less common types of insurance such as legal insurance or pet insurance. Exhibit 2 provides information on the types of employee insurance committee offerings employees are spending the most to purchase.

Exhibit 2

Employees Spend the Most on Life, Dental, and Disability Insurance When Purchasing Products Through an Employee Insurance Committee



Notes: Insurance product type data is not available through the BEACON payroll system. The Program Evaluation Division estimated product type mix for these deductions based on vendor-supplied data or agency survey information. The life insurance category includes term, whole, and universal types of life insurance. The "Other" category, ranked in descending order by total premium amount, consists of the following: accident, home/auto, heart/stroke, hospital indemnity, critical illness, legal, unknown, accidental death and dismemberment, long-term care, vision, and pet insurance.

Source: Program Evaluation Division based on December 2014 state agency and university payroll data, insurance vendor data, and agency survey data.

[2] N.C. Gen. Stat. § 58-31-60.
[3] As a result of modernization of the State's payroll system, "payroll units" have been consolidated into "personnel areas."

In 1992, the North Carolina Government Performance Audit Commission (GPAC) found the State's benefits program lacked a comprehensive design and recommended the State implement a flexible benefits plan available for employees. For several years, supplemental insurance products were only offered to state employees through employee insurance committees and these committee offerings varied. In 1994, the Governor created the NCFlex program through Executive Order, and the program began offering benefits in 1995.[4]

The NCFlex program is a centralized, statewide program that offers several types of benefits, including dental, vision, accidental death and dismemberment, and group term life insurance. Employees also can enroll in a health care or dependent day care flexible spending account. NCFlex benefits are offered at all North Carolina agencies and universities, as well as certain community colleges and charter schools that have chosen to participate in the program. NCFlex benefits are portable across state government, meaning that if an employee changes agencies or universities, the employee will continue to receive the same NCFlex benefits.

The NCFlex program is offered under Section 125 of the IRS Code. Under Section 125, employees can pay for benefits on a pre-tax basis, allowing employees to reduce their tax liability because they do not pay federal and state income taxes or Federal Insurance Contributions Act (FICA) taxes on the premium amounts deducted from their pay.[5] The State benefits by not paying its share of FICA taxes on premium amounts at a rate of 7.65%. However, this savings to the State is offset to a degree because the State also is not able to collect state income taxes on premium amounts at a rate of 5.75%.[6] Thus, the net benefit to the State is 1.9% of the premium amounts deducted on a pre-tax basis through the NCFlex program.

North Carolina now has two separate supplemental insurance systems—the employee insurance committee system and the NCFlex program. More dollars are spent by state employees as part of the NCFlex program than on offerings available through employee insurance committees. However, in the aggregate there are many more vendors offering products through employee insurance committees than through NCFlex. Exhibit 3 illustrates some of the similarities and differences between the NCFlex program and the employee insurance committee-administered benefit system.

[4] N.C. Executive Order 66, December 5, 1994.
[5] One impact of pre-tax contributions is that the contribution amounts do not count toward the FICA wages used to determine a person's Social Security retirement benefit amount.
[6] The individual income tax rate is a flat 5.8% for tax years beginning on or after January 1, 2014, and is reduced to 5.75% for tax years beginning on or after January 1, 2015.

Exhibit 3: North Carolina Has Two Separate Supplemental Insurance Systems with Overlapping Benefits

Governance	**Office of State Human Resources—NCFlex**	**Employee Insurance Committees at Agencies/Universities**
Uniformity of Offerings	Same set of benefits offered statewide	Benefits offered vary across 46 agencies and universities
Top 5 Products by Employee Contribution Amount	 Dental, Cancer, Life, Health Care/ Dependent Care FSA, Vision	 Dental, Cancer, Life, Accident, Disability
Tax Treatment	Employees generally pay premiums with pre-tax dollars	Employees pay premiums with post-tax dollars
Estimated Annual Deductions	$121 million in annual employee deductions	$44 million in annual employee deductions

Notes: FSA stands for Flexible Spending Account. For purposes of comparability, the NCFlex annual employee deduction calculation only includes state agencies and universities and does not include community colleges or charter schools that choose to participate in NCFlex. NCFlex began offering a Tricare supplement plan through Selman & Company on June 1, 2015, to employees retired from the military and enrolled in a Tricare plan; this supplement plan is not included in this data.

Source: Program Evaluation Division based on 2014 calendar year data from the Office of the State Controller, UNC General Administration, Office of State Human Resources, North Carolina General Assembly, and other state agency payroll systems.

Much has changed since the General Assembly established the employee insurance committee system in 1985. The NCFlex program has experienced substantial growth and is now the predominant supplemental benefit program for North Carolina state employees. However, roughly 45% of all eligible state employees still also participate in one or more product offerings through the employee insurance committee system. This report seeks to evaluate the effectiveness of the employee insurance committee system and address how to best administer these supplemental insurance benefits for state employees.

Findings

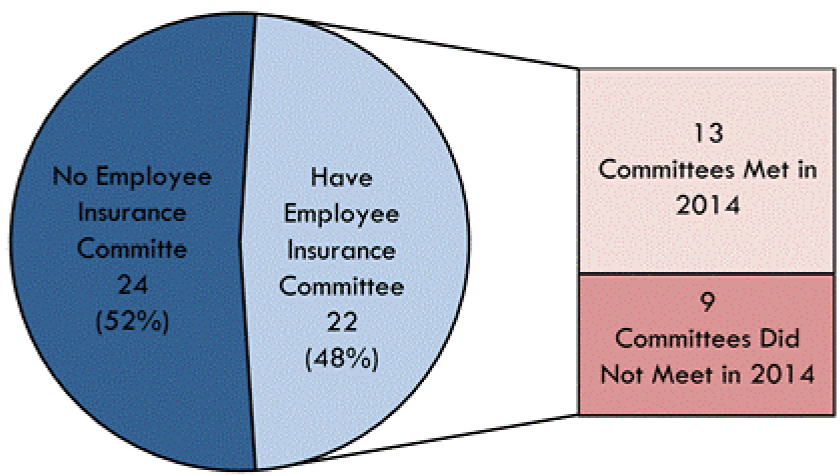
Finding 1. Employee insurance committees are ineffective and have failed to manage the selection of supplemental insurance products.

Each agency or university offering supplemental insurance products through payroll deduction is required by statute to have an employee insurance committee. The committees are required to consist of between five and nine employees who serve three-year terms, with one-third of the terms expiring annually. Beyond competitively selecting supplemental insurance products, each committee also is charged with reviewing insurance products currently offered to determine if those products meet the needs and desires of employees. Appendix B provides summary data for each of the agencies and universities offering supplemental insurance, including the number of eligible and participating employees, number of vendors, amount of deductions, and whether the agency or university has an employee insurance committee.

Many agencies and universities do not have employee insurance committees, resulting in limited management and oversight of supplemental insurance products. As shown in Exhibit 4, 22 of 46 agencies and universities surveyed reported having employee insurance committees. Of those 22 committees, only 13 reported holding a meeting in calendar year 2014.

Exhibit 4

Over Half of All Agencies and Universities Do Not Have Active Employee Insurance Committees



Source: Program Evaluation Division based on a March 2015 survey of state agencies and universities.

Agencies and universities without an active committee maintain no statutorily-authorized entity to select insurance products or review existing product selection. In addition, no entity is held accountable for ensuring employees are offered insurance products that meet their needs. Additional committee activities might include analyzing the claims experience for committee insurance product offerings, meeting with vendors, preparing educational and communication materials about product offerings, and surveying employees; these are all activities that the Office of State Human Resources undertakes as part of administering the NCFlex program. Agencies and universities reported different reasons for lacking active committees.

One agency stated that prior to implementation of NCFlex the committee was very active, but that now there is less interest in supplemental products considering NCFlex offers similar products on a pre-tax basis. Many entities appear to have taken a more passive approach to managing supplemental insurance by maintaining long-standing offerings through existing vendors but not actively reviewing existing offerings or periodically bidding products to ensure competitive prices.

> *"We have allowed these companies, particularly [vendor name withheld], to offer any new or updated products, but we have not accepted requests for any other vendors. We do not have an insurance committee, management has not appointed one, and no one really seems to want one. If we get a request from another vendor (I've had one or two call me over the last few years) I've been instructed to tell them to submit a package and we'll convene a committee to make a decision about the product."*
>
> - Agency Health Benefit Representative

Many employee insurance committees exhibit deficiencies in the procurement process. The process of selecting and competitively bidding supplemental insurance products is a primary responsibility of employee insurance committees. However, most committees identified by the Program Evaluation Division survey did not have documented procedures for competitively selecting insurance products. Of the 22 existing committees, only 5 submitted documentation of a formalized process for evaluating products and making decisions on product offerings.

Several agencies have permitted vendors to offer insurance products despite the absence of a current contract between the employee insurance committee and insurance vendor. In total, state agencies reported currently offering insurance through 63 vendor relationships.[7] As shown in Exhibit 5, agencies reported having active contracts for 33 of these relationships, or only 52% of the total. This survey result indicates many agencies are currently offering supplemental insurance products absent an active contract between the employee insurance committee and the vendor. Having a contract is important because it specifies roles and responsibilities of the agency and vendor as well as product pricing.

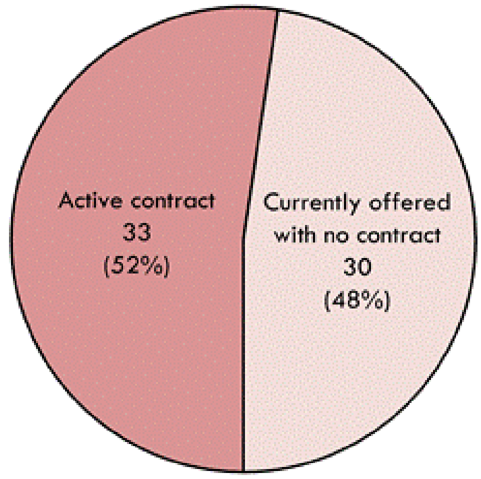
In cases where there is a contract, many of the contracts may not involve the appropriate parties. An Attorney General advisory opinion from 1993 states the award of a payroll deduction slot is the function of an autonomous employee insurance committee of an agency or university, not the agency or university itself. Thus, the employee insurance committee is the appropriate party to such a contract, not an agency or university manager. However, the employee insurance committee was party to the contract in fewer than a quarter of the 33 contracts reviewed.

[7] Because each employee insurance committee must separately select insurance products, the same vendor may have an association with multiple insurance committees and each association between a vendor and an employee insurance committee is counted in this calculation, resulting in some vendors being counted multiple times. Vendor counts related to active contracts and whether that association with a vendor was competitively bid only include state agencies. The Program Evaluation Division did not survey universities for this information.

Exhibit 5

Many Agencies Offer Supplemental Insurance with No Associated Contract

Relationships with Supplemental Insurance Vendors at State Agencies



Source: Program Evaluation Division based on responses from a March 2015 survey of state agencies.

Many employee insurance committee contracts did not contain strategically important contract terms and conditions. In cases where agencies were able to provide contracts, many did not contain the standard contract terms and conditions used by the Division of Purchase and Contract of the Department of Administration. Examples of important terms and conditions missing include the following:

- **General indemnity.** Requires that the contractor shall hold and save the State, its officers, agents, and employees, harmless from liability of any kind, including all claims and losses accruing in connection with the performance of the contract, and from any and all claims and losses accruing or resulting to any person, firm, or corporation that may be injured or damaged by the contractor in the performance of this contract and that are attributable to the negligence or intentionally tortious acts of the contractor.
- **Access to persons and records.** Requires that the State Auditor and the agency's internal auditors have access to persons and records as a result of all contracts or grants entered into by state agencies in accordance with General Statute. The State Auditor and internal auditors may audit the records of the contractor during the term of the contract to verify accounts and data affecting fees or performance.
- **Performance and default.** Stipulates that if the contractor fails to fulfill the obligations of the contract in a timely and proper manner, the agency has the right to terminate the contract by giving written notice to the contractor and specifying the effective date thereof.
- **Termination.** Allows the agency to terminate the contract at any time by giving a certain number of days' notice in writing. In that event, all finished or unfinished deliverable items prepared by the contractor under the contract shall, at the option of the agency, become its property. If the contract is terminated by the agency, the contractor is paid for services satisfactorily completed, less payment or compensation previously made.

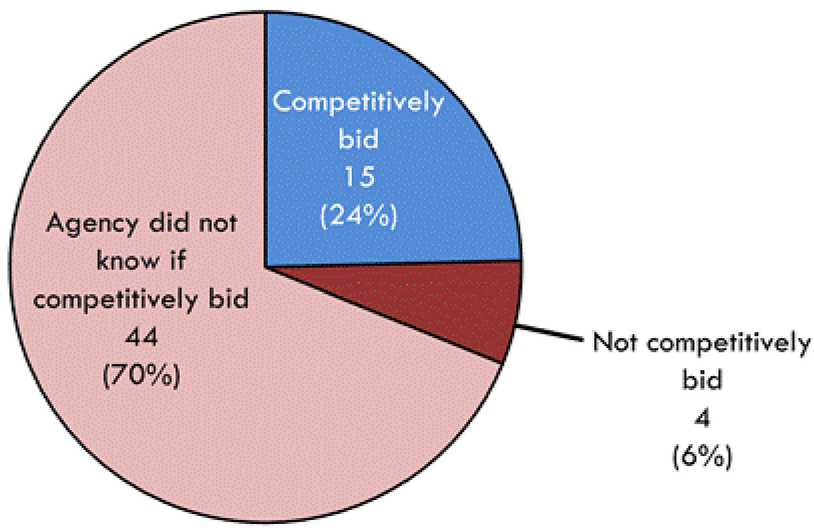
State contracting is an area the Program Evaluation Division has consistently identified as possessing deficiencies and risks for waste, abuse, and mismanagement.[8] It is important that contracts contain terms and conditions that adequately protect the State's interest. Of the 33 contracts reviewed, only 9 contained all four terms and conditions discussed above.

In a survey of state agencies, the majority did not know whether current vendor offerings had been competitively bid. As shown in Exhibit 6, of the 63 vendor relationships through which insurance is currently offered to employees, agencies reported that they could confirm 15 of those vendors are offering products resulting from a competitive bid process.[9] In the majority of cases, agencies reported not knowing whether offerings through vendors had been competitively bid or stated the vendors were offering products that had not been competitively bid.

Exhibit 6

Many Agencies Offer Supplemental Insurance Products That Were Not Subject to a Documented Competitive Bid Process

Relationships with Supplemental Insurance Vendors at State Agencies



Source: Program Evaluation Division based on responses from a March 2015 survey of state agencies.

Agencies and universities may not know whether the products provided by vendors have been competitively bid because the relationships with the vendors have been longstanding. For example, one university representative stated the university had not bid a new product in many years and the current vendor had offered its products for several decades. Another agency representative stated many longstanding products have not gone through committee review and "absence of complaints is our standard for continuing with a particular product."

As a result of weak or nonexistent competitive bidding processes, employees at these agencies and universities are potentially not being offered supplemental insurance products that best meet their needs or provide the best value. State employees may enroll in insurance offerings

[8] Deficiencies in state purchasing and contracting have been a concern of the Joint Legislative Program Evaluation Oversight Committee since 2009. The most recent Program Evaluation Division Report to focus on this issue was *North Carolina Should Eliminate the Use of Personal Services Contracts in Favor of Using Existing Mechanisms* (February 2015).

[9] Program Evaluation Division did not survey universities for this information, and thus these numbers pertain only to state agencies.

in the mistaken belief that a committee is actively overseeing and bidding these offerings. Finally, a failure to competitively bid insurance products on a periodic basis means that insurance vendors seeking the opportunity to do business with the State are not afforded a chance to compete for business.

Finding 2. Separation of the employee insurance committee system and the NCFlex program makes supplemental insurance selection and enrollment confusing and unnecessarily complex for state employees.

Rather than making selections from one set of integrated and coordinated supplemental benefits, employees choose supplemental insurance offerings from two different programs: NCFlex and an employee insurance committee. These two programs have different enrollment systems and procedures while sharing some similar offerings, posing challenges for employees who must navigate a fragmented system.

NCFlex conducts an annual enrollment period during the month of October that is integrated with State Health Plan enrollment. At the same time that employees must decide which health insurance plan to select, they also must decide which NCFlex supplemental insurance products to elect. After employees have completed the process of electing NCFlex supplemental insurance coverage, they are provided with a printable benefit confirmation statement detailing each insurance product currently held and those elected during the open enrollment period. However, this benefit confirmation statement does not contain any information about supplemental insurance products employees may have purchased through employee insurance committees because these products are administered at each agency or university through a different system.

The process for selecting and enrolling in employee insurance committee supplemental benefit offerings varies by agency or university. Many employee insurance committee offerings allow employees to sign up or cancel the insurance at any time, though some offerings have open enrollment periods similar to NCFlex. Enrollment might involve filling out a paper form and submitting it to the human resources or payroll department. In other cases, an employee might enroll in supplemental insurance through a vendor's website, which then sends information to the payroll administrator in order to process payroll deduction.

Similar supplemental benefit products offered through NCFlex and employee insurance committees complicates the insurance selection process for employees. There are several types of insurance that are available through both NCFlex and the employee insurance committee system. As Exhibit 7 shows, each of the top four employee insurance committee products in terms of total employee spending overlaps with or duplicates a benefit offered through NCFlex or another statewide benefit program.

Exhibit 7: Several Popular Employee Insurance Committee Product Types Also Are Offered Through NCFlex or Another Statewide Benefit Program

Type of Product	Employee Insurance Committees	NCFlex	Other State Benefit Program
Cancer Insurance	✓	✓	
Dental Insurance	✓	✓	
Disability Insurance	✓		✓
Life Insurance	✓	✓	✓

Notes: Cancer, dental, disability, and life insurance are the top four employee insurance committee products by total employee contribution amount, though not all employee insurance committees offer these four products. In addition to life insurance offered through employee insurance committees and NCFlex, eligible employees also receive a death benefit of $25,000 to $50,000 through the Teachers' and State Employees' Retirement System.

Source: Program Evaluation Division based on review of employee insurance committee offerings, NCFlex offerings, and other state employee benefits.

As an example, NCFlex offers a cancer and specified disease plan through Allstate. Several state agencies and universities also offer cancer plans through companies such as Colonial Life or AFLAC. These plans are all intended to help insure against losses incurred resulting from cancer, but the designs of these plans differ in terms of cost, coverage, and benefits provided. For an employee considering a cancer plan offered through both an employee insurance committee and NCFlex, making an informed decision is complicated by several factors:

- **Varying plan designs.** Plan design can vary in any number of ways, such as which conditions/diseases are covered, the types of benefits the plan provides, the amount paid for various types of benefits, how/whether the plan pays benefits separate from or in coordination with health insurance or other benefits, and the types of limitations and exclusions.
- **Varying information formats.** NCFlex has an enrollment booklet that is designed by Office of State Human Resources (OSHR) staff and covers all supplemental insurance plans available through NCFlex. Employee insurance committee plan enrollment information is generally available in a stand-alone booklet or brochure created by the particular product vendor.
- **Difficulty in comparing costs.** Costs of NCFlex and employee insurance committee plans are not readily comparable because NCFlex plans are generally pre-tax, whereas employee insurance committee plans are post-tax.

Having separate supplemental benefit systems also can result in employees unintentionally electing insurance plans that provide duplicative or overlapping coverage. In order to better understand some of the difficulties and consequences of having similar types of supplemental insurance offerings available through both NCFlex and the employee insurance committee system, the Program Evaluation Division examined payroll deduction data for dental insurance plans. NCFlex offers a dental insurance plan with a high and low option through United Concordia. Several other insurance vendors offer dental plans through employee insurance committees.

The Program Evaluation Division identified 434 state agency employees enrolled in two dental plans simultaneously.[10] In most cases, enrollment in two plans resulted from an employee having both NCFlex dental insurance and another dental plan through an employee insurance committee. One employee was identified as being enrolled in three dental plans—NCFlex and two different employee insurance committee plans. Carrying two dental plans can be costly to state employees; the average individual enrolled in two plans paid $87.10 a month for the two plans. Given the expense of being enrolled in two plans, the Program Evaluation Division surveyed a subset of 154 employees newly enrolled in two plans in 2015 in order to better understand why they had made these elections.[11]

> *"I switched [dental] plans from Humana to NCFlex. No one informed me that I had to do paperwork to stop the Humana plan. So I ended up having both insurance premiums deducted from every paycheck last year and then was told there was no way to fix it. I sure hope you can do something to keep this from happening to anyone in the future. None of us can afford to pay twice and there certainly should be a way to stop the double deduction."*
>
> \- Anonymous state employee

The majority of employees who responded to the survey reported being unaware that they had recently enrolled in two dental plans. Specifically, 68% of survey respondents stated that, prior to being contacted by the Program Evaluation Division, they were unaware they were paying for two separate dental insurance plans through payroll deduction. Thirteen percent were aware they were enrolled in two plans but did so unintentionally. Finally, 19% of respondents indicated they had chosen to enroll in two dental plans in order to receive more coverage than a single plan provided.

Having separate supplemental insurance systems and enrollment processes has resulted in confusion for some employees, who are unaware of the difference between NCFlex and employee insurance committee offerings or are unaware that the enrollment systems are not integrated. Employee survey comments illustrated the difficulties some employees experienced in navigating separate enrollment systems with similar offerings. Several employees stated that they did not see their employee insurance committee dental plan listed when electing benefits during open enrollment. For example, one employee stated, "I think during enrollment in BEACON this year, it didn't show that I was registered for any dental benefits even though I knew I was." In fact, employee insurance committee system offerings are administered at the agency or university

[10] This analysis did not include university system employees and was based on February 2015 payroll data.
[11] The Program Evaluation Division surveyed 154 employees; 37 responded to the survey for a 24% response rate.

level and, therefore, are not visible to an employee as part of the open enrollment process for the State Health Plan and NCFlex elections. This separation of enrollment systems has caused confusion for many employees, who mistakenly believed that during open enrollment they were making elections for all supplemental insurance offerings and not just the NCFlex offerings. Several employees stated they thought that, when they signed up for the NCFlex dental plan, the enrollment system would automatically cancel the employee insurance committee plan.

A centralized, integrated system for supplemental insurance enrollment could prevent employees from unintentionally enrolling in duplicative coverage either by not offering duplicative coverage or by having system controls that prevent enrollment in two similar plans. Currently, NCFlex and employee insurance committee products have separate enrollment systems and procedures for enrollment. Consequently, employees are forced to make decisions about their benefits across multiple systems that do not allow for integrated decision-making and are susceptible to producing undesired outcomes.

In the case of disability insurance, overlapping benefit plans result in employees being able to purchase more disability insurance than they need to replace their pay. State employees can qualify to receive a disability benefit through the Disability Income Plan of North Carolina, which is part of the State Retirement System. Eligible employees with one year of retirement system membership service can qualify for a short-term benefit that replaces up to 50% of their salary.[12] In addition to the State Retirement System disability benefit, many employee insurance committees offer short-term disability insurance plans. In fact, state employees spend almost $10 million a year on disability insurance through employee insurance committees. One plan reviewed by the Program Evaluation Division allows employees to receive short-term disability income replacement for up to 60% of their salary with disability benefits paid regardless of benefits received from other sources.

It is possible then for a state employee to receive short-term disability benefits that are greater than the employee's salary. Employees receiving both of the above-mentioned benefits could achieve a short-term disability payment of 110% of their gross earnings. In addition, the disability payment from the employee insurance committee plan is not taxed, resulting in the employee receiving a benefit that, when taxes are taken into consideration, exceeds 110% of pay. Because these benefits are offered through different programs and enrollment systems, employees may not be aware that they could be overinsured because their short-term disability coverage exceeds their pay.

Having disability benefits that can be combined to exceed employee pay creates a perverse incentive. When an employee receives a disability benefit that exceeds regular take-home pay, there is an increased incentive for malingering, which is defined as intentionally pretending to

[12] The monthly short-term benefit is equal to 50% of 1/12th of an employee's annual base salary last payable prior to the beginning of the short-term benefit period. The Disability Income Plan of North Carolina (DIPNC) Benefits Handbook provides a full description of eligibility requirements and how benefits are calculated and can be found at https://www.nctreasurer.com/ret/Benefits%20Handbooks/TSERS_DisabilityHandbook.pdf.

have or grossly exaggerating symptoms for personal gain. Excessive benefits also provide a disincentive for an employee to return to work as soon as possible from legitimate cases of short-term disability. Because the State pays a portion of the disability benefit and experiences a loss in productivity due to an employee's absence, the State has reason to limit this perverse incentive. From the employer's perspective, disability plans should be structured to balance financial assistance in a time of need with incentives to return to work. Yet when employee insurance committee disability plans offer benefits that are not coordinated with the Disability Income Plan of North Carolina, the resulting disconnect triggers an incentive for overutilization of disability benefits that is harmful to the State as an employer.

Finding 3. Weak oversight and management of supplemental insurance elections and payroll deductions by agencies and universities presents risks to employees and the State.

Whereas employee insurance committees are charged with the selection of supplemental insurance products, state agencies and universities are responsible for enrolling employees in employee insurance committee supplemental insurance products and administering corresponding payroll deduction. Responsibilities include

- processing enrollment and changes in insurance elections,
- ensuring the accuracy of payroll deduction amounts, and
- ensuring applicable federal and state laws and regulations for payroll deducted supplemental insurance products are followed.

Most state agencies are part of the BEACON system administered by the Office of the State Controller.[13] Within the University of North Carolina System, the payroll function is not centralized, and institutions and affiliates utilize several different systems.[14] Agencies are responsible for entering deductions, maintaining deductions, and ensuring the accuracy of payroll deduction amounts. For agencies that are part of the BEACON system, the Office of the State Controller (OSC) pays supplemental insurance product vendors, but the individual agencies are still responsible for maintaining deductions.

OSC policy is that all state entities should perform proper payroll reconciliation. Reconciliation is an accounting process that brings together different sets of records to ensure that they are in agreement. The policy states, "Reconciliation procedures and system controls should provide assurance that errors are properly identified, and that payroll costs and deductions are correctly calculated."

[13] The North Carolina Education Lottery, North Carolina Housing Finance Agency, and North Carolina General Assembly are not part of the BEACON system.

[14] Fourteen campuses use a Banner ERP system. The University of North Carolina at Chapel Hill and North Carolina State University use Oracle's PeopleSoft system. UNC Health Care uses Lawson ERP software. The School of Science and Math uses the Office of the State Controller's BEACON system.

Most agencies and universities could not confirm that they reconcile payroll deduction amounts to ensure the correct amount is being taken out of employees' pay and paid to vendors. In a survey of state agencies and universities, 17 of 46 entities confirmed they complete a monthly reconciliation of payroll deduction amounts with vendor invoices. The remaining agencies and universities either do not conduct a monthly reconciliation of all supplemental insurance payroll deductions or failed to state that they do so when asked specifically about how they ensure payroll deduction amounts are correct.

Rather than conducting a monthly reconciliation process, several agencies or universities appear to operate on the assumption that monthly amounts deducted are accurate and rely upon employees to review pay statements. For example, a representative of the Department of Commerce stated, "The employee knows the monthly deduction for the respective product. If the deduction is incorrect, the employee contacts HR. We have not experienced many errors." This reliance upon employees to review payroll deduction amounts is a weak control because employees may not know the correct deduction amount and may not review their monthly pay statements. Other agencies or universities stated they rely on insurance vendors to let them know if deduction amounts are incorrect. This arrangement also is a weak control because it assumes that the vendor's records are accurate and that a vendor will identify inaccuracies and inform the agency when an employee is overpaying.

Other agencies responding to the survey incorrectly believed that the Office of the State Controller handles payroll deduction reconciliation for supplemental insurance products purchased through employee insurance committees. For example, a Department of Insurance representative stated, "The department is only involved in the initial enrollment or if a request for termination has been received. The Office of the State Controller receives the monthly premium bill and is responsible for the balancing of the bill against the amount of premiums deducted." OSC reported that it does reconcile all NCFlex payroll deductions for state employees who are part of the BEACON system. However, responsibility for reconciling employee insurance committee products belongs to each agency or university; OSC does not perform this function.

Even if they are attempting to comply with the requirement to reconcile payroll deduction amounts, many agencies and universities cannot reconcile payroll deduction amounts for supplemental insurance products because they lack necessary data. Regardless of whether agencies are attempting to reconcile deductions, they may not be able to perform a reconciliation of payroll deduction amounts because

- many agencies do not receive monthly invoices from vendors to reconcile with deduction amounts and
- many agencies do not have contracts for the products offered and, consequently, cannot determine the correct cost of a given supplemental insurance product.

One example of agencies not receiving the data necessary to conduct a reconciliation of payroll deductions involves Colonial Life products. Colonial Life has an inbound interface into the BEACON system that allows the insurer to directly upload payroll deduction amounts to be paid by BEACON. Employees enroll in or cancel insurance products directly through Colonial Life and not through their employing agencies. As a result of this arrangement, many agencies do not possess the necessary data that would allow them to verify insurance product enrollment is accurate or reconcile payroll deduction amounts against enrollment information or a product invoice.

Failure by agencies to reconcile monthly deduction amounts can result in inaccurate payroll deductions. Employees can be harmed as a result of inaccurate payroll deduction. When insufficient amounts are deducted, employees may be required to make a one-time payment in order to make up for the underpayment. If these insufficient payroll deductions continue for an extended period, there is a risk that an insurer could cancel a policy because the policy is not being paid in full. Conversely, when payroll deduction amounts exceed the policy premium, overpayment may not be identified and employees may not recoup their money.

The Program Evaluation Division reviewed payroll deduction amounts for dental and legal insurance purchased through employee insurance committees in February 2015 and identified cases where improper amounts were payroll deducted. Incorrect deductions can occur for several reasons, including incorrect data being entered into the payroll system, a lack of communication between vendor and agency when a rate changes, and an employee changing agencies but continuing to have deductions for products at the previous agency.

For example, the Program Evaluation Division identified inaccurate payroll deductions for dental insurance by the Department of Transportation. There were four instances in which incorrect data were entered into the payroll system related to a 2015 rate increase, resulting in incorrect amounts being deducted from employees' pay. In two other cases, a 2015 rate increase was not entered into the system for employees, resulting in employees paying less than the monthly premium amount. The Department of Transportation does not require the vendor to submit a monthly invoice, which would allow for monthly reconciliation of deduction amounts.

Another example involves a North Carolina Prepaid Legal Services plan in which several Department of Health and Human Services (DHHS) employees participate. In four cases, employees were paying amounts in excess of the $9.50 monthly premium cost for this plan. In one case, an employee had $36.20 deducted monthly, while another had $84.23 deducted monthly. DHHS stated that these two deduction amounts were keyed into the payroll system incorrectly.

Incorrect payroll deductions for supplemental insurance can occur when employees change agencies. The OSC payroll policy manual explains that payroll deductions should not continue when employees transfer between state agencies or universities. Instead, the agency the employee leaves is required to assign an end date for that deduction at the time of transfer or, according to an OSC training document, the result could be that "the deduction will remain active and create possible retro-calculations and take deductions that it should not."

The Program Evaluation Division identified employees at DHHS and the Department of Public Safety (DPS) who remained enrolled in dental plans managed by an employee insurance committee at a different agency. For example, in February 2015, 11 DHHS employees were paying for a MetLife Dental plan available only through the DPS employee insurance committee. Eight of these employees were paying incorrect rates. Conversely, nine employees at DPS were paying for a Humana Dental plan available through the DHHS employee insurance committee. Six of these nine were paying incorrect amounts. Once an employee transfers agencies, only the new agency can change payroll deduction amounts when vendor rates change. However, the new agency may not have a way to discover that rates have changed because it is the old agency employee insurance committee that has a contract with the vendor.

The Program Evaluation Division's review was narrowly focused on dental and legal insurance deductions at state agencies; the results suggest there may be other cases where incorrect amounts are being payroll deducted for other types of insurance. Incorrect deductions for these other products are more challenging to detect based on deduction amount alone because many of the products have variable rates based on factors such as employee wages or employee age and have numerous potential premium amounts. Unless agencies and universities reconcile deduction amounts against contractual amounts and monthly invoices, these employers cannot ensure that proper amounts are being payroll deducted.

Weak oversight of payroll deductions for supplemental insurance has allowed vendors to sell products that were not authorized by the associated employee insurance committee or permitted by state law. North Carolina General Statute § 58-31-60 states, "The company selected by the Employee Insurance Committee shall be permitted to sell through payroll deduction only the products specifically approved by the Employee Insurance Committee." Weaknesses in agency controls have allowed vendors to sell products that were not approved by an employee insurance committee.

The Program Evaluation Division identified instances in which vendors sold products for which they did not have authorization from the associated employee insurance committee. For example, at the Administrative Office of the Courts (AOC), two insurance vendors have enrolled employees in products that were not selected by the AOC employee insurance committee. In 2010, AOC selected AFLAC to provide voluntary accident insurance and ING to provide voluntary whole and universal life insurance products. The AOC committee also selected Colonial Life to provide four products: cancer, supplemental hospitalization, disability, and term life insurance.

Since 2011, when the AOC contracts became effective, employees have enrolled in 268 Colonial Life accident insurance policies and 52 Colonial Life whole and universal life insurance policies. Colonial Life did not hold a contract to offer these products to AOC employees—the AOC employee insurance committee had instead selected AFLAC and ING to offer these products, respectively. The Program Evaluation Division also reviewed AFLAC data and found AOC employees have enrolled in six AFLAC cancer and hospital indemnity policies since 2011, a time period during which

Colonial Life had been selected to offer these products to AOC employees. This issue is not confined to AOC; the Program Evaluation Division identified a similar issue at the Department of Transportation (NCDOT), where Colonial Life only holds a contract for disability insurance but has also enrolled NCDOT employees in cancer and universal life insurance products.

When vendors are able to sell products not approved by the employee insurance committee, the integrity of the committee process is undermined because a vendor can sell additional products that have not been vetted and approved by the committee or products for which another vendor has been selected. In addition, the process is undermined because employees can be sold products that may not represent the best value or products that may not meet the needs of employees.

Inept oversight of supplemental insurance administrative processes cost the State $225,000 in 2012. In 2001, the NCDOT employee insurance committee cancelled life and disability policies with Connecticut General Life Insurance Company (CIGNA) without notifying employees. According to NCDOT, 641 employees had permanent life policies cancelled without being notified. For an additional 93 employees, policies were cancelled but payroll deductions continued for the cancelled policies until 2010. NCDOT refunded the money payroll deducted for the cancelled policies, but the employees experienced an opportunity cost in not being able to benefit from alternative uses of their money over those years and also experienced a false sense of security in thinking they possessed active insurance policies.

At around the same time the CIGNA policies were cancelled, the NCDOT employee insurance committee requested assistance from State Benefit Services, LLC, which in 2001 was awarded a contract to provide coverage for life insurance and short-term disability to NCDOT employees. State Benefit Services, LLC was asked by NCDOT to help sort through years of records to create a list of active CIGNA permanent life policies. State Benefit Services described trying to sort out the accounts as being similar to "a situation where a person had been making savings deposits by payroll deduction over many years, but neither the employer nor the bank had adequate records of the deposits or the accounts, or even the name of the account holder." A dispute arose between NCDOT and State Benefit Services, LLC and in 2012, as a result of a lawsuit in Wake County Superior Court, NCDOT agreed to pay State Benefit Services $225,000 as part of a settlement agreement.

The problems at NCDOT related to the cancelled CIGNA life insurance policies appear to have resulted from multiple failures, including weak oversight of the NCDOT employee insurance committee's actions and a lack of coordination between the NCDOT employee insurance committee and NCDOT payroll staff. Proper administrative controls, including reconciling payroll deduction amounts with a vendor invoice, would have likely prevented this situation, which ultimately cost state taxpayers.

Another danger of weak oversight and management of payroll deduction for supplemental insurance products is the potential for non-compliance with applicable state and federal laws. There are several state and federal laws and regulations regarding payroll deduction for supplemental insurance, particularly with respect to whether applicable state and federal taxes are applied to the premiums that are payroll deducted. State law gives the Director of the Budget and, separately, the Board of Governors of the University of North Carolina, the authority to establish benefits under Section 125 of the IRS code, which allows employees to pay premiums for supplemental insurance through payroll deduction before any taxes are withheld on those earnings.[15] Employee insurance committees do not have this authority under state law; NCFlex is the state's IRS Section 125 plan.

However, the Program Evaluation Division found Appalachian State University has offered certain supplemental insurance products since 2007 to employees under Section 125 of the IRS code, allowing over 230 employees to pay premiums for these supplemental insurance products on a pre-tax basis. Appalachian State University did not have authority under state law to establish this type of plan—that authority is reserved for the Board of Governors of the University of North Carolina. Beyond lacking authority, Appalachian State University offering these benefits presents a compliance risk due to the complex IRS requirements Appalachian State University would have to follow in administering its own Section 125 plan.

In sum, weak oversight and management of supplemental insurance by agencies has created risks such as inaccurate payroll deductions, noncompliance with state and federal laws, and unintended costs to the State. Oversight of employee insurance committee-selected supplemental insurance is challenging because responsibilities are fragmented at the agency and university levels.

Finding 4. Continuing the employee insurance committee system has costs and centralizing supplemental insurance would reduce duplication and result in a number of benefits to the State and its employees.

The employee insurance committee system was formally implemented in 1985, 10 years before the NCFlex program began offering benefits in 1995. Payroll systems and processes have changed since the creation of employee insurance committees. Starting in 2006, implementation of the BEACON system replaced several legacy payroll systems. Previously, the legacy payroll systems did not adequately communicate with each other and were difficult to modify to meet operational requirements. Because payroll has moved to a more centralized model, administering supplemental benefits at the agency level is unnecessary. In fact, having a centralized payroll system with separate employee insurance committee offerings at each agency leads to problems, as referenced in Finding 2, when state employees change agencies and deductions for insurance products purchased at the former agency continue.

The NCFlex program has demonstrated the viability of a centralized supplemental insurance program. NCFlex now has more than four times the number of deductions and almost three times the total dollar value in deductions when compared with the employee insurance committee system of insurance offerings.

[15] N.C. Gen. Stat. §§ 126-95, 116-17.2.

Continuing to administer the employee insurance committee system has costs. The Program Evaluation Division identified 46 different active or inactive employee insurance committees carrying out the same type of procurement and oversight processes. Procuring supplemental insurance at the individual agency or university level rather than in a centralized manner results in many agencies and universities duplicating the same functions, including contracting with many of the same insurance vendors for the same products.

The average committee that met in 2014 did so for approximately eight hours. If every agency and university had an active employee insurance committee that met for 8 hours per year, it would equate to an estimated 1,840 to 3,312 annual state employee hours spent in employee insurance committee meetings.[16] This calculation does not include any state employee time spent working for these committees outside of insurance committee meetings.

Agency and university human resources and payroll staff also spend time administering the employee insurance committee system. Unlike the NCFlex program, where employees can use an electronic enrollment system, many employee insurance committee enrollment processes are paper-based and must be individually processed by agency or university staff. Deduction amounts are usually manually keyed into the payroll system and manually terminated when an employee cancels the insurance product or ends employment. In addition, as discussed in Finding 3, payroll deduction amounts should be reconciled, which requires employee time to administer. As noted previously, some agencies are not reconciling deduction amounts to ensure they are correct. If agencies did reconcile all employee insurance committee product deductions, doing so would require many more hours of staff time than are currently being spent.

The Office of the State Controller (OSC) also bears costs in administering payroll processing and payroll deduction setup in BEACON for employee insurance committee products. OSC estimates that initial setup of payroll deduction for a vendor in BEACON costs $1,080 per vendor, with an average of roughly two new vendors a year. OSC estimates that ongoing payroll processing for all employee insurance committee vendors costs between $14,220 and $56,880 annually.[17]

Several employee insurance committee-selected products have low participation, and the State absorbs the administrative cost of these products. South Carolina only allows a vendor to have a payroll deduction slot if there are at least 250 enrollees. Seventy-four percent of all vendors in BEACON have fewer than 250 deductions. Exhibit 8 provides a list of 14 vendor accounts in BEACON with five or fewer employees receiving a payroll deduction.

[16] Committees are required to have between five and nine members, resulting in a range in potential employee hours dedicated to serving on an employee insurance committee.
[17] This estimate only includes the ongoing cost of payment processing for 55 unique vendors and does not include costs that agencies and universities incur in selecting the insurance products, promoting/enrolling employees, and reconciling enrollments to payments.

Exhibit 8

Office of the State Controller Processes Payments for 14 Vendor Accounts with Five or Fewer Participating Employees

Vendor	Employees Enrolled Across State	Total Monthly Payment
American General Life Insurance	1	$100
Aegon SID	1	$28
National Traveler's Life	1	$352
New York Life Insurance	1	$25
Veterinary Pet Insurance	1	$22
Central Security Life Insurance	2	$111
Alexander Hamilton Life	2	$50
Liberty National Life Insurance	2	$39
State Farm Insurance Company	2	$66
Northwest Nat Life Insurance Company	3	$106
Lincoln Financial	4	$137
Gen American Life Insurance Company	4	$105
United Teacher Association Insurance	4	$159
Occidental Life of NC	5	$212

Source: Program Evaluation Division based on December 2014 data from the Office of the State Controller.

Employee insurance committee-selected vendors solicit state employees on state time. State law permits employee insurance committee vendor representatives to solicit employees.[18] Though the Program Evaluation Division could not estimate number of employee work hours spent meeting with insurance vendor representatives, employees do use state work hours to meet with vendors in various meeting formats such as new hire orientations, informational sessions, and personal consultations with vendors. These vendor meeting formats can create the impression that vendors' offerings are endorsed by the State and that an employee insurance committee has done due diligence in its selection of vendor product offerings. However, such an impression may be misguided because, as noted previously in this report, many agencies and universities do not have employee insurance committees and many products are offered to employees without an associated contract or competitive bidding process.

In contrast, the NCFlex program utilizes Office of State Human Resources staff and agency or university health benefit representatives as the primary sources of information on NCFlex insurance products; health benefit representatives have no vested interest in what supplemental

[18] N.C. Gen. Stat. § 58-31-60.

insurance products an employee chooses. One agency survey respondent stated, "One thing I have understood in my years as a health benefit representative is employees are vulnerable when it comes to purchasing products from an agent. Most supplemental benefit agents prefer to meet with the employee to promote their product. Supplemental agents entice an employee to enroll because it's profitable for the agent. If NCFlex manages the supplemental benefits, then the responsibility will fall to the health benefit representative, who is not partial to one product over another. The health benefit representative gives better information about the product and leaves it up to the employee to choose."

Neighboring states reviewed by the Program Evaluation Division generally offer supplemental insurance administered by a centralized agency. The Program Evaluation Division reviewed four adjacent states to determine how they organize supplemental insurance products offered to employees.

- **Georgia** has a centralized set of supplemental insurance products that are managed by the Georgia Department of Administration. Supplemental insurance is offered to all state agency employees, though the university system does not participate.
- **South Carolina** manages supplemental insurance offered to state employees through the Public Employees Benefits Authority. South Carolina permits agencies to offer other supplemental insurance products to employees, but agency offerings cannot be of the same type as a Public Employees Benefits Authority product. In addition, agency supplemental insurance products must have at least 250 employees enrolled in order to be eligible for payroll deduction.
- **Tennessee** has a committee that selects supplemental insurance for state agencies and the university system, and benefits are centrally administered through the Tennessee Department of Finance and Administration.
- **Virginia** offers voluntary benefits through the Department of Human Resource Management and Virginia Retirement System.

Centralizing all supplemental insurance offerings would result in a number of benefits to the State and employees.

- **Better value to employees.** Centralization is likely to result in better value to employees through improved procurement practices and an improved bargaining position resulting from economies of scale. In addition, more efficient plan design and coordinated offerings could reduce or eliminate the existence of multiple plans containing overlapping coverage.
- **One system for all employee insurance enrollment.** Employees could enroll in all supplemental insurance products concurrently and receive one annual benefit statement that would detail all insurance in which they are enrolled, including the State Health Plan. A single annual benefits statement could protect against situations in which employees unknowingly enroll in duplicative or overlapping plans.

- **Uniformity of product offerings.** Benefit communication and education efforts could be streamlined and better coordinated because offerings would be consistent across state agencies and universities. When state employees transfer agencies or universities, the benefits would be portable.
- **One system to oversee.** Oversight of the employee insurance committee system is challenged by the fact that currently there are potentially 46 different committees to monitor. Centralization would ensure there would be one entity accountable for all supplemental insurance benefits. In addition, all insurance products would be procured in accordance with Division of Purchase and Contract policies and procedures.
- **Improved data availability.** State oversight of supplemental insurance programs is challenging due to data availability issues involving multiple supplemental insurance programs and committees. Having a centralized system with electronic enrollment data would improve the availability of data and the potential for improved decision-making.
- **Greater assurance of accurate payroll deduction amounts.** A single supplemental insurance program would allow administrators to cost-effectively ensure the accuracy of payroll deductions through centralized reconciliation.

Administering the NCFlex program is a core activity of OSHR, but it is not a core activity for the agencies and universities that have employee insurance committees. A centralized structure would allow for an aggregation of expertise in selecting and administering supplemental insurance products. For example, NCFlex looks at loss ratios annually to evaluate the value of supplemental insurance products to state employees.[19] OSHR administers the NCFlex program with employees who specialize in employee benefits; the current staffing structure includes a manager and four human resource consultants. In addition, OSHR has contracted with a consultant who assists with supplemental insurance procurement, including evaluating product offerings, developing requests for proposals, and analyzing existing claims experience. Independent consultants are not utilized by employee insurance committees and it is not cost-effective to pay a consultant at each agency every time an employee insurance committee requests bids.

A centralized structure with a standard set of benefit options would lessen compliance risk because there would be fewer plans to administer, and it would be less complex for the General Assembly to oversee one centralized supplemental insurance program rather than 46 agencies and universities offering separate insurance products through employee insurance committees. All contracts for NCFlex insurance products are drawn up in accordance with Division of Purchase and Contract guidelines and, as mentioned previously, include important contract terms and conditions that help protect the State. Centralized administration also

[19] An insurance loss ratio is the ratio of losses incurred in claims by an insurer to premiums earned, usually for a one-year period. For example, if an insurer pays $70 in claims for every $100 collected, its loss ratio is 70%.

carries less risk of noncompliance with state and federal tax laws arising from improper administration of a Section 125 cafeteria plan.

If OSHR administered all supplemental insurance products, the State could take advantage of the existing experience within OSHR and the insurance consulting services available to OSHR through contract. OSHR stated it would not anticipate needing any additional staff in order to administer supplemental insurance offerings.

Centralized administration of all supplemental insurance would allow one entity to oversee both pre-tax and post-tax insurance offerings. One of the primary distinctions between products offered by the NCFlex program and the employee insurance committee system involves whether an employee is taxed on the premium amounts that are payroll deducted. However, having separate systems based on how premiums are taxed is unnecessary; these distinctions can be handled by programming a payroll system to either deduct the premium before or after taxes are applied.

Having one centralized system for supplemental benefit offerings would allow administrators to more readily make judgments as to whether it is preferable to offer products on either a pre-tax or post-tax basis. More importantly, bringing all supplemental benefits together under centralized administration allows for a more integrated approach to overall employee benefit design, which is an important part of an employee compensation package and important to the State's human resource strategy.

One common argument against centralization is that employees would have fewer choices, but several options would remain for employees. Employees could maintain enrollment in many products through direct payment to the vendor by the employee. With many banks and vendors now offering different methods of recurring electronic payment, this option is more convenient than in the past. In addition, employees can always choose to privately purchase supplemental insurance on the open market if the State does not offer a particular type of product or the employee is not satisfied with the options available through the State.

Arguments in favor of more employee choice should be tempered because too much choice can lead to impaired decision-making by employees. For example, Finding 2 discussed the cases of employees who enrolled in two separate dental insurance plans, many of whom did so unintentionally. Another potential danger is that employees can become overinsured by purchasing insurance products that cover risks employees are already insured against through the State Health Plan, the State Disability Income Plan, or other state employee benefits. The argument for more supplemental insurance choice for employees also presumes that employees are choosing from a range of options that are all suitable. However, with many agencies unable to demonstrate competitive selection of insurance products or provide contracts for insurance products, employee insurance committees often cannot provide assurance that products offered are the most suitable options or represent the best value for employees.

Recommendations

Recommendation 1. The General Assembly should eliminate the employee insurance committee system and create a single committee charged with selection and oversight of all pre- and post-tax supplemental insurance benefits offered to state employees.

The General Assembly should repeal the state law authorizing employee insurance committees and create a single employee insurance selection committee that is responsible for both post-tax supplemental insurance products and the pre-tax NCFlex program.[20]

A similar recommendation was made by the Office of State Budget and Management in the North Carolina Government Efficiency and Reform (NC GEAR) final report in March 2015, which recommended consolidation of employee insurance committees to leverage the buying power of all state government.[21]

This committee should be known as the State Employee Insurance Selection Committee and should consist of five members: the Office of State Human Resources (OSHR) director, Office of State Budget and Management director, the University of North Carolina System president, the State Treasurer, and the State Controller, or their designees.[22] The recommended governance structure should include representation of the State Treasurer because of the importance of coordinating supplemental benefits with other employee benefits administered by the Department of State Treasurer including the State Health Plan and the Teachers' and State Employees' Retirement System. The committee should include the State Controller because of the importance of enrollment and payroll systems in administering supplemental insurance offerings.

The responsibility for administering supplemental benefits and staffing of the State Employee Insurance Selection Committee should reside with OSHR, which currently administers the NCFlex program but would now have administrative responsibility for all supplemental insurance plans.

The State Employee Insurance Selection Committee should be charged with several responsibilities for the selection and oversight of employee supplemental insurance:

- requesting proposals from vendors to provide supplemental insurance coverage to state employees within detailed specifications;
- competitively bidding products at least every five years in order to obtain competitive pricing;
- reviewing all supplemental insurance benefits and selecting supplemental insurance products the committee determines to be in the best interest of the State and state employees;

[20] Currently, NCFlex is directly administered by the Office of State Human Resources (OSHR) and does not operate with an oversight committee, though OSHR does consult with a benefits working group regarding NCFlex. When competitively bidding supplemental insurance products, OSHR convenes a committee made up of agency and university benefits representatives to select vendors.
[21] NC GEAR (2015, March). *Report to the Joint Legislative Commission on Government Operations*. Raleigh, NC: General Assembly.
[22] House Bill 940, the 2015 Governor's Budget, proposed the creation of an Employee Insurance Selection Committee, which would be made up of the Office of State Human Resources director, Office of State Budget and Management director, and the University of North Carolina System president. This Program Evaluation Division recommendation includes two additional committee members: the State Treasurer and State Controller.

- overseeing all supplemental insurance contracts, including but not limited to ensuring terms and conditions of the contracts are met;
- coordinating education and communication regarding supplemental insurance benefit design and enrollment;
- receiving input from agency and university health benefit representatives on how to improve supplemental insurance offerings and administration; and
- surveying a representative sample of state employees at least every five years to receive input on supplemental insurance product design, vendor performance, and state administration of supplemental insurance.

Recommendation 2. The General Assembly should direct the newly-created State Employee Insurance Selection Committee to oversee the transition to a centralized system of supplemental insurance benefits by establishing processes for terminating payroll deduction for insurance products not associated with a valid contract and phasing out products with valid contracts when the contracts expire.

In order to determine which products are associated with a valid contract, the General Assembly should require each agency and university to submit copies of all current employee insurance committee contracts to the State Employee Insurance Selection Committee and the Attorney General's Office. The Attorney General's Office should review those contracts and create a list of all valid, active contracts including each contract's earliest end date. Working in coordination with the Office of the State Controller, the State Employee Insurance Selection Committee should ensure payroll deduction is terminated for all insurance products without a valid contract within 12 months of the Attorney General's Office making that determination. For those insurance products with valid contracts, oversight of the contracts should be transferred to the State Employee Insurance Selection Committee. Once the contracts expire, payroll deduction should be terminated for those products as well. At that time, employees can elect any of the competitively bid products through the State Employee Insurance Selection Committee.

The committee should establish a process for agencies and universities to identify and notify employees with existing payroll deductions for employee insurance committee-selected products in order to give them time to prepare for the transition. This process should ensure employees receive written notification at least six months prior to the termination of deductions so employees have time to make alternative arrangements. Such arrangements could include employees purchasing insurance offered through the State Employee Insurance Selection Committee, purchasing supplemental insurance on the open market, or exercising portability provisions that allow employees to continue to buy the insurance directly from the current vendor.

Appendices

Appendix A: Types of Supplemental Insurance Products Available Through the Employee Insurance Committee System and/or the NCFlex Program

Appendix B: Supplemental Insurance Available Through Employee Insurance Committees: Participation, Vendors, Deductions, and Committee Status

Agency Response

A draft of this report was submitted to the Office of State Budget and Management, Office of State Human Resources, and Office of the State Controller for review. Report recommendations were also reviewed by the Department of State Treasurer and University of North Carolina General Administration. Responses are provided following the appendices.

Program Evaluation Division Contact and Acknowledgements

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Staff members who made key contributions to this report include Chuck Hefren and Jim Horne. John W. Turcotte is the director of the Program Evaluation Division.

Appendix A: Types of Supplemental Insurance Products Available Through the Employee Insurance Committee System and/or the NCFlex Program

Accident	Insurance designed to defray the costs associated with an accidental injury
Accidental Death & Dismemberment	Pays benefits to the beneficiary should the insured be killed or dismembered as a result of an accident
Cancer	Insurance designed to help defray the costs associated with treatment of cancer or other specified diseases
Critical Illness	Provides funds, usually a lump sum payment, for certain critical illnesses such as cancer, heart attack, stroke, or other conditions
Dental	Insurance designed to pay a portion of the costs associated with dental care
Disability	Provides supplementary income in the event of an illness or accident that results in a disability that prevents the insured from working
Flexible Spending Account	Allows employees to set aside a portion of pre-tax wages to pay for qualified expenses established through a cafeteria plan such as medical expenses or child care
Heart/Stroke	Pays a benefit to defray costs associated with treatment of heart and stroke-related conditions
Hospital Indemnity	Pays a cash benefit when the insured is confined in a hospital
Identity Theft	Covers certain expenses in the event of the insured's identity being stolen
Legal Expense	Provides benefits to pay for certain legal expenses such as wills, adoptions, civil and criminal lawsuits, traffic offenses, real estate transactions, rental disputes, and bankruptcy
Pet Insurance	Covers certain expenses of veterinary treatment of pets for certain injuries or illnesses
Term Life	A life insurance policy that provides a stated benefit upon death of the insured, provided that the death occurs within a specific time period
Universal Life	A type of permanent life insurance whereby the excess of premium payments above the current cost of insurance is credited to the cash value of the policy, which allows the insured to shift money between the insurance and savings components of the policy
Vision	Insurance designed to pay a portion of the costs associated with vision care
Whole Life	Life insurance that pays a benefit upon the death of the insured and also accumulates a cash value

Notes: Descriptions of the types of insurance products are general and are not intended to describe the coverage or limitations of any specific plan offered through NCFlex or any North Carolina state agency or university employee insurance committee.

Source: Program Evaluation Division.

Appendix B: Supplemental Insurance Available Through Employee Insurance Committees: Participation, Vendors, Deductions, and Committee Status

Count	Agency Name	Number of Participating Employees	Total Eligible Employees	Percentage Employee Participation	Number of Vendors	Total Deductions	Annual Amount Payroll Deducted	Insurance Committee?
1	Administrative Office of the Courts	1,961	6,413	31%	11	2,706	$ 1,794,942	Yes
2	Appalachian State University	782	2,632	30%	9	1,111	377,316	Yes
3	Board of Cosmetic Art Examiners	1	26	4%	1	1	403	No
4	Community College System Office	48	180	27%	5	60	48,562	No
5	Department of Administration	182	803	23%	10	228	158,849	Yes
6	Department of Agriculture & Consumer Services	288	1,902	15%	7	342	189,284	No
7	Department of Commerce	629	1,831	34%	11	747	610,384	No
8	Department of Cultural Resources	170	714	24%	6	195	106,504	No
9	Department of Environment & Natural Resources	329	2,501	13%	10	370	280,578	No
10	Department of Health and Human Services	7,843	16,187	48%	29	12,053	7,738,350	Yes
11	Department of Insurance	79	404	20%	8	88	40,681	Yes
12	Department of Justice	91	756	12%	8	103	65,214	Yes
13	Department of Labor	52	353	15%	5	54	33,633	Yes
14	Department of Public Instruction	249	1,103	23%	7	276	216,400	No
15	Department of Public Safety	15,069	22,770	66%	19	26,282	14,889,322	Yes
16	Department of Revenue	439	1,293	34%	5	513	422,620	Yes
17	Department of State Treasurer	42	363	12%	4	44	33,056	No
18	Department of the Secretary of State	65	182	36%	8	79	57,047	Yes
19	Department of Transportation	5,754	11,276	51%	17	8,598	6,426,072	Yes
20	East Carolina University	2,103	5,646	37%	7	2,833	720,777	Yes
21	Elizabeth City State University	149	424	35%	8	228	106,761	No
22	Fayetteville State University	331	825	40%	7	460	216,993	No
23	NC A&T State University	515	1,517	34%	7	637	235,928	No
24	NC Central University	307	1,279	24%	10	426	320,840	No
25	NC School of Science & Mathematics	65	219	30%	7	75	17,271	Yes
26	NC State Ports Authority	117	209	56%	3	252	103,047	Yes

Count	Agency Name	Number of Participating Employees	Total Eligible Employees	Percentage Employee Participation	Number of Vendors	Total Deductions	Annual Amount Payroll Deducted	Insurance Committee?
27	NC State University	3,735	8,353	45%	5	5,463	2,411,245	Yes
28	North Carolina Education Lottery	40	252	16%	1	74	35,864	No
29	North Carolina General Assembly	58	331	18%	2	60	37,831	No
30	North Carolina Housing Finance Agency	12	108	11%	2	13	7,254	No
31	Office of Administrative Hearings	13	43	30%	4	15	15,693	No
32	Office of Information Technology Services	93	526	18%	7	110	72,509	No
33	Office of the State Auditor	11	136	8%	3	12	14,451	No
34	Office of the State Controller	38	161	24%	7	47	35,190	Yes
35	State Board of Elections	2	56	4%	2	2	1,422	No
36	UNC Asheville	105	692	15%	3	109	21,130	No
37	UNC Chapel Hill	5,476	12,592	43%	6	8,135	3,358,346	Yes
38	UNC Charlotte	959	3,275	29%	3	970	124,533	Yes
39	UNC Greensboro	1,093	2,447	45%	4	1,352	465,868	No
40	UNC Health Care	4,508	8,853	51%	6	8,674	1,272,379	Yes
41	UNC Pembroke	400	836	48%	6	491	204,372	No
42	UNC School of the Arts	112	426	26%	4	131	45,958	No
43	UNC Wilmington	1,247	1,863	67%	5	1,626	216,114	Yes
44	Western Carolina University	621	1,504	41%	3	695	133,957	Yes
45	Wildlife Resources Commission	116	595	19%	4	133	96,318	Yes
46	Winston-Salem State University	293	841	35%	3	302	85,240	No
	Totals	**56,592**	**125,698**	**45%**	**309**	**87,175**	**$ 43,866,505**	**22-Yes 24-No**

Notes: Certain agency and university affiliate institutions participate in the offerings of another employee insurance committee. For that reason, Department of Administration totals also include the Governor's Office, Lt. Governor's Office, Office of State Budget & Management, Office of State Human Resources, and State Ethics Commission. UNC Chapel Hill totals also include UNC General Administration and UNC Press. Because the State Ports Authority has its own employee insurance committee, it was counted separately from the Department of Transportation.

Source: Program Evaluation Division based on several data sources including BEACON payroll data, UNC Data Mart, Housing Finance Agency payroll data, NC Education Lottery payroll data, North Carolina General Assembly payroll data, and agency and university survey data. All figures are based on December 2014 data except for "Annual Amount Payroll Deducted," which is based on calendar year 2014 with the exception of amounts listed for UNC institutions, which were estimated based on December 2014 data due to data availability limitations.

STATE OF NORTH CAROLINA
OFFICE OF STATE HUMAN RESOURCES
1331 MAIL SERVICE CENTER • RALEIGH, NC 27699-1331

PAT MCCRORY
GOVERNOR

C. NEAL ALEXANDER, JR.
STATE HUMAN RESOURCES DIRECTOR

August 14, 2015

Mr. John Turcotte, Director
Program Evaluation Division
300 North Salisbury Street, Suite 100
Raleigh, NC 27603-5925

Dear Mr. Turcotte:

On behalf of the Office of State Human Resources (OSHR), and the Office of State Budget and Management (OSBM), thank you for the opportunity to review the Program Evaluation Division's report titled *North Carolina Centralized Management of State Employee Supplemental Insurance Benefits.* This report provided a very comprehensive view on how employees' insurance committees operate in the State, and our offices are appreciative of the hard work of you and your staff.

We agree that your recommendation to form the State Employee Supplemental Insurance Selection Committee is in the best interest of State employees. This committee will be charged with selection and oversight of all pre-tax and post-tax supplemental insurance benefits. We also agree that OSHR, which administers the NCFlex programs, is the best organization to administer these supplemental insurance plans. This new committee will ensure better supplemental insurance products are offered at competitive rates, provide communication regarding employee benefits that is timely and accurate, significantly reduce the cost associated with administering these supplemental plans, and at the same time minimize the risk to the State.

OSHR and the newly created State Employee Insurance Selection Committee will ensure a smooth transition for employees to either continue their coverage through alternative arrangements, or to transition them to one of the current NCFlex offerings. Our goal would be to ensure the employee's continuity of coverage is not harmed during this change. We also support your recommendation to terminate payroll deductions not associated with a valid contract.

As noted in the report, a similar recommendation was made in the NC GEAR March 2015 report, and a supporting provision was proposed in the Governor's Budget Bill to implement that recommendation (House Bill 940, Section 23.8).

While the structure of the committee recommended in this report differs slightly from that proposed in the Governor's Budget, we support the report's recommendations on the committee selection.

Finally, if the administration of all post-tax supplemental insurance plans is moved to OSHR, we do not anticipate the need to hire additional staff to administer these supplemental insurance plans. Our current structure of four HR/Benefits consultants and a manager should be adequate to effectively manage these products.

We look forward to working with the General Assembly to enact your recommendation to centralize administration of all supplemental insurance offerings and in doing so provide a better value to State employees. Again, we appreciate the opportunity to review and comment on your report.

Sincerely,

C. Neal Alexander, Jr.
State Human Resources Director, Office of State Human Resources

Lee Harriss Roberts
State Budget Director, Office of State Budget and Management

State of North Carolina
Office of the State Controller

LINDA COMBS
STATE CONTROLLER

July 15, 2015

John W. Turcotte, Director
Program Evaluation Division
NC General Assembly
300 N. Salisbury Street, Suite 100
Raleigh, NC 27603-1406

Dear Mr. Turcotte:

The Office of the State Controller appreciates the opportunity to review and respond to the Program Evaluation Division draft report 2015-07, *North Carolina Should Centralize Management of State Employee Supplemental Insurance Benefits."* Thank you for the work Jeff Grimes and his team did to research and document the issues with the current system. Please accept this letter as our formal response to the draft report.

OSC agrees with the report's recommendations. Replacing the multiple committees with a single statewide committee, overseen by the Office of State Human Resources, will better leverage the expertise and established processes of the NCFlex program staff. We appreciate the inclusion of the State Controller as a member of this committee. Participation on this committee will allow us to have input to contract negotiations to more easily pursue automation considerations for efficient payroll processing. We also agree that current payroll deductions for insurance products not associated with a valid state contract should be terminated as soon as practical. Employees wishing to keep these products should move to a direct billing relationship with the vendor.

We look forward to working with the General Assembly and the Office of State Human Resources to enact these changes and to provide better benefit options for state employees.

Sincerely,

Linda Combs

Linda Combs
State Controller

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NORTH CAROLINA

OFFICE OF THE TREASURER **JANET COWELL, TREASURER**

July 31, 2015

John Turcotte, Director
Program Evaluation Division
300 N. Salisbury Street, Suite 100
Raleigh, NC 27603-5925

Dear Mr. Turcotte:

The Department of State Treasurer thanks you for the opportunity to review an excerpt of your division's report on the state's employee supplemental insurance benefits. The stated scope of the report – to examine the supplemental post-tax benefits that North Carolina state agencies offer to employees beyond the options available through the NCFlex program – affects a large number of North Carolina's public servants. Program Evaluation Division reports typically inform the General Assembly's deliberations in a manner conducive to effective decision making, and the Department is happy to provide collaborative input to enhance the utility and applicability of the important information contained in these evaluations.

The report includes valuable information regarding provision of supplemental post-tax benefits. Our agency found no technical flaws in the excerpt of the report we were asked to review.

By way of a friendly comment, we do wish to suggest that a logical extension of this policy research would be to explore the possible use of the governance structure you identified in Recommendation One (or a parallel structure) to oversee the administration of supplemental benefits provided to benefit recipients in the state's public sector retirement systems. Our agency would be pleased to participate in such an evaluation.

Further, we appreciate the Program Evaluation Division's indefatigable efforts to provide policy research to members of the General Assembly. We thank you for understanding that our agency is committed to administering the state retirement benefits in a cost-efficient manner for the members of the system and taxpayers of our state.

Once again, we appreciate being asked to comment on the excerpt of the report.

Sincerely,

Steven C. Toole
Retirement Director

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UNIVERSITY OF
NORTH CAROLINA

PO Box 2688
Chapel Hill, NC 27515-2688

Brian Usischon
Associate Vice President for Human Resources
and University Benefits Officer
Phone: 919-962-4530
Email: bmusischon@northcarolina.edu

August 14, 2015

Mr. John Turcotte, Director
Program Evaluation Division
NC General Assembly
100 Legislative Office Building
Raleigh, NC 27603-5925

Dear John:

On behalf of the University of North Carolina, I am writing to respond to the recommendations to be included in the Program Evaluation Division (PED) Report on Employee Insurance Committee Supplemental Benefits, as shared in Jeff Grimes' email of August, 7, 2014.

Recommendation 1: The General Assembly should eliminate the employee insurance committee system and create a single committee charged with the selection and oversight of all pre- and post-tax supplemental insurance benefits offered to state employees.

Response to Recommendation 1: The University agrees that employees are best served when benefit programs are established and administered through a central office, rather than at or by individual campuses; however, the University believes that any such programs for University employees are best administered by the University, rather than another State agency. First, authorizing the University to administer these supplemental insurance programs is consistent with the General Assembly's prior authorization to the University to offer retirement and other benefits programs to University employees. Those programs are administered by UNC-General Administration under the authority of the President for the entire University system. The University has a long record of success in administering these programs, as well as the professional and administrative capacity to do the same for employee insurance programs. Benefits Administration is a core function of the UNC System. We manage retirement programs exceeding $6 billion in assets under management and we maintain an insurance portfolio for non-employee based products totaling more than $83 million dollars annually.

Second, the University of North Carolina statutorily is a single University encompassing 17 constituent institutions and affiliated entities. It recruits nationally for faculty and non-faculty talent. In order to be competitive with other public colleges and universities, the University needs to manage its employee supplement insurance products with existing offerings provided by the State. Consolidating the supplemental insurance program oversight at the University level has been identified as a priority of the University, and the UNC Board of Governors' 2015 Legislative Priorities included a recommendation to amend G.S. 58-31.62 to grant authority to the President to review insurance products offered to employees (with input as requested from University employees, committees, or other groups), to select the types of insurance products to make available to employees, to competitively select insurance products that promote recruitment and retention of qualified University employees, and enter into agreements establishing the duties of the insurance companies selected to provide products to employees (*see* S637 introduced this session).

Recommendation 2: The General Assembly should direct the newly created State Employee Insurance Selection Committee to establish a process for terminating payroll deduction for insurance products not associated with a valid contract and to phase out products with valid contracts when the contracts expire.

Response to Recommendation 2: The University does not disagree with an appropriate phasing-out/phasing-in approach to a more consolidated insurance product offerings. With the proposed changes to amend G.S. 58-31.62 as outlined by our response to Recommendation 1, the University had planned on engaging the UNC Benefits Committee, which has oversight for the University Retirement Programs, to review all existing insurance products offered by constituent institutions and eliminate and procure new products that would better serve the needs of our workforce. The University was extremely successful in bidding a UNC 403(b) plan back in 2008 and went from over 50 vendors at various constituent institutions to a single UNC 403(b) plan managed at UNC General Administration.

The University of North Carolina is a large complex multi-campus university with distinct constituent institution missions and a diverse employee population. To recruit and retain quality employees who compete at a national level, it is critical that the University offer a competitive benefits package. UNC has been very effective in implementing products that are:

- *Cost Effective* - low cost, making more prudent use of benefit spending
- *Competitive* – as measured against other higher institutions in the marketplace
- *Flexible* –allows administrators to tailor benefits to the needs of campuses and occupational groups
- *Integrated and Branded as University Programs* – this includes strong customer service feature, even if primary administrative functions are handled by a vendor, or as in the case of the NC Flex program, another state agency
- *Secure* – managed such that the programs are funded and can meet the promises made to participants.

The University currently maintains a strong partnership with the Office of State Human Resources and participates in the State-wide Flexible Compensation Program (NC Flex), however, the University retains the authority to establish its own plan of flexible compensation for eligible employees (see G.S. 116-17.2). Both the NC Community College System and North Carolina Public Schools have similar authority. For these reasons, having a committee overseeing insurance benefits for University employees separate from other State employees best serves employees and the State and recognizes the unique recruitment and retention challenges of the University. We will continue to look for partnerships, like our current participation in the NCFlex Program, but also seek authority for programs that we believe should be managed by the University for the reasons described above.

We appreciate this opportunity to provide a response to the PED Report on Employee Insurance Committee Supplemental Benefits and look forward to your final report and revised recommendations. Please let me know if you would like to talk further.

Sincerely,

Brian Usischon

Brian Usischon

cc: Charlie Perusse, Chief Operating Officer
Matthew Brody, Vice President for Human Resources
Jeff Grimes, Senior Program Evaluator, Program Evaluation Division