REPORT OF THE
SECRETARY OF ADMINISTRATION ON

Short-Term Disability Insurance Program for State Employees

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

HOUSE DOCUMENT NO. 21

COMMONWEALTH OF VIRGINIA
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COMMONWEALTH *of* VIRGINIA

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Dear Governor Wilder and Members of the General Assembly:

The 1990 General Assembly, by House Joint Resolution 98, requested the Secretary of Administration to study two issues: (1) the possibility of providing a short-term disability insurance program for Virginia's State employees, and (2) the possibility of employees using sick leave credits to fund their health insurance premiums upon retirement.

Enclosed for your review and consideration is the Report of the Secretary of Administration on a Short-Term Disability Insurance Program for State Employees that has been prepared in response to this Resolution.

Respectfully submitted,

Ruby G. Martin

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Secretary of Administration

/jmc

Enclosure

PREFACE

House Joint Resolution 98 requested the Secretary of Administration to study two issues: (1) the possibility of providing a short-term disability (STD) insurance program for State employees; and (2) the possibility of employees using sick leave credits to fund their health insurance premiums upon retirement. This report presents findings on these issues.

The Resolution directed the Department of Accounts and the Virginia Retirement System to assist the Secretary with this study. The Department of Personnel and Training, along with representatives from the Virginia Polytechnic Institute and State University, the Department of Mental Health, Mental Retardation, and Substance Abuse Services, and the Department of Planning and Budget, also provided assistance. Additionally, the Department of Accounts obtained the services of Coopers and Lybrand, a national accounting firm, to assist with the study.

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EXECUTIVE SUMMARY

House Joint Resolution 98 requested the Secretary of Administration to study two issues: (1) the possibility of providing a short-term disability (STD) insurance program for state employees; and (2) the possibility of employees using sick leave credits to fund their health insurance premiums upon retirement.

I. Short-Term Disability Program

Under the Commonwealth's current policies, employees who become permanently disabled are eligible for the long term protection afforded under the State's "disability retirement" program. However, there is no income protection if employees become temporarily disabled for periods exceeding their sick and annual leave balances. A short-term disability program could provide some income protection to these employees.

A. Need

An employee survey was conducted to determine the need for a STD program and employees' desire to have a STD program available to them. Survey results show that 95.4% of employees annually take no unpaid leave for disabilities, thereby indicating that they have no need for a STD program.

Sixty-five percent of employees responding to the survey indicated that a STD program was not "very important" in their consideration of employment with the Commonwealth. In addition, the majority of respondents indicated that, if a STD program were implemented, they would prefer one that does not make any modifications to the current sick leave policies.

B. Program Components

To determine the feasibility of implementing a STD program, certain program components must be determined. These components include eligibility, determination of a waiting period, and determination of the benefits provided and the length of the benefits period.

If a STD program were implemented, it was concluded that its components include: eligibility only to full-time classified employees (consistent with current benefits), who have been employed at least six months (to coincide with the end of each employee's probationary period); a waiting period of 14 consecutive calendar days (10 work days) (illnesses which disable employees for more than two weeks are generally indicative of the illnesses intended to be covered by a STD program); payments equivalent to of at least 50% to 60% of salary (to be consistent with industry practice and to provide reasonably meaningful income protection); and a benefit period of 26 weeks (to be consistent with industry practice).

The following two modifications to the current sick leave program also were examined as potential adjuncts to a STD program: 1) changing to a non-cumulative program (i.e. unused sick leave is not carried forward from year to year); and 2) reducing the number of sick leave days provided annually.

C. Mandatory or Optional Participation

If employees are required to help pay for the cost of a STD program, then mandatory participation could eliminate adverse selection (i.e. having a disproportionately large percentage of employees participate who are likely to become disabled), and thus reduce claims cost. Nonetheless, if a STD program is instituted, participation should be optional because it may be undesirable to force employees to pay for a benefit which some may not want, need, or be able to afford. Of course, if the Commonwealth alone paid for the cost of a STD program, then this issue would be irrelevant, because it is highly likely that almost all employees then would participate, even under an optional program.

D. Cost

It was estimated that a STD program with the components set forth above, would result in annual claims costs of $18, 390, 363 (benefits at 50% of salary) to $22, 068, 437 (benefits at 60% of salary). It was estimated that administrative services would cost an additional $1.3 million to $2.2 million annually.

It is possible that these costs could, in time, be defrayed by changing to a non-cumulative sick leave program, or by reducing the number of sick leave days provided annually. However, realization of any substantial savings through these sick leave modifications, may be delayed due to employees continued use of sick leave balances already earned, and their increased use of annual leave balances.

The monthly cost estimates for employees to purchase STD policies on their own, ranged from $20.50 to $43.50. The effective cost of these policies to employees could be reduced if they were purchased with "pre-tax dollars" through an expansion of the State's Flexible Spending Accounts program.

E. Funding

If a STD program is implemented, two funding issues must be addressed: (1) who will pay the cost of funding the program, and (2) how will claims be administered. It is recommended that if a participation in a STD program is mandatory, or if it involves the reduction of current sick leave benefits, then the Commonwealth should bear the cost of the program for several reasons including: it is the industry norm for employers to pay the cost; there is a general lack of demand by employees for a STD program; it may be considered unfair to reduce sick leave benefits (for which employees do not pay) and replace them with STD benefits for which employees pay.

It is recommended further that, due to cost considerations, if a STD program is implemented that it be self-funded , utilizing the services of a third-party administrator to adjudicate claims and determine liability. This method is similar to the method currently used by the Commonwealth to fund its health benefits program.

F. Conclusion

In light of the Commonwealth's current budget situation, funding the costs of a STD program with State funds, without offsetting the costs by reducing sick leave benefits, is not financially feasible. Most employees, however, wish to have no modifications to the current sick leave program, and few would benefit annually from a STD program. Moreover, even if the sick leave program were modified, cost savings may not be realized for several years due to employees continued use of sick leave balances already earned, and their potential increased use of annual leave balances.

For these reasons, it is concluded that, at this time, the Commonwealth not provide short-term disability insurance as an additional fringe benefit to employees. Employees, however, should be provided the opportunity to purchase short term disability insurance with their own "pre-tax" funds through an expansion of the State's Flexible Spending Accounts program.

II. Funding Retirees' Health Insurance Premiums With Sick Leave Credits

Due to concern with rising health insurance costs, HJR 98 also requested an examination of the feasibility of funding retirees' health insurance premiums with the payment due them under current policy for 25% of their unused sick leave balances, up to a maximum $2,500.

Three methods for the use of this payment were assessed: (1) direct debit, (2) full premium annuity, and (3) life annuity. Implementation of a program for funding retirees' health insurance premiums with sick leave credits would provide retirees a tax advantage. However, the majority of employees indicated a desire to retain the current lump sum payment for unused sick leave.

Using sick leave credits to fund retirees' health insurance premiums would not alleviate significantly the high costs of premiums. Furthermore, it could result in the Commonwealth incurring administrative costs at a time when fiscal constraints are critical. Therefore, it is recommended that the Commonwealth maintain the current lump sum reimbursements for unused sick leave. Employees, of course may choose to invest this lump sum in any manner they desire, including purchasing annuities.

I. INTRODUCTION

A. Short-Term Disability Insurance

House Joint Resolution (HJR) 98 (see Appendix A) stated that "there are instances when an employee depletes all of his sick and annual leave due to a serious illness or injury but is not eligible for" disability retirement. Thus, HJR 98 found that "there may be a need for a short-term disability policy for state employees to fill the gap between sick leave and disability retirement. . . . "

Accordingly, HJR 98 directed the Secretary of Administration to study:

1. the need for a short-term disability insurance policy for state employees;
2. the cost and feasibility of such a policy;
3. how such a policy should be funded;
4. what the policy should include; and
5. whether it should be optional or mandatory.

The Commonwealth currently provides long-term income protection when employees become permanently disabled from performing their job. This program is referred to as "Disability Retirement." Employees are eligible for payments under this program beginning their first day of permanent disability.

The Commonwealth's current sick leave program is designed to provide income protection when employees are acutely ill. Under this program, employees are provided a total of fifteen days of paid sick leave per year. These fifteen days are accrued at the rate of five hours per pay period. There is no limit on the number of hours which employees may carry forward from year to year. Thus, employees may have sick leave balances far in excess of the fifteen days.

Employees also earn annual leave, which, although ordinarily used for vacations, may be used for any reason, including illness. Employees earn between 12 and 21 days of annual leave per year (accrued at rates of four to seven hours per pay period), depending on employees' years of service. Like sick leave, accrued annual leave may be carried forward from year to year. However, unlike sick leave, the maximum number of hours that may be carried over is limited. That number varies from 24 to 42 days according to an employee's years of service.

Thus, under the Commonwealth's current policies, there is no income protection if employees become temporarily disabled for periods exceeding their sick leave and annual leave balances. A short-term disability insurance program would be established to provide income protection for these periods of time. Short-term disability insurance policies provide income for non-permanent disabilities whose duration will exceed a specified period of time, typically two weeks.

B. Funding Retirees' Health Insurance Premium With Sick Leave Credits

House Joint Resolution 98 also stated that due to the rising cost of health insurance, "innovative methods of helping retirees pay for the cost of health insurance must be considered." Accordingly, HJR 98 directed the Secretary of Administration to study:

1. the feasibility of using the payment that retirees are entitled to receive for their unused sick leave for paying health insurance premiums after retirement; and
2. how such a plan should be administered.

The Commonwealth contributes varying amounts towards the cost of active state employees' health insurance, from $143 to $276 per month, depending on the type of membership. When employees retire, these monthly contributions end. However, section 2.1-20.1:2 of the Code of Virginia provides a monthly credit toward the cost of health insurance for retirees with at least 15 years of creditable service. Retirees eligible for the credit receive $1.50 per month for every year of creditable service not to exceed a maximum monthly allowance of $45.00.

Thus, HJR 98 identified the need to assist retirees with their increased health insurance cost. One such method of assisting with this cost is to identify an innovative way of more fully maximizing the money which certain employees receive for their sick leave balances when they leave active state service.

Currently, employees with at least five years of state service who leave state employment receive payment for 25% of their sick leave accruals, up to a maximum of $2500. This report discusses the feasibility of using this payment to assist retirees with their health insurance premiums after retirement.

II. SHORT-TERM DISABILITY INSURANCE PROGRAM

A. Need

To assess employees' need for a short-term disability (STD) program, the Department of Personnel and Training surveyed 804 randomly-selected full-time, classified employees (see Appendix B). Four hundred fifteen, or 51.7%, of the employees responded to the questionnaire.

This needs assessment consisted of survey questions focusing on two areas: employees' use of unpaid leave for illness under the state's current program, and their subjective desire for a STD program. The former area was designed to determine the extent of "the gap between sick leave and disability retirement" (HJR 98). The latter area sought to gauge employees' desire for a STD program, and their potential receptiveness to such a program.

Table 1 displays the survey results for employees' use of unpaid leave for illness under the state's current program.

Table 1

UNPAID LEAVE TAKEN FOR ILLNESS	
0 Days	95.4%
1 - 5 Days	1.5%
6 - 10 Days	0.1%
11 - 15 Days	0.7%
16 - 20 Days	0.0%
21 - 25 Days	0.1%
26 - 30 Days	1.7%
31 - 35 Days	0.1%
36 - 40 Days	0.2%
41 - 45 Days	0.0%
46 - 50 Days	0.1%
51 & Up to 77 Days	0.1%

The most compelling finding as displayed in this Table is that on an annual basis the vast majority of employees (95.4%) do not take unpaid leave for illness. Thus, most state employees are unaffected by the potential "gap" between sick leave and disability retirement. Accordingly, a STD program would not benefit these employees.

Of the 4.6% of employees reporting leave without pay for illness, two factors may impact whether all of these employees may benefit from a STD program.

First, it would have to be determined whether these unpaid days which employees reported were all consecutive. Thus, for example, employees who reported taking fifteen days of unpaid leave may not benefit from an STD program if the days they took were not in succession. Second, even if all unpaid days of leave were taken consecutively, those employees reporting less than sixteen days may not benefit from a typical STD program unless these days were immediately preceded by a sufficient number of paid days of sick leave or annual leave. For example, employees reporting 11 days of unpaid leave may not benefit from a typical STD requiring 15 consecutive days of disability if those were not preceded by more than four days of paid sick leave or annual leave.

The significance of these two factors lies in the fact that a STD program requires a specific number of consecutive days of disability (typically 15 days) before benefits are paid. Thus, these two factors may result in a higher percentage of employees who would not benefit from a STD program.

Employees also were asked questions designed to gauge employees' desire for a STD program, and their potential receptiveness to such a program. Employees' survey responses indicated that 65% preferred a STD program that did not involve any modifications to the current leave policies. The cost ramifications of not modifying the current sick leave program are discussed in section II.D. In addition, as set forth in the following table, 65% of the employees surveyed indicated that a STD program was not "very important" when considering whether to accept a position.

Table 2

IMPORTANCE OF A STD PROGRAM WHEN TAKING A JOB		
Very Important	Somewhat Important	Not Important
35%	55.1%	9.9%

Given the relatively small percentage of employees who would benefit annually from a STD program, and given employees' relative lack of demand for a STD program, it is concluded that there is little need for a STD program.

B. STD Program Components

In designing a STD program, certain necessary components must be determined, including: eligibility, the waiting period, the benefits provided, and the benefits period.

1. Eligibility

Eligibility involves determining which employees are covered under a STD program. In determining the eligibility requirements that would be recommended, consideration was given to the employees covered under other benefit programs offered by the state. Because all benefit programs are made available to full-time classified state employees, it is recommended that any STD program also be afforded to this group of employees. The expansion of eligibility to other categories of state employees (e.g. wage) is not recommended because of cost considerations.

It also is recommended that a STD program cover only those full-time classified employees who have been employed for at least six months. This six-month period is equivalent to the probationary period which must be served by all employees. It was concluded that it may not be appropriate to insure probationary employees' salaries for an extended period of time under a STD program, because those employees may be terminated without cause during the probationary period.

2. Waiting (Elimination) Period

STD programs commonly require employees to be disabled a pre-determined number of consecutive days before they may receive benefits. A waiting period of 14 consecutive calendar days (10 work days) is recommended on the assumption that employees would continue to earn 15 work days of paid sick leave to be used for personal and family illness (See section II.B.5). Coopers and Lybrand analyzed the cost of various STD programs with waiting periods consisting of 0 days, 7 days, and 14 days. The fourteen day waiting period was significantly less expensive. An illness which prevents employees from returning to work for more than 14 days is generally indicative of the types of illnesses intended to be covered by a STD program (i.e., illnesses more severe and longer in duration than ordinary acute illnesses covered by the sick leave program). Thus, the waiting period, in essence, defines those illnesses that will be covered under the STD program.

3. Benefits Provided

Government statistics show that STD programs usually provide 50% to 67% of employees' salaries. Accordingly, two options were studied: 50% of employees' salary and 60% of employees' salary. It is recommended that if an STD program is implemented that it provide at least 50% to 60% of salary to be consistent with industry practice and to provide income protection to employees at a reasonably meaningful level.

4. Benefit Period

The benefit period is the maximum period of time for which employees will be paid benefits for an illness. On the advice of Coopers and Lybrand that 26 weeks is the industry standard, it is recommended that if a STD program is implemented that the benefit period be 26 weeks.

5. Possible Modifications to the Sick Leave Program

Although the sick leave program is not strictly a STD program component, the two programs are logically intertwined. One purpose of cumulative sick leave programs such as the one which the Commonwealth currently has in place (i.e. programs where unused sick leave is carried forward from year to year), is to provide employees with income protection during extended periods of illness. Because a short-term disability program serves a similar purpose, modifications to the current sick leave program were considered in conjunction with the possible implementation of a STD program.

One possible modification would be to change to a non-cumulative program. According to a recent Bureau of Labor statistics survey, approximately 60% of the employees covered by annual sick leave plans, had non-cumulative plans. The potential cost implications of changing to a non-cumulative program are discussed in section II.D.1.C.

If a non-cumulative program were implemented, a determination would need to be made concerning the preservation of employees' current sick leave balances. If these balances are to be preserved ("grandfathered"), then the estimated cost savings in changing to a non-cumulative plan likely would not be realized for several years. On the other hand, if current balances are to be eliminated, then potential legal ramifications should be evaluated. For example, whether the leave balances which employees accrued under the current program "vested" such that they cannot be eliminated would have to be determined. In addition, most employees have indicated that a STD program which includes modifications to the current sick leave program is not desired.

Another potential modification would be to reduce the 15 days employees currently are provided for sick leave. An appropriate determination of this issue involves a recognition that sick leave is needed not only as a "bridge" to STD coverage, but also for ordinary acute illnesses and preventive medical care. To provide sufficient sick leave coverage to bridge the recommended STD waiting period (14 calendar days) would require ten sick leave days. Accordingly, to provide sick leave coverage for acute illnesses and preventive care as well, requires more than ten days.

Thus, in order to provide a complete "bridge" to STD coverage, as well as reasonable leave for other necessary medical care, it is recommended that the current 15 days of sick leave be retained.

C. Mandatory or Optional Participation

Coopers and Lybrand was asked whether employees' participation in a STD program should be optional or mandatory. They advised that if employees are required to help pay for the cost of a STD program, their mandatory participation could reduce claims costs. Permitting optional participation, they opined, would result in adverse selection (i.e., a disproportionately large number of employees likely to become disabled would choose to participate). Of course, this phenomenon would not occur if the Commonwealth paid the entire cost, because it is highly likely that, under such circumstances, almost all employees would participate, even under an optional program.

It may be undesirable, however, to force employees to pay for a benefit which some may not desire, need or be able to afford. Thus, it is recommended that participation be optional.

D. Cost

1. STD Program

The primary cost of a STD program is the amount paid in claims. A lesser cost is the cost of administering the program.

a. Claims Cost

Coopers and Lybrand determined actuarially that the estimated amount which would be paid annually in claims to disabled state employees under a STD program which has the components outlined in section II.B would be $18,390,363 with benefits paid at 50% of salary, and $22,068,437 with benefits paid at 60% of salary.

Cost estimates also were determined actuarially for STD programs with other variations on the program elements recommended in section II.B. The various elements featured into these cost analyses include: covering employees from the first day of employment, after one year of employment, and after two years of employment; capping the maximum weekly benefit at $200 and at $500; and insuring through a third party (i.e., not self-funded).

Appendix C sets forth the estimated cost of STD programs containing these various elements.

b. Administrative Cost

Cost estimates were established for a third party administrator of a self-funded short-term disability program. Third party administration can take many forms, and actual cost are determined by the level of administration sought. The levels can range from minimum administration involving receipt of pre-certified claims, check issuance, and reconciliation performance, to more complex administration involving actual claims adjudication and monitoring of employee rehabilitation.

Generally, the cost to administer a STD program could range from 6% to 10% of the total claims, depending on the level of administration required. Based on an estimated claims cost of approximately $18.2 million to $22 million for the plans outlined in section II.B., the annual administrative costs could range from approximately $1.3 million to $2.2 million.

c. Defraying STD Program Costs By Modifying Current Sick Leave Program

It is possible that the cost of a STD program could, in time, be defrayed by changing to a non-cumulative sick leave program (i.e. unused sick leave is not carried forward) or by reducing the number of sick leave days provided annually. Based on the survey responses it was estimated that employees' current use of paid leave (i.e. annual or sick leave) for illness costs approximately $90.5 million per year. That is, if employees were provided no paid days of leave for illness (their own illness or their family members' for whom they care), employees continued to be absent at the same rate because of illness, and employees were placed on leave without pay for those days, then the Commonwealth would avoid paying $90.5 million per year in wages.

It is unknown, however, the extent to which the $90.5 million represents the use of annual leave for sick purposes. Thus, to determine the extent of the cost savings which might result from changing to a non-cumulative sick leave program (i.e., no carryover of unused leave balances from year to year), or from reducing the number of sick leave days provided, it would be necessary to determine the annual leave portion of the $90.5 million. Moreover, whatever savings which may derive from these sick leave modifications, must be discounted if employees retain (are"grandfathered") their current sick leave balances. That is, until employees' sick leave balances already earned are depleted, modifications to the sick leave program will not produce maximum savings.

Table 3 displays the current level of employees' sick leave balances according to the survey responses.

Table 3

SICK LEAVE BALANCES	
0 - Days	0.4%
1 - 5 Days	15.0%
6 - 10 Days	18.0%
11 - 15 Days	10.0%
16 - 20 Days	9.0%
21 - 25 Days	11.1%
26 - 30 Days	7.8%
31 - 35 Days	5.4%
More Than 30 Days	28.7%

Based upon these figures and employees' current use of sick leave, it may take several years for employees to exhaust their current sick leave balances.

Another factor which could reduce any immediate savings from modifying the sick leave program, would be if employees began using annual leave balances at even greater rates to cover periods of illness formerly covered by their sick leave balances. Because the Commonwealth ultimately would be liable to employees for their annual leave balances anyway, then this factor does not represent an additional financial obligation. However, it could have the effect of hastening the payment of this obligation, and thus of delaying the realization of savings associated with revising the sick leave program.

2. Employee-Purchased STD Programs

The costs for employees to obtain their own STD program also were reviewed. The cost of short-term disability policies can vary greatly, based on age, salary, waiting period, any maximum or minimum benefit amounts, the degree of underwriting, and the definition used to determine disability. Thus, various representative plans were selected to obtain estimated premiums as shown in Table 4.

Table 4

COSTS FOR EMPLOYEE-PURCHASED STD			
AGE BASED PLAN		NON-AGE BASED PLANS	
60% of salary for six months up to $1,500 per week		60% of salary for six months up to $1,000 per week	60% of salary for six months up to $1,500 per week
Age	Premium/Month	Premium/Month	Premium/Month
<29	$20.50	$24.75	$30.50
30-39	24.50		
40-49	29.00		
50-59	36.00		
60+	43.50		
SOURCE: DPT Health Benefits Staff Analysis			

The effective cost of these plans to employees could be reduced if employees purchased them with "pre-tax dollars" through a State flexible spending accounts ("FSA") program. In fact, the Department of Personnel and Training currently is investigating adding short-term disability insurance to the services and products which State employees may purchase through an FSA program. Currently employees have an FSA program (i.e. "premium conversion") for health insurance, and, by this spring, they will have an FSA program for child care expenses, and for out-of-pocket medical expenses. Employees who choose to establish FSA accounts pay a monthly fee to cover administrative expenses.

E. Funding

Funding a STD program involves two questions: who will pay the cost of the program (i.e., employer and/or employee), and by what method will claims be paid (i.e., third party insured or self-insured).

With respect to who will bear the cost of a STD program, Coopers and Lybrand advised that it is customary in the industry for employers to pay the full cost of short-term disability benefits. In addition to it being the industry norm for employers to bear the costs, it may not be prudent to compel employees to pay for a STD program for several reasons:

1. the general lack of demand for a STD program according to employee survey responses;
2. because employees currently do not pay for their sick leave benefits, it may be considered unfair to reduce these benefits (e.g. from a cumulative program to a non-cumulative one) and replace them with a STD program for which employees would be required to pay;
3. the uncertain availability of raises for state employees in the immediate future, and the rising cost to employees of other benefits (e.g. health care) may impair their ability to contribute to a STD program.

Thus, for these reasons, it is recommended that if a STD program which involves the reduction of sick leave benefits is implemented, or if participation in a STD program is mandatory, then the Commonwealth should bear the cost of the program.

Concerning the method by which claims will be paid, Coopers and Lybrand recommend that "consideration be given to self-funding and utilizing the services of a third party administrator to adjudicate claims and determine liability." This method is similar to the method by which the Commonwealth currently funds its health benefits program. Coopers and Lybrand's cost analyses demonstrated that self-funding is less expensive than a fully insured program. Thus, it is recommended that if a STD program is implemented that it be self-funded.

F. Conclusion

In light of the Commonwealth's current budget situation, funding the costs of a STD program with State funds without offsetting the costs with reductions in sick leave benefits is not financially feasible. Most employees, however, wish to have no modifications to the current sick leave program, and few would benefit annually from a STD program. Moreover, even if the sick leave program were modified, substantial cost savings may not be realized for several years due to employees continued use of sick leave balances, and their potential increased use of annual leave balances.

For these reasons, it is concluded that, at this time, the Commonwealth not provide short-term disability insurance as an additional fringe benefit to employees. Employees, however, should be provided the opportunity to purchase short term disability insurance with their own "pre-tax" fund through an expansion of the State's Flexible Spending Accounts program.

III. FUNDING RETIREES' HEALTH INSURANCE PREMIUMS WITH SICK LEAVE CREDITS

Due to concern with rising health insurance costs, HJR 98 requested a study of the feasibility of funding retirees' health insurance premiums with the sick leave credits due them when they retire.

As previously stated, under the current sick leave policy employees' unused sick leave is carried forward from year to year. Employees with at least five years of state service who leave state employment receive payment for 25% of their unused sick leave accruals, up to a maximum of $2,500.

A. Analysis

Three approaches were identified by the Virginia Retirement System (VRS) for using the $2,500 sick leave payment to offset health insurance premiums. These approaches were: (1) direct debit, (2) full premium annuity, and (3) life annuity.

Under the direct debit approach, the money due to be paid to a retiree for unused sick leave would be placed in a non-interest bearing health insurance account in the retiree's name. Thereafter, the monthly amount of the insurance premium would be deducted from the account until the account is exhausted.

Under the full premium annuity approach, the money due to be paid to a retiree for unused sick leave would be invested in an annuity to generate interest. The annuity would be structured to produce a monthly benefit equal to the health insurance premium, less the premium credit. This benefit would continue until the payment owed to the employee, plus the interest generated from the annuity, is exhausted.

The life annuity approach would invest the payment for unused sick leave and use only the generated interest to reduce the amount of monthly health insurance premiums. This approach would provide premium reductions for life.

All three approaches could be administered by the State or by a private administrator. The fees and costs associated with a third-party administrator could be paid out of the interest generated by the annuity fund. If the State were to administer the program, VRS would be the appropriate agency to handle the program. However, VRS has determined that designing and implementing significant computer system modifications to accommodate this program would take 12 to 18 months. In addition, there would be a need to hire an additional staff person to administer the program. Administrative costs would be incurred at a time when fiscal restraints are critical. For these reasons administration by a third party who is paid from interest on retirees' accounts, is recommended.

The relative effect of the three identified methods of investing retirees' payment for unused sick leave on premiums of various health insurance plans is outlined in Table 5. The examples shown in the table are based on the following assumptions:

- All retirees have 25 years of service and would receive a $37.50 monthly health insurance premium credit, as currently provided;
- Premium rates reflect 1991 rates for Blue Cross/Blue Shield Standard Plan;
- No rate increase would occur over time;
- Maximum credit for unused sick leave of $2,500 per retiree;
- Annuities will earn 8% annual interest; and
- Monthly annuity payments of $21 for those who retire at age 55 and $25.55 for those who retire at age 65.

Table 5

COMPARISON OF THREE APPROACHES FOR FUNDING RETIREES' HEALTH INSURANCE PREMIUMS WITH SICK LEAVE CREDITS

COVERAGE	MONTHLY PREMIUM	DIRECT DEBIT	FULL PREMIUM ANNUITY	LIFE ANNUITY
Single Coverage; Retiring at 55	$105.50	Paid in full for 23 months	Paid in full for 25 months	Premium cost reduced 20% until age 65; Paid in full after age 65 **plus** $6.50 cash payment monthly for life
Dual Coverage; Retiring at 55	$248.50	Paid in full for 10 months	Paid in full for 10 months	Premium cost reduced 9% until age 65; Premium reduced 32% after age 65
Single Coverage; Retiring at 65 Medicare Option I	$ 14.50	Paid in full for 172 months	Paid in full for life	Paid in full for life **plus** $11.00 cash payment monthly for life
Dual Coverage; Retiring at 65; Medicare Option I	$ 66.50	Paid in full for 37 months	Paid in full for 43 months	Premium cost reduced 38% for life

SOURCE: VRS staff analysis.

In all three programs, any money paid directly for health insurance premiums would not be taxed as ordinary income for retirees. Funds paid directly to retirees in the life annuity program would be taxable at the time of payment.

As shown in Table 5, the direct debit approach offers the least attractive option. For example, this approach would provide employees with dual health coverage (i.e., coverage for the employee and one dependent), retiring at age 55, to only ten months of health insurance coverage. Of the three approaches, the two annuity options offer a better benefit to employees. Under annuity options, employees' health insurance premiums would be paid for greater periods of time.

B. Conclusion

Even under the more attractive annuity approaches, the reduction in health insurance premiums is not significant. Furthermore, 65% of employees indicated a desire to retain the current lump sum method of reimbursing sick leave balances. Therefore, it is recommended that the state maintain its current lump sum reimbursements to retirees for unused sick leave. Employees, of course, may choose to invest this lump sum in any manner they desire, including purchasing annuities.

APPENDIX A

1990 SESSION

LD4271528

HOUSE JOINT RESOLUTION NO. 98

AMENDMENT IN THE NATURE OF A SUBSTITUTE

(Proposed by the House Committee on Rules
on February 11, 1990)

(Patron Prior to Substitute–Delegate Moss)

Requesting the Secretary of Administration to study the need for and the feasibility of providing a short-term disability insurance policy for state employees and the feasibility of using sick leave credits for payment of health insurance premiums.

WHEREAS, the issues of sick leave and health insurance are of great concern to state employees; and

WHEREAS, state employees receive fifteen days of sick leave per year regardless of the length of service and there is no limit on the number of days of sick leave that can be accumulated; and

WHEREAS, sick leave is intended to be used for personal illness and injury, medical and dental appointments, pregnancy and childbirth, and to a limited extent for illness and death in the immediate family and in most cases sick leave covers the time that state employees must be absent from work due to illness and injury; and

WHEREAS, there are instances when an employee depletes all of his sick and annual leave due to a serious illness or injury but is not eligible for disability benefits because he does not meet the criteria for disability retirement; and

WHEREAS, an employee who has depleted all of his sick and annual leave but is unable to return to work due to an illness or injury must go on leave without pay which can render considerable hardship to the employee and his family; and

WHEREAS, there may be a need for a short-term disability policy for state employees to fill the gap between sick leave and disability retirement; and

WHEREAS, many state employees use only a small portion of the sick leave that they accumulate and state employees who retire are entitled to a payment of an amount equal to twenty-five percent, not to exceed $2,500, of their sick leave balance upon retirement; and

WHEREAS, the cost of health insurance continues to rise and innovative methods of helping retirees pay for the cost of health insurance must be considered; and

WHEREAS, the idea of allowing the sick leave payment to be used to fund health insurance premiums has been raised and may provide certain tax benefits; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the Secretary of Administration is requested to study the need for a short-term disability insurance policy for state employees, the cost and feasibility of such a policy, how such a policy should be funded, what the policy should include, and whether it should be optional or mandatory. The Secretary of Administration is also requested to study the feasibility of using the payment that retirees are entitled to receive for their unused sick leave for paying health insurance premiums after retirement and how such a plan should be administered. The Virginia Supplemental Retirement System and the Department of Accounts shall assist the Secretary of Administration in the study of these matters.

The Secretary of Administration shall complete this study in time to submit findings and recommendations to the Governor and the 1991 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for processing legislative documents.

APPENDIX B

SHORT-TERM DISABILITY SURVEY
SEPTEMBER, 1990

A survey was administered to 804 randomly-selected employees. The survey was used to collect data for two separate studies. Survey questions related to short-term disability follow.

1. In the appropriate column, indicate the approximate number of days you spent on leave with and without pay for each of the following reasons since August 31, 1989. (If you are not sure how much leave you used, contact your human resource officer for assistance.)

Type of Leave	With Pay	Without Pay
Maternity	____ Days	____ Days
Personal Illness	____ Days	____ Days
Family Sick for Child	____ Days	____ Days
Family Sick for Spouse	____ Days	____ Days
Family Sick for Relative	____ Days	____ Days
Death in Family	____ Days	____ Days
Workers' Compensation	____ Days	____ Days

SHORT-TERM DISABILITY: For the purposes of this study, short-term disability insurance would offer employees 10 work days of sick leave with full pay each year. When these 10 days have been used, short-term disability coverage would begin and provide employees 60% of their current salaries for up to six months. This type of program would eliminate the need for employees to go on leave without pay while they are sick or disabled. The program would provide coverage no matter how long employees had been in state service. Under this program, employees with current sick leave balances would still receive cash reimbursement for 25% of these balances (up to $2,500) when they separate from state service provided they had worked five or more years at the time of separation. Based on this explanation, please answer the following questions related to short-term disability insurance.

2. What effect, if any, would the implementation of a short-term disability program have on you as a state employee? For each factor listed below, CIRCLE THE APPROPRIATE NUMBER.

	Improve	Decrease	No Change
Productivity	1	2	3
Morale	1	2	3
Desire to stay in state service.	1	2	3

3. In a short-term disability program, which of the following options would you prefer? (CIRCLE THE APPROPRIATE NUMBER)

Offering it <u>in</u> <u>addition</u> to the current sick leave accrual program and <u>charging</u> employees insurance premiums....1
Using it to <u>replace</u> the current sick leave accrual program at <u>no</u> <u>cost</u> employees 2

4. What was your annual leave balance as of August 16, 1990? (This information can be found on your August 31st paycheck stub.)
ENTER WHOLE NUMBER IN THE SPACE PROVIDED ________ hours

5. What was your sick leave balance as of August 16, 1990? (This information can be found on your August 31st paycheck stub.)
ENTER WHOLE NUMBER IN THE SPACE PROVIDED ________ hours

6. Sick leave currently is accrued at a rate of 5 hours per pay period, for a total of 15 days per year. This leave cannot be taken until it has been earned. Would you prefer to receive your sick leave hours at the beginning of the year so all of it would be available immediately? (CIRCLE THE APPROPRIATE NUMBER)

Yes..........................1
No...........................2

7. State retirees are responsible for paying a portion of the cost of their health insurance premiums. For dual basic coverage, these monthly premiums range from $104 (if both people have Medicare coverage) to $423 (if neither has Medicare coverage). Retiring employees with 5 or more years of service are reimbursed for 25% of their unused sick leave, up to $2,500. If you were to retire, which of the following options would you prefer for distributing the reimbursement of your unused sick leave? (CIRCLE THE APPROPRIATE NUMBER)

Retain the current policy of a lump sum reimbursement payable to me upon retirement........1
Apply this money directly to my retiree health insurance premiums, until the total sum has been expended.................................2

8. The current family sick leave policy defines the "immediate family" as an employee's spouse, children, stepchildren, parents, step-parents, sister, step-sister, brother, and step-brother. Also included in the current definition are other relatives (by blood or marriage) who live in the employee's household. The policy provides

the use of up to 24 hours of sick leave for any one illness or death in the immediate family, not to exceed 48 hours annually. Does the current policy meet your needs? (CIRCLE THE APPROPRIATE NUMBER)

Yes (SKIP QUESTION 9).............1
No (GO TO QUESTION 9).............2

9. If your response was "No" to Question 8, describe any changes you think should be made to this policy.

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SURVEY METHODOLOGY

This technical summary describes the methodology used to conduct the survey and analyze the responses.

A questionnaire was set to 804 randomly-selected classified employees to determine: (1) if there is a need for a short-term disability program and, (2) if there is employee interest in a short-term disability program. Four hundred and fifteen or 51.7% of the employees responded to the questionnaire.

The survey instrument was designed to obtain information for two studies being conducted by the Department of Personnel and Training, one on short-term disability and one on family leave. Therefore, some of the questions on the survey dealt with short-term disability and others dealt with family leave issues.

The questionnaire provided a general description of a typical short-term disability program. Employees were asked if they would choose short-term disability instead of the current sick leave program. They were also asked to provide data on their current leave balances.

To determine if length of service had an effect on the responses, employees were separated into four groups (1) those with less than five years service, (2) those with five to nine years service, (3) those with ten to 19 years service, and (4) those with 20 or more years service. The number of survey respondents in each of these groups did not accurately reflect the proportion of that group in the employee population. Consequently, some answers were weighted so that population inferences could be made appropriately. Table 1 reflects the demographics of the state's population of 76,145 classified employees and the respective weighing used for analysis.

Table 1

WEIGHTS USED IN CONVERTING SAMPLE ANALYSIS RESULTS TO GENERALIZED POPULATION FINDINGS FOR COMBINED GROUPS

Years of Service	Total Classified Population	Weight (% of Total Population
less than 5	30,143	.414
5 - 9	13,373	.169
10 - 19	22,560	.297
20+	10,069	.120
Total:	76,145	1.000

Source: DPT Staff Analysis

Additional raw survey results from DPT's Family and Short-Term Disability Leave Study may be obtained by writing to the Department of Personnel and Training, Office of Evaluation and Policy, 101 N. 14th Street, Richmond, Virginia 23219. Please specify the type of information being sought.

APPENDIX C

COST OF VARIOUS STD PLANS

No Cap on Amount of Pay

	Annual Cost
Coverage Upon Date of Employment	
50% of pay, payable for 26 weeks, 14-day waiting period	$19,004,000
60% of pay, payable for 26 weeks, 14-day waiting period	$22,804,000
Coverage After 1 Year of Employment	
50% of pay, payable for 26 weeks, 14-day waiting period	$16,261,000
60% of pay, payable for 26 weeks, 14-day waiting period	$19,513,000
Coverage After 2 Years of Employment	
50% of pay, payable for 26 weeks, 14-day waiting period	$12,733,000
60% of pay, payable for 26 weeks, 14-day waiting period	$15,279,000

$200 Cap on Amount of Pay

Coverage Upon Date of Employment	
50% of pay, payable for 26 weeks, 14-day waiting period	$15,149,000
60% of pay, payable for 26 weeks, 14-day waiting period	$15,397,000
Coverage After 1 Year of Employment	
50% of pay, payable for 26 weeks, 14-day waiting period	$12,636,000
60% of pay, payable for 26 weeks, 14-day waiting period	$12,758,000
Coverage After 2 Years of Employment	
50% of pay, payable for 26 weeks, 14-day waiting period	$ 9,392,000
60% of pay, payable for 26 weeks, 14-day waiting period	$ 9,432,000