
1987 Survey of Flexible Compensation Programs and Practices



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About the Survey

The 1987 Survey of Flexible Compensation Programs and Practices contains information on 206 flexible programs sponsored by 202 different organizations. As in the past, only those companies that have implemented either a flexible spending account or a program offering choices in benefits were invited to participate. The survey excludes flexible compensation programs consisting of only pre-tax premiums or just a 401(k) option.

The mix of survey participants is diverse, and represents both newly implemented flexible programs as well as programs which have been in effect for several years. The survey's purpose is to reflect current practices and highlight trends in designing, communicating, and administering flexible programs.

Report Format

The survey results are presented in three major sections:

- Section I profiles survey participants,
- Section II covers choicemaking plans, and
- Section III presents findings on spending accounts.

Sections II and III cover program objectives, design, eligibility, administration, and communication for choicemaking plans and spending accounts, respectively.





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Executive Summary

Following are some highlights of 1987 survey findings:

- Meeting the diverse needs of employees is the most frequently mentioned design objective, while containing medical costs comes in a close second.
- Approximately 80% of choicemaking plans give employees control over the allocation of some employer dollars.
- Per capita medical costs under flexible programs are increasing at a slower pace than national per capita costs. Over the three-year period from 1983 through 1985, national per capita cost increases exceeded those of employers with flexible programs by about 10%.
- Spending account contributions tend to increase over time, reflecting a "learning curve" on the part of employees.
- Employees continue to estimate spending account expenses accurately. Forfeitures for the 1986 plan year averaged less than \$10 per employee.
- In administration, there has been a trend away from internal systems development toward the purchase of software for both choicemaking and spending account programs.
- Communication media are becoming more sophisticated, with greater use of video, election confirmation reports, and interactive software.



I. Profile of Survey Participants



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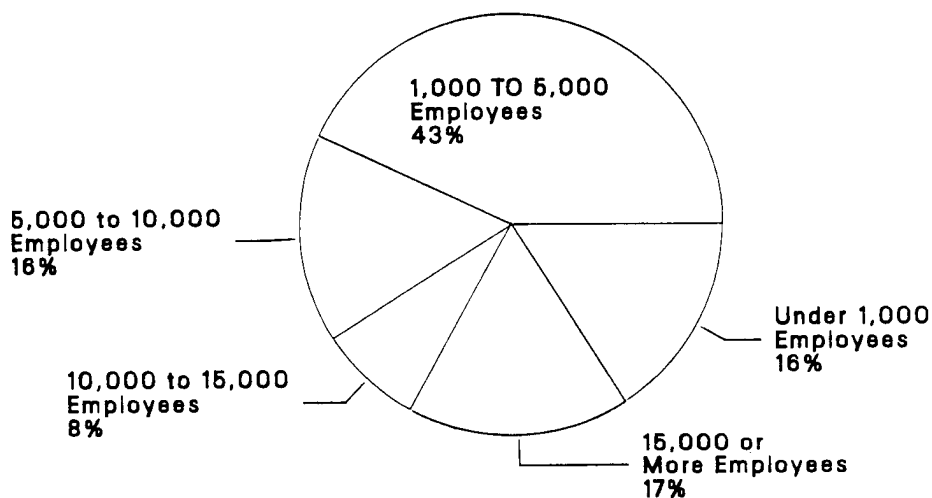
I. Profile of Survey Participants

This section highlights the characteristics of employers responding to the 1987 survey, the basic structure of their flexible benefit programs, and their implementation strategies.

Organization Size

As found in past surveys, flexible compensation programs are offered by all sizes of organizations. As many organizations with less than 1,000 employees offer a flexible program as do organizations with over 15,000 employees. Organizations with 1,000 to 5,000 employees continue to be the largest segment represented.

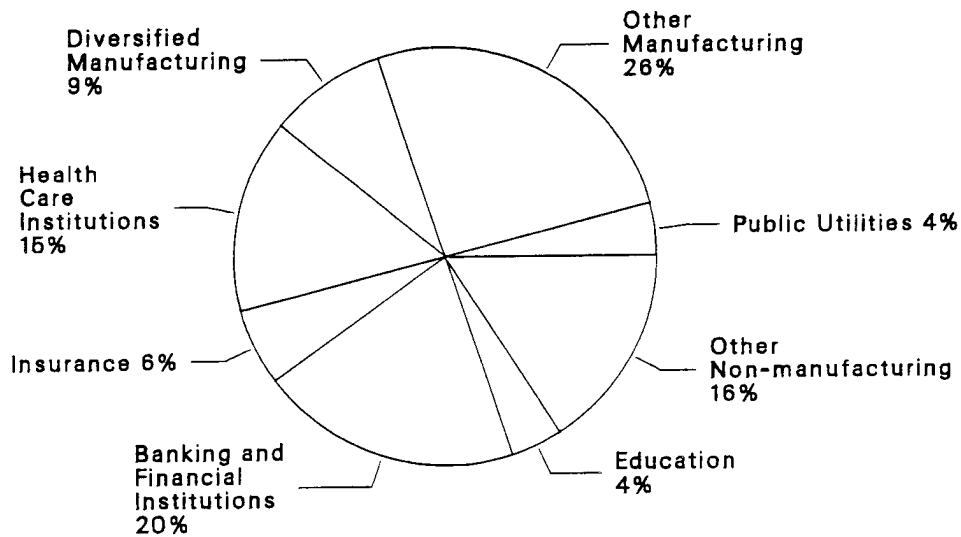
Organization Size



Industry Classification

Flexible compensation programs are also offered by a wide variety of industry groups. Almost two-thirds of the survey participants can be classified as service employers (65%), while the remainder are manufacturing organizations. About one-third of the service industry organizations are banks or financial institutions. Of the manufacturing organizations, about one-fourth are diversified manufacturers.

Industry Classification

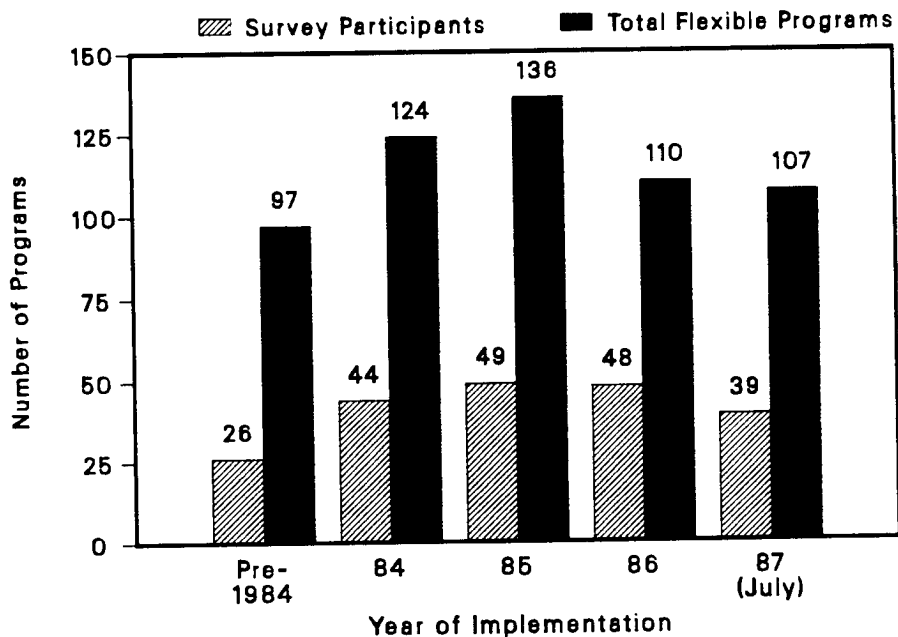


Effective Date of Program

Survey participants represent recently implemented programs as well as older flexible programs, providing a range of experience. This range is important for two reasons: (1) it ensures that the survey represents a cross section of all programs in effect, and (2) it enables identification of trends that have emerged over time.

The graph below shows the number of flexible programs implemented at major employers each year through 1987. For each implementation year, survey respondents are shown next to the total number of known implemented programs among major employers to demonstrate that the survey does provide a cross section of experience.

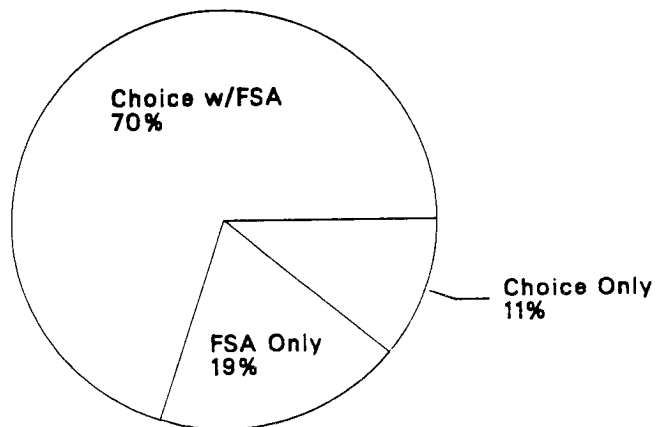
Flexible Programs by Year of Implementation



Type of Flexible Program

The vast majority (70%) of flexible programs include choices in benefit areas plus a flexible spending account (FSA). Programs consisting of only a spending account, or only choices among benefits, continue to be less common.

Flexible Program Structure



Implementation Strategy

The most common implementation strategy is to introduce the flexible program in its entirety in the first year (the "full-fledged" strategy), rather than introducing the changes in planned phases. Very few organizations choose to "test market" the concept of flexibility by offering the program at one division, or to a selected group of employees, on a trial basis.

Just over one-third (37%) cited a "build-up" strategy, which consists of initially offering pre-tax premiums and/or a spending account and moving later to a broad choicemaking program. Nine percent are using a "phase-in" strategy of offering choices in one or two benefit areas initially and adding more areas later.

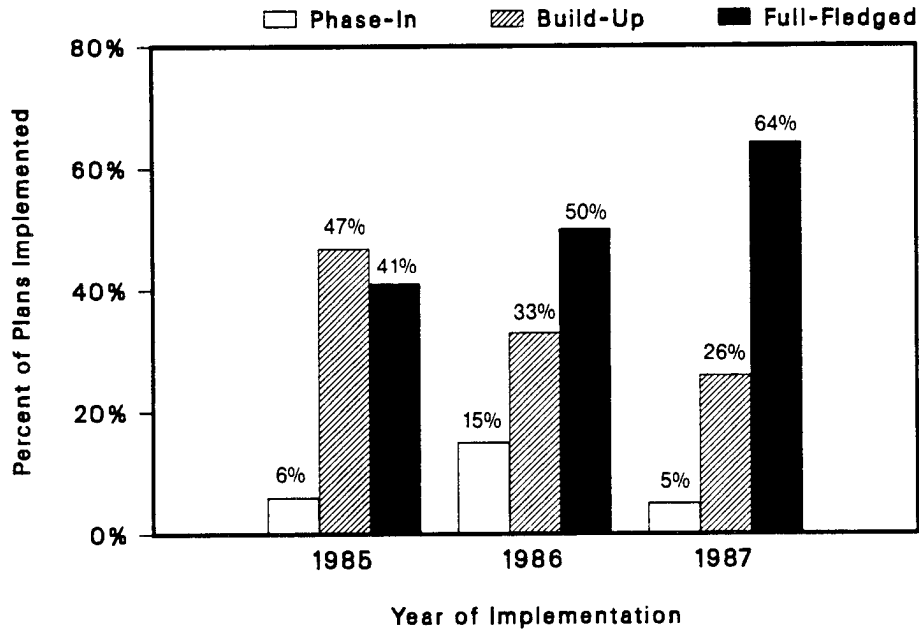
Table 1: Implementation Strategies

Full-Fledged	48%
Build-Up	37%
Phase-In	9%
Test-Market	3%
Other	3%

It should also be noted that most (85%) of the stand-alone spending account programs are the first stage of a build-up strategy. This suggests that more choicemaking plans will appear in the near future as the rest of the program is implemented.

There appears to be a trend away from the partial implementation strategies and toward implementing the entire program at once. In 1987, 64% of programs implemented used the full-fledged approach, while only 26% used the build-up strategy.

Implementation Strategy



II. Choicemaking Plans



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II. Choicemaking Plans

This section summarizes survey findings from the 166 flexible compensation programs that offer choices in benefit areas, and/or between benefits and cash. Where significant differences exist between choicemaking plans with spending accounts and those without, the differences are noted.

Program Objectives

Survey participants were asked to identify and rank the top four objectives for their program. The most highly ranked objective is meeting the diverse needs of employees, followed closely by the objective of containing medical costs.

Interestingly, flexible programs consisting of choices in benefits only (no spending account) ranked medical cost containment as the primary objective more often than did choicemaking programs with a spending account (41% vs. 33%). Conversely, choicemaking programs with a spending account listed meeting diverse employee needs as the primary objective more often than did choicemaking only programs (33% vs. 14%).

These findings support the idea that flexible program design is driven largely by underlying program objectives. To the extent that these objectives differ, so does program design.

Another finding of interest concerns the objective of increasing employee understanding of benefits. This objective is becoming more prevalent: fifty percent of programs implemented in 1987 ranked it as one of four major objectives, compared to 35% in 1985 and 23% in 1983.

Major program objectives are listed below, ordered from most to least frequently mentioned. Also presented are responses to the question of whether the objective has been met.

Table 2: Evaluation of Program Objectives

Possible Objectives	Was Objective Met?		
	Yes	No	Too Soon To Tell
Meet Diverse Employee Needs	84%	2%	14%
Contain Medical Costs	56%	5%	39%
Maximize Tax-Effectiveness of Benefits	90%	1%	9%
Increase Employee Understanding of Benefits	71%	3%	26%
Reduce Benefit Expenditures	62%	4%	34%
Offer New Benefits at Low or No Employer Cost	88%	6%	6%
Control Other Benefit Costs	54%	7%	39%
Meet Competitive Pressures	69%	2%	29%
Facilitate Mergers or Acquisitions	88%	0%	12%

Flexible programs appear to be highly successful in meeting major program objectives. As financial data becomes available, the "too soon to tell" response is becoming less frequent for cost-related objectives.

However, some objectives appear to require a longer time frame, or have more subjective criteria. For example, many organizations said it was too soon to tell whether the objectives of increasing employee understanding of benefits and meeting competitive pressures have been accomplished.

A recently appearing objective is using flexible benefits to facilitate mergers or acquisitions. For those organizations that mentioned this as a program objective, 75% ranked it as first or second in importance.

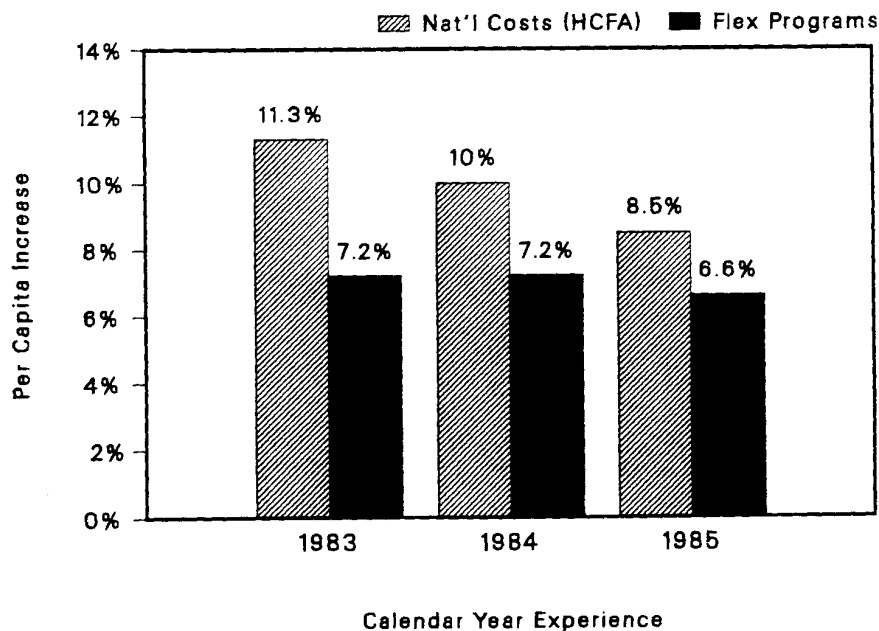
Medical Cost Containment

Of the 163 programs that offer a choice of medical plans, 125 stated that medical cost containment is a major objective. Of these, 92% indicated that it is a long-term objective, while to 8% it was a more immediate objective. The available claims data from these programs supports earlier findings that offering choices in medical plans does, in fact, reduce medical costs over time.

Organizations were asked to provide average per capita claim costs, both total and net of any employee contributions, for each year under the flexible program. In order to ascertain how the annual change in these per capita costs compares to national trends, data compiled by the Health Care Financing Administration (HCFA) in July 1986 on national per capita health care costs in the private sector were utilized as a basis for comparison.

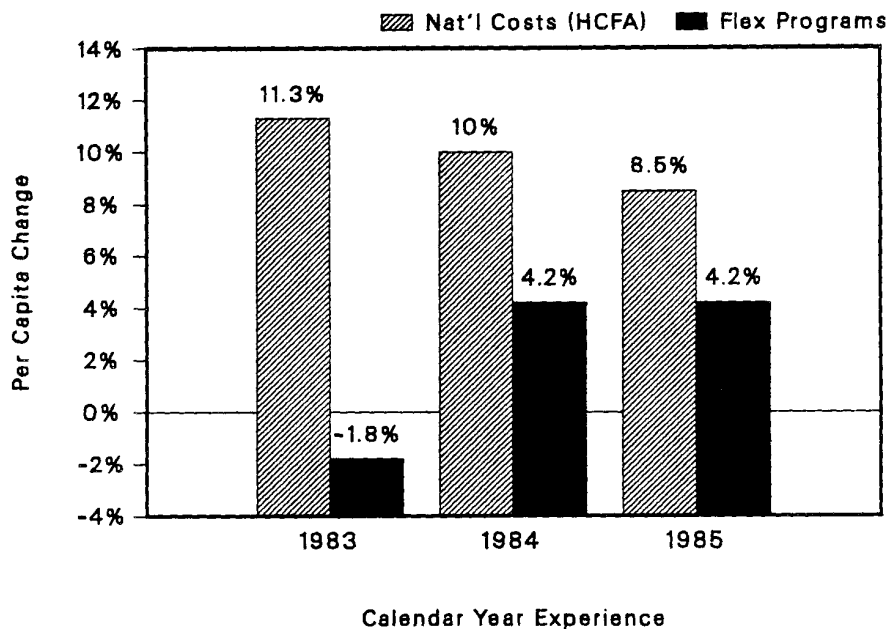
The following graph illustrates how the percentage change in per capita medical costs for the flexible programs differs from the national figures in 1983, 1984 and 1985. As the data indicates, the flexible programs experienced significantly lower medical cost increases than private plans in general on an ongoing basis.

Percentage Increases in Medical Costs



The second graph, which compares the employer-paid share of per capita increases to the national figures shows an even more dramatic difference. On a cumulative basis for the three-year period, national per capita increases exceeded those of employers with flexible programs by almost 25%.

Percentage Increases in Employers' Medical Costs



Comparative data for 1986 is not yet fully available, but it is reasonable to expect that the differences seen in 1983 through 1985 will recur, particularly with respect to employer costs, which are significantly more controllable under a flexible program.

Design Overview

Sources of Funds

A variety of mechanisms are used to create funds which employees use to purchase benefits. In addition to the common sources of funds—employer contributions and employee salary reduction—benefits trade-offs (e.g., selling of vacation) is used.

Table 3: Sources of Funds for Choicemaking Plans

Employee Salary Reduction	93%
Employer Contribution	78%
Trade-Off Among Benefits	35%

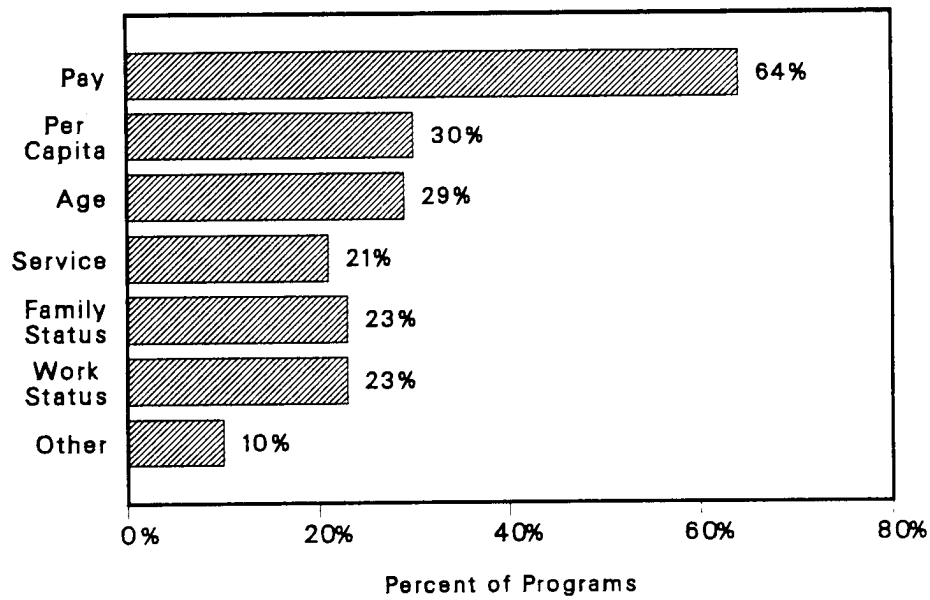
Credit Allocation

Flexible credits or dollars which can be used to purchase benefits are provided in almost two-thirds (64%) of the choicemaking programs.

Of those programs in effect for more than one year, the majority (55%) have not increased the amount of non-pay-related flexible credits provided when the program was implemented. For the 1988 year, 34% of all programs which provide credits do not plan to increase credits, while 13% say they will; 53% are undecided. It appears that organizations are exercising careful control over increases in credits, thus controlling total benefit expenditures.

Many different credit allocation bases are used. As shown in the following graph, most organizations use multiple bases for allocating credits. It appears that many credit formulas contain an age and/or pay-related component to determine credits for pay-related benefits, such as life insurance and LTD. About one-third (30%) of programs allocate credits on a per capita basis, i.e., provide every employee the same amount.

Credit Allocation Factors



Benefit Areas

The following table shows, for each benefit area: the percentage of survey organizations that include the benefit in the flexible program, the average number of options (a no coverage option is not counted as an option), and whether the benefit is purchased with pre-tax dollars. It should be noted that the 4% of medical plans not paid with pre-tax premiums are completely employer-paid plans and, therefore, have no employee contribution.

Not shown but worth mentioning is the finding that 2% of programs offer employees the choice of how premiums are paid (before or after tax) for medical, dental, and AD&D. Another 8% of programs offer this choice for LTD.

Table 4: Benefit Areas Offered

<u>Benefit Area</u>	<u>Part of Flexible Program*</u>	<u>Average Number of Options</u>	<u>Paid With Pre-Tax Premiums**</u>
<u>Health Benefits</u>			
Medical Care: Indemnity	98%	3	96%
Medical Care: HMO	83%	6	96%
Dental Care	83%	2	95%
Vision Care	17%	1	93%
<u>Death Benefits</u>			
Group Life	77%	4	76%
Dependent Life	59%	3	58%
Survivor's Income	8%	2	62%
Employee AD&D	56%	6	63%
Dependent AD&D	30%	7	58%
<u>Disability Benefits</u>			
Short-Term Disability	14%	1	64%
Long-Term Disability	48%	2	71%
<u>Other Benefits</u>			
Capital Accumulation/401(k)	57%	N/A	N/A
Vacation/Holidays	27%	N/A	N/A
Retirement/Pension	4%	N/A	N/A

*Of 166 organizations with choicemaking plans.

**Base is those organizations with benefit area as part of the flexible program.



Industry-Specific Plan Design

The table below shows program design for the major industry groups: health care, banking/finance, and manufacturing. Medical, dental, and group life insurance are the most popular flexible benefit areas offered, for all industry types. Dependent life insurance is offered by over half of all these organizations, showing an increase in popularity from past years.

Table 5: Program Design by Type of Industry

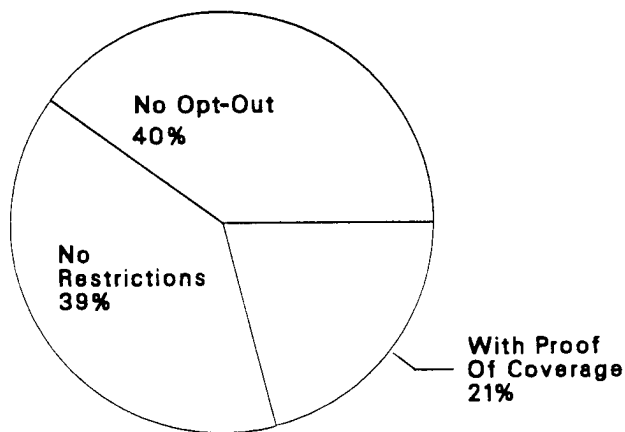
<u>Benefit Areas</u>	<u>Health Care</u>	<u>Banking/ Finance</u>	<u>Manufacturing</u>
Medical (Indemnity)	96%	100%	98%
Dental	81%	76%	86%
Group Life	81%	76%	80%
Dependent Life	58%	61%	66%
Employee AD&D	58%	58%	54%
Long-Term Disability	42%	61%	47%
Short-Term Disability	15%	3%	20%
Vacation Trading	15%	33%	31%
Capital Accumulation (401(k) or 403(b))	42%	67%	58%
Number of Respondents	26	33	59

Health Benefits

Medical

Among the survey group, virtually all organizations (98%) include medical benefits in the flexible program. Of these, a majority (60%) allow employees to opt out of medical coverage. Only half of the survey respondents allowed employees to opt-out of coverage prior to the flexible program. A summary of opt-out policies is shown below.

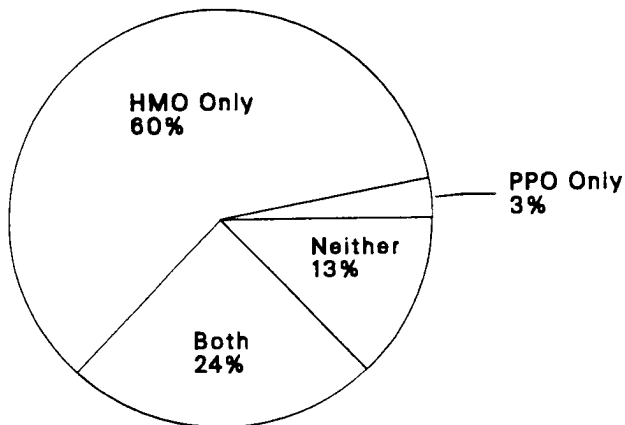
Medical Opt-Out Policies



If an employee chooses no medical coverage, a majority (56%) of organizations restrict the availability of medical options during subsequent enrollment. For example, 34% require proof of insurability, while 22% have other restrictions. The remaining 44% place no restrictions on employees coming back into the medical plan.

Health Maintenance Organizations (HMOs) and Preferred Provider Organizations (PPOs) are appearing more frequently as options in the medical benefit area. As shown below, 87% of flexible programs include a PPO or HMO option.

Prevalence of HMOs and PPOs



Offering choices between indemnity plans and HMOs affects medical enrollment patterns in a variety of ways. Six percent report that employees returned to an indemnity plan from an HMO. This may indicate that employees with low medical expenses can be attracted back to a lower cost, higher deductible indemnity plan.

Table 6: Effect of Offering Choices on HMO Enrollment

Employees Left HMOs for Indemnity Plan	6%
More Young Employees Chose HMOs	29%
More Families Chose HMOs	31%
No Change	34%

Medical Plan Design Changes

In addition to offering choices between medical plans, many organizations make other design changes with the implementation of the flexible program. Many organizations (42%) used the opportunity to replace their basic plus major medical plan with a comprehensive plan.

Table 7: Medical Plan Design Changes

Design Change	First Year	Subsequent Years
Choices Offered Where Previously There Were None	52%	13%
Comprehensive Plan(s) Replaced First Dollar Plan(s)	42%	9%
Deductibles Increased	41%	31%
Higher Employee Contribution For Dependent Coverage	23%	31%
Higher Employee Contribution For Employee Coverage	23%	27%
Opt-Out Option Added	18%	19%
No Changes	18%	30%
Other Changes	5%	16%
Total Number of Respondents	141	67

The type of medical design change varies slightly by industry. For example, 28% of financial institutions require higher first-year contributions for employee coverage, compared to 15% for health care organizations and 13% for insurance companies.

Cost Management

In addition to design changes, 70% of organizations implemented cost management tactics at the same time as the flexible program. The most common first-year features added were second surgical opinions (44%) and out-patient surgery for certain conditions (42%). In subsequent plan years, pre-admission certification and concurrent utilization review were the most prevalent cost management methods adopted, by 44% and 35% of organizations, respectively.

Subsidy for Dependent Coverage

The level of subsidy for dependent health coverage is another design feature that varies according to an organization's objectives. Medical coverage options can be priced to encourage, or discourage, employees to cover their dependents under the company's plan. Virtually all survey organizations (94%) subsidize dependent coverage by making a larger contribution for family medical insurance.

Over half (53%) of those programs which subsidize dependent coverage plan to maintain the present level of subsidy. Another 27% say they will reduce, but not eliminate the subsidy, while 20% plan to gradually phase out the entire subsidy. The most frequently cited time period anticipated for eliminating the subsidy is five years, with responses ranging from one to twelve years.

Most organizations planning to reduce the level of employer contributions identify 50% of total dependent cost as the target level of subsidy.

Dental

Of the 138 survey programs that include dental, 15% are offering the benefit for the first time. Over three-fourths (77%) of all choicemaking programs offer a no coverage option in dental. In order to limit the impact of adverse selection, the majority of plans place restrictions on subsequent dental elections. Requiring dental elections to be in effect for two years is now the most common reenrollment restriction.

Table 8: Dental Reenrollment Restrictions

None	48%
Elections for Two-Year Period	26%
Based on Prior Option	13%
Other Restrictions	13%

Alternative choices to traditional dental insurance are appearing, in the form of dental PPOs and HMOs. More flexible programs may offer these as options as their availability increases.

Table 9: Alternative Dental Plans

Dental HMO	18%
Dental PPO	4%
Both	4%
Neither	74%

Group Life Benefits

Of the 128 programs which include group life, about two-thirds (66%) allow an open enrollment in group life for the first election.

Table 10: Group Life Initial Enrollment Restrictions

None	66%
None if Level Is Equal or Less than Pre-Flexible Coverage Level	15%
Proof of Insurability Required for All but Lowest Option	6%
Other Restrictions	13%

In subsequent enrollment periods, 76% of programs place some type of restriction on available options. For example, movement is limited to an increase of one coverage level per election in about one-third of these programs.

Table 11: Group Life Reenrollment Restrictions

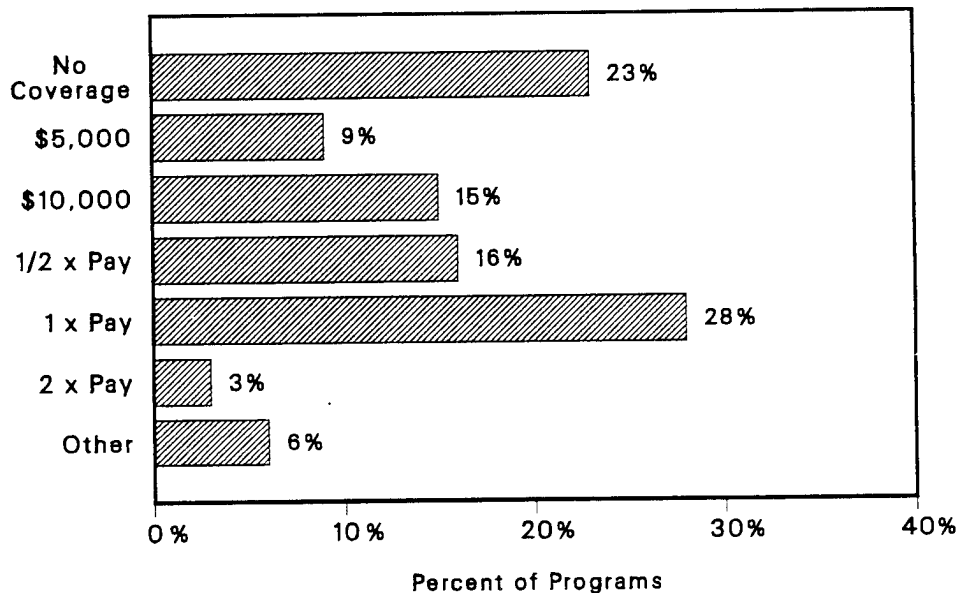
Proof of Insurability Required for All Higher Levels	39%
None if Coverage Is Increased by One Level	31%
Proof of Insurability Required for Other Reasons	6%
None	24%

Design Features

Most survey organizations (77%) require employees to have life insurance. Traditionally, life insurance is the benefit area that has the lowest availability of no coverage options in a flexible program. Also, there is little variation among industry groups concerning this requirement for a minimum level of life insurance.

However, many programs require fairly low levels of group life protection. The most typical required core level is one times pay, but lower and higher levels of core life insurance are also common.

Lowest Group Life Benefit Available



Almost three-fourths of organizations (73%) calculate pricetags for optional life insurance on an age-graded basis. Another 17% use a flat rate while 10% use a combination. Both methods might be used in programs that added optional coverage to the company-provided coverage: the optional coverage is age related and the old basic coverage is kept at a flat rate.

Dependent Life

Of the 98 programs which include dependent life insurance as an option, 77% determine pricetags on a flat rate basis. Also, in over half of these programs (58%), dependent life is purchased with pre-tax dollars. This is lower than the 76% of programs that pay employee group life on a before-tax basis.

One reason for purchasing dependent life insurance with after-tax dollars is to avoid the issue of imputed income. One-fourth of organizations offering dependent life calculate imputed income on some amount of coverage. Of the programs that do not impute income, many require that employees purchase this coverage on an after-tax basis.

Disability Benefits

More organizations include long-term disability benefits (48%) than short-term disability benefits (14%) in the flexible program. Almost two-thirds (62%) of the 79 programs with LTD options allow employees to opt out, while less than half (48%) of the 23 programs with short-term disability options allow employees to choose no coverage.

For LTD benefits, the majority of organizations (63%) have pre-tax payment of premiums. Of the remaining companies, 29% pay with after-tax dollars, while 8% offer employees a choice. Short-term disability is usually purchased on a pre-tax basis (64%).

Cash and 401(k) Options

Employer contributions provided in the form of credits or flexible dollars can be used to purchase benefits, taken in cash, or put into a 401(k) plan. Of the 107 organizations that provide employees with credits, 84% permit employees to take unused credits as taxable pay, and 50% permit employees to direct them to 401(k) accounts.

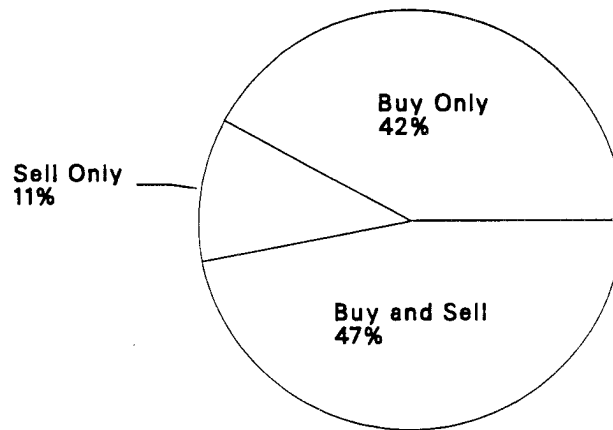
There is some variation by industry for cash and 401(k) options. For example, more banks and financial institutions than health care organizations allow cash to be taken out of the program (95% vs. 74%).

Financial institutions and public utilities are the industry groups most likely to include a 401(k) option for unused credits (67% and 100%, respectively).

Paid Time Off

Paid time off is included in about one-fourth (27%) of all programs. Vacation trading is complicated by the current limitations on carryovers. More programs are offering both buying and selling of vacation days; fewer allow only vacation selling.

Vacation Options



There is little variation between manufacturing and non-manufacturing companies in the vacation options offered. But within service organizations, 33% of financial institutions include vacation trading, compared to only 15% of health care organizations.

Vacation Buying Policies

Virtually all organizations (97%) charge 100% of a day's pay as the pricetag for purchasing an additional day of vacation. The maximum number of additional days that can be bought ranges from 2 to 15, with five days being the most common maximum.

Table 12: Maximum Days for Vacation Buying

No Maximum	2%
Two Days	8%
Three Days	5%
Five Days	78%
Ten Days	5%
Fifteen Days	2%

Additional vacation days that are not used by the end of the plan year are forfeited at most of the organizations with vacation buying. However, 14% allow unused days to be cashed in prior to the end of the plan year.

Vacation Selling Policies

Of the 26 organizations which offer vacation selling, most (92%) buy vacation days back from employees at 100% of a day's value. Another buy-back price is 75% of a day's value.

Some organizations (23%) reduce their potential vacation buy-back expense by limiting the amount paid for a vacation day. These limits range from \$100 to \$300 for each day sold.

Most programs with vacation selling (92%) set a maximum on the number of days which can be sold. The most common maximum is five days, with a range of 2 to 21 days.

Table 13: Maximum Days for Vacation Selling

None	8%
Two Days	8%
Five Days	62%
Ten Days	12%
Other	10%

Restrictions that limit an employee's ability to sell vacation are present in 73% of the programs. The most common restriction is no vacation selling for those with two weeks or less of vacation (74%). Service-related restrictions are in effect at another 22% of organizations, which require five or six years of service before any vacation can be sold.

Eligibility Requirements

Most choicemaking programs (96%) are offered to full-time salaried and/or exempt employees. Non-bargaining hourly employees are covered in 62% of programs, while bargaining hourly are eligible in 16%. Part-time employees are eligible if they meet certain conditions in 53% of programs: only 5% of choicemaking programs include all part-time employees.

Table 14: Full-Time Eligibility Requirements

Full-Time Salaried/Exempt	96%
Non-Bargaining Hourly	62%
Bargaining Hourly	16%
International	5%

Table 15: Part-Time Eligibility Requirements

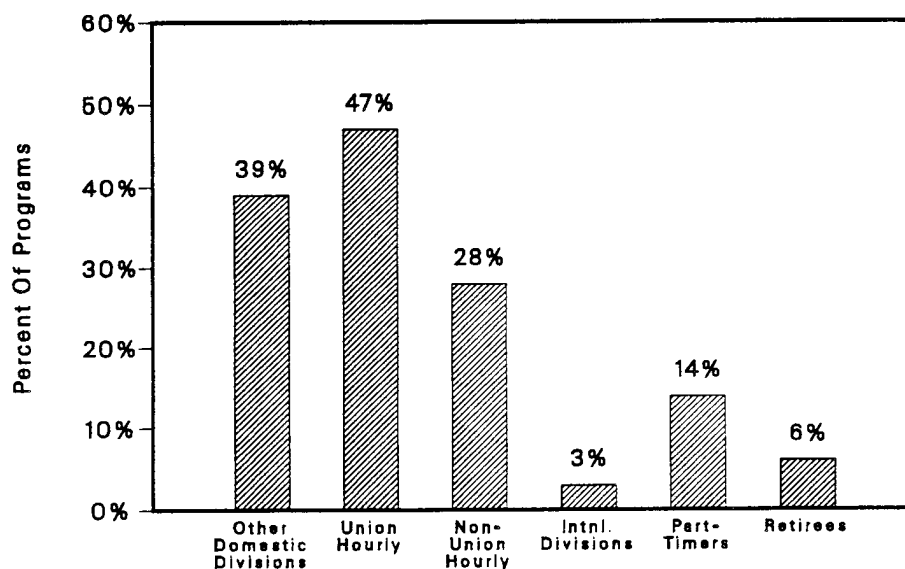
All Part-Timers	5%
Must Work 20 Hours/Week	33%
Must Work 30 Hours/Week	7%
Other Restrictions	13%
Not Eligible	42%

Changes in Eligibility Requirements

Of those programs in effect for over one year, most (72%) have not extended the flexible program to other employee groups in subsequent years. However, over half (54%) of the programs implemented in 1983 have extended eligibility.

Interestingly, the most frequently added group is bargaining employees. Forty-seven percent of those that did extend the program added bargaining employees, while 28% added non-bargaining hourly employees. This indicates that bargaining units may be becoming more receptive to choicemaking programs.

Newly Eligible Employee Groups



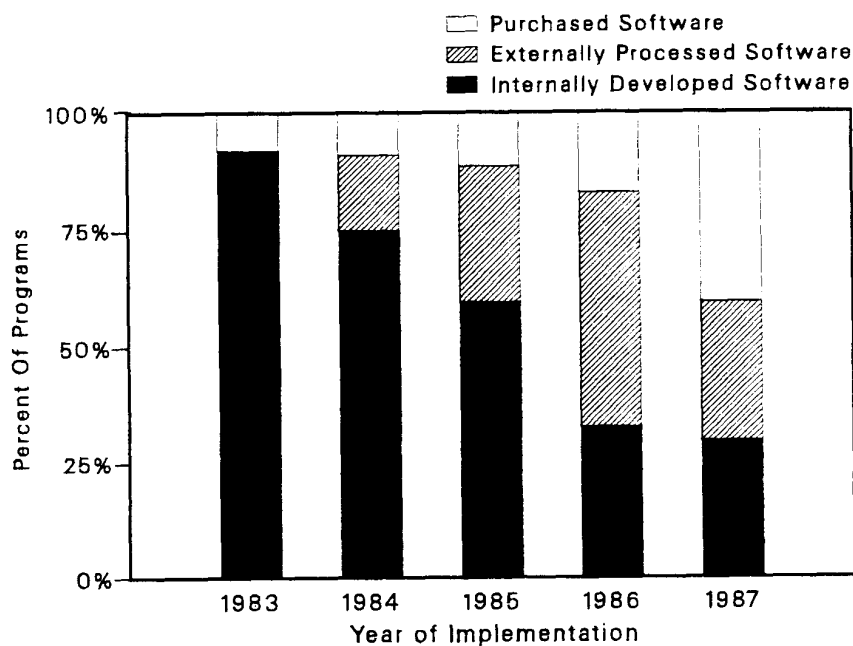
Of those companies with bargaining units not already participating in the choicemaking program, 12% plan to include bargaining employees at some future date, while 39% have not yet decided whether bargaining units will be included.

Administration

Fewer organizations implementing a flexible program in recent years are choosing to develop their own administration system. This is probably due to the increased availability of computerized software.

In 1987, the number of organizations that purchased software and used it to handle administration internally outnumbered those using an external source for administration. Internal processing is now feasible for both large and small organizations: software packages can be installed on a mainframe or run on a personal computer.

Type of Administration System



Administration Costs

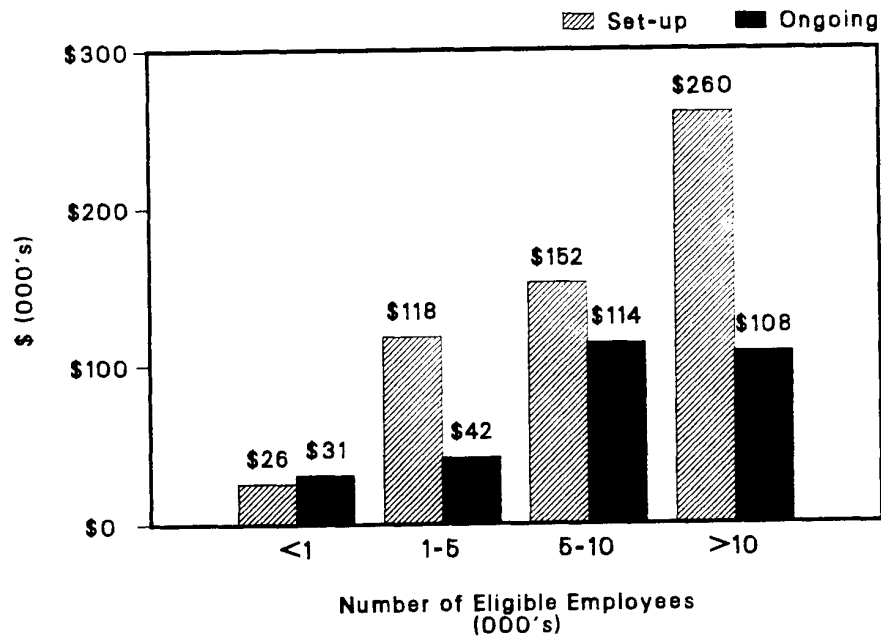
The cost of developing and implementing the benefit administration system can be lower than \$10,000 or as high as \$1 million, depending on factors like the complexity of the program and the number of participants.

Set-up costs generally increase with the number of program participants because more complex computerized administration systems become necessary for larger organizations.

Ongoing administration costs are also influenced by the number of participants. As shown below, the highest cost is reported by programs with 5,000 to 10,000 participants. The drop in ongoing expense among larger companies may be explained by the fact that programs with over 10,000 participants are more likely to install mainframe software, thereby reducing ongoing administration costs.

Administration Costs (in thousands)

Choicemaking Plans

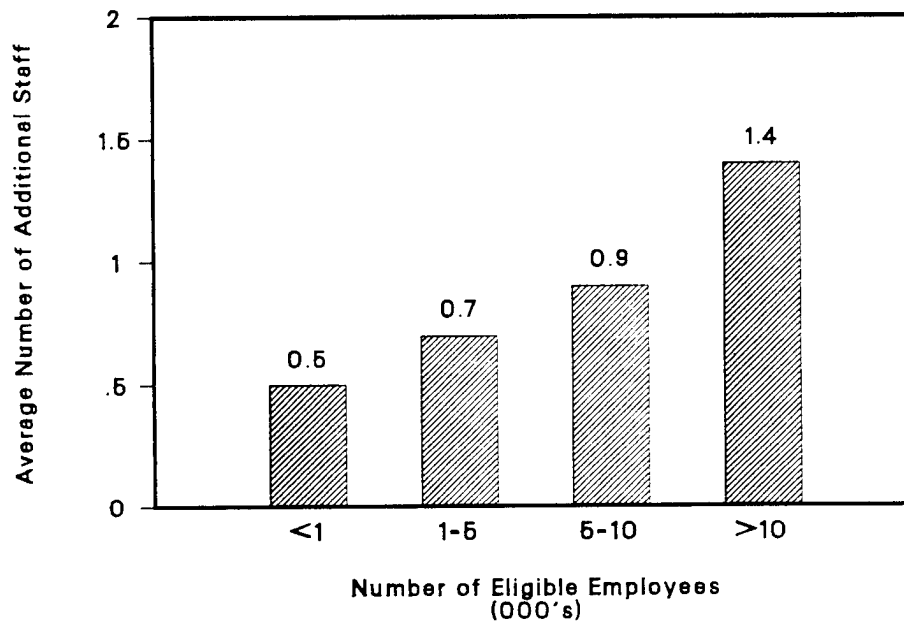


Centralized administration is the prevalent practice, with most (83%) flexible programs administered from one location. Only 11% are administered from three or more locations.

Administrative Personnel Requirements

Just over half of the survey organizations increased administrative staff to administer the flexible program. Forty-one percent of respondents said that no additional employees were needed, while 16% added two or more employees. Of those organizations that added more than two staff, 91% have over 5,000 employees participating in the flexible program.

Administrative Personnel Requirements

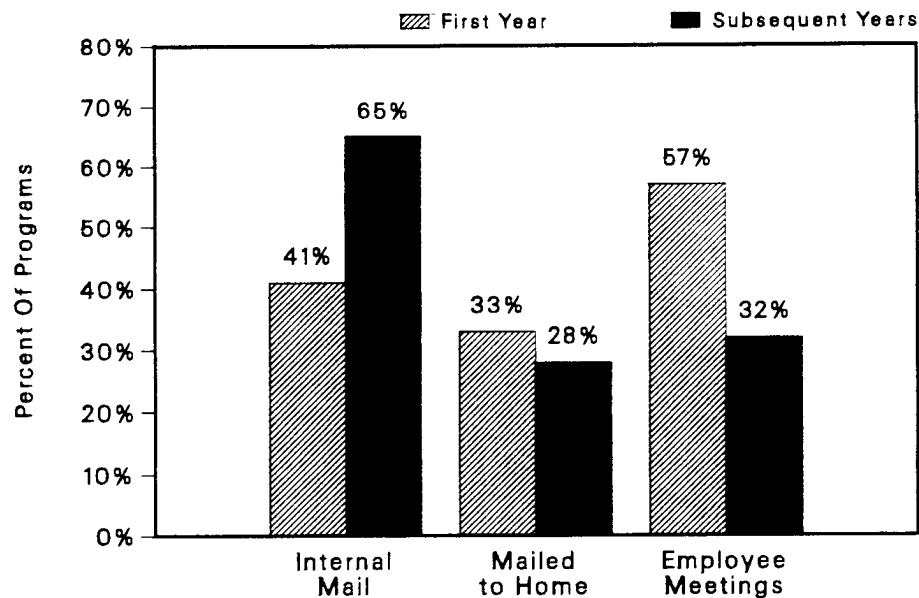


Enrollment Procedures

For the first election period, enrollment material is distributed at employee meetings by over half of choicemaking programs. More organizations are using internal mail to distribute materials, rather than having materials sent to an employee's home.

In subsequent years, there is also a greater use of internal mail to distribute enrollment materials. Use of employee meetings drops, probably because fewer organizations hold mandatory meetings for reenrollments.

Distribution of Enrollment Materials



Enrollment Errors

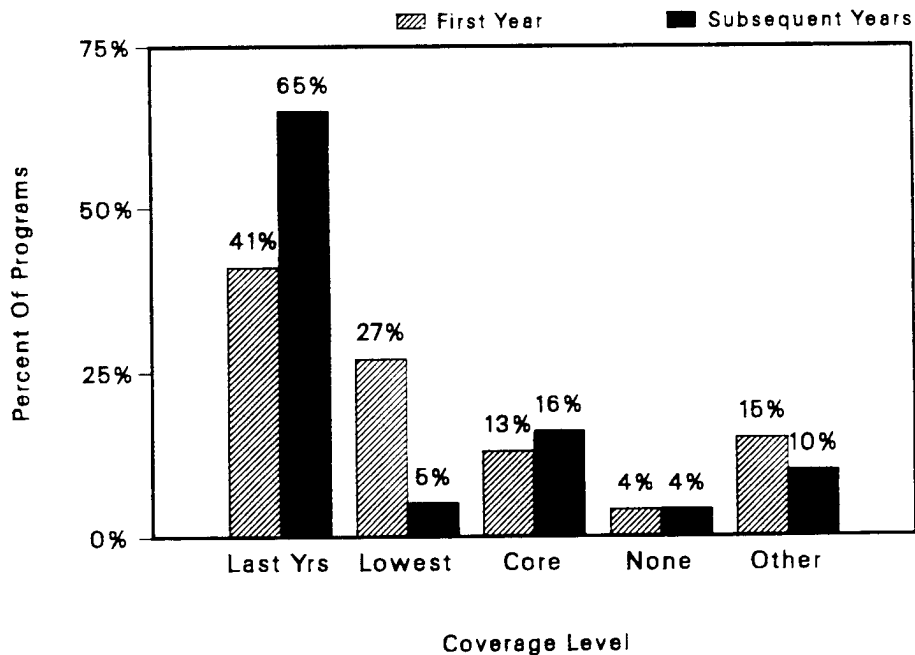
The extensive communication campaign used to introduce the new choicemaking program reduces, but does not eliminate errors and omissions on election forms.

Organizations tracking the rate of "errors and omissions" on enrollment forms find that it declines over time. On average, 19% of forms were returned with errors during first year enrollment. This dropped to 11% during subsequent enrollments.

On average, 9% of employees fail to return a form for the initial enrollment, while 10% do not actively re-enroll in subsequent years.

Different procedures are followed for employees who fail to return an enrollment form. Some organizations (41%) use individual follow-up to secure enrollment for the first enrollment period. In subsequent years, fewer (29%) use individual follow-up. If an election is not made, virtually all organizations assign some level of coverage—only 4% provide no coverage. The levels of coverage assigned are as follows:

Default Enrollment Procedures



Ongoing Administration

Common current practice for enrolling new hires is split between allowing immediate enrollment in the complete flexible program (32%), and providing no coverage until the end of a waiting period (31%). Ten percent offer immediate enrollment in certain benefit areas, while another 25% provide standard (non-flexible) coverage for the duration of a waiting period.

For those organizations that do not allow immediate enrollment, the most common enrollment dates are shown below.

Table 16: Enrollment Date for New Employees

Next Annual Enrollment	20%
First of Month After 30 Days Service	18%
First of Month After 90 Days Service	15%
First of Month Following Hire	13%
Other	34%

By law, benefit elections are irrevocable for the duration of the plan year unless there is a "change in family status." The definition of what constitutes a change in family status varies somewhat among organizations, as shown below.

Table 17: Permissible Events for New Elections

Marriage/Divorce of Employee	98%
Birth or Death of Dependent	96%
Adoption of Child	95%
Loss of Coverage by Spouse	83%
Change of Employment Status of Spouse	73%
Part-Time to Full-Time Status Change	57%
Retirement of Spouse	51%
Full-Time to Part-Time Status Change	46%
Switching Divisions Within the Organization	13%
Other Event	9%

Communication

Communication Media

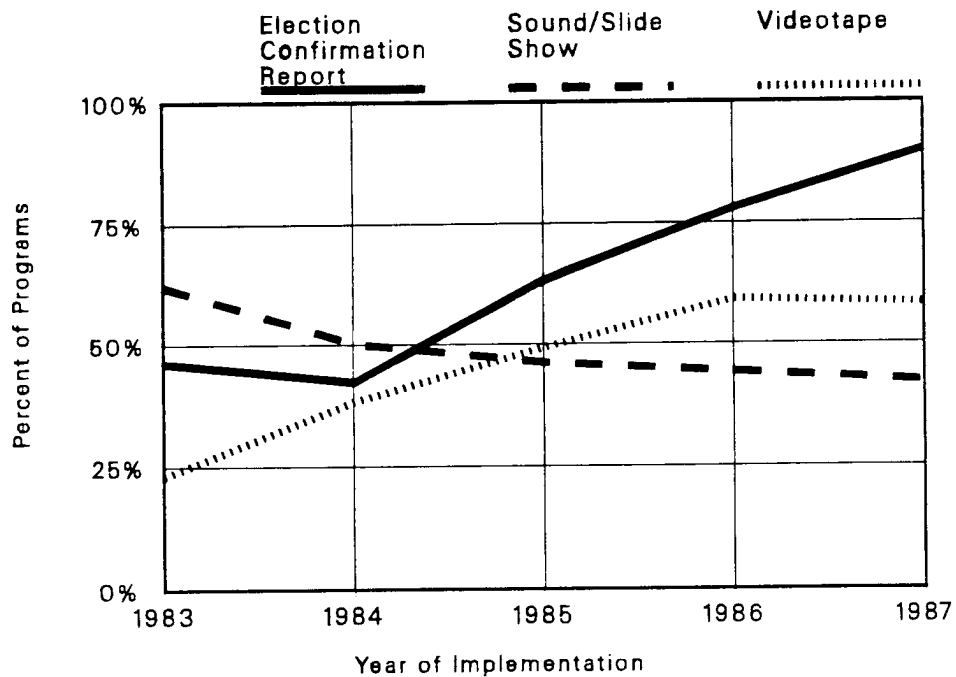
Because of the need for a high level of employee understanding, multiple media are used to communicate flexible programs. Methods used to introduce the program differ somewhat from those used in subsequent years for ongoing communication. For example, highlights brochures are used more to introduce the program (79%) than as a means of ongoing communication (57%).

Table 18: Communication Media

	First Year	Subsequent Years
Newsletters	79%	67%
Highlights Brochure	79%	57%
Personalized Enrollment Material	71%	71%
Election Confirmation Report	68%	65%
Bulletin Board Notices, Memos	63%	60%
Enrollment Workbook	63%	48%
Hotline and/or Information Center	54%	45%
Summary Plan Descriptions (SPDs)	49%	61%
Sound/Slide Show	48%	25%
Videotape Presentation	47%	20%
Benefit Statements	39%	54%
Payroll Insert	23%	16%
Claim Kit	18%	11%
Interactive Computer Software	5%	4%

Communication campaigns to introduce the flexible program are becoming increasingly more sophisticated, judging by the type of media used. As shown on the graph below, election confirmation reports are used more today than they were for plans implemented two or three years ago. Conversely, use of sound/slide shows is decreasing.

Communication Media Trends

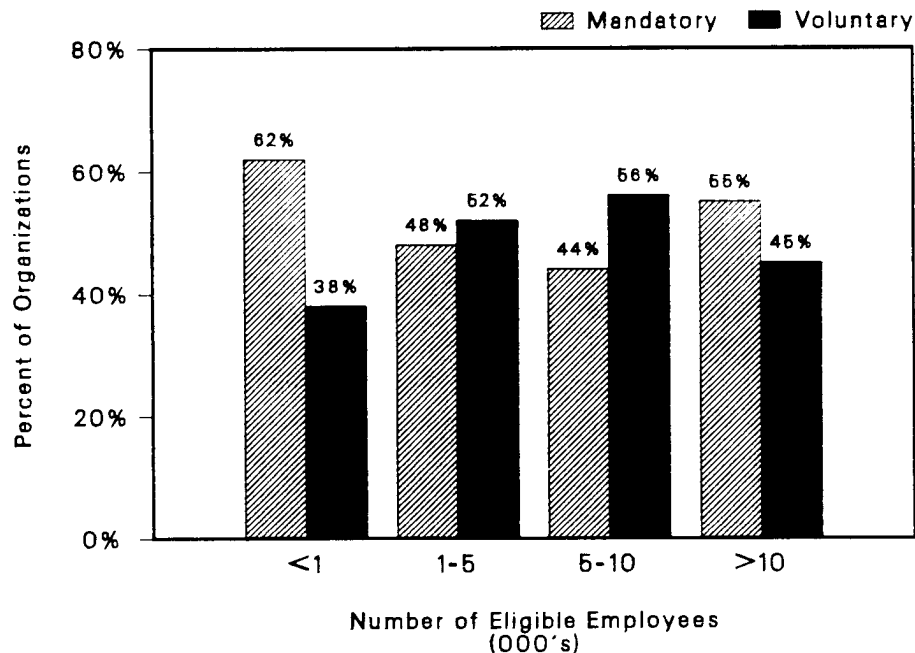


Employee Meetings

Employee meetings are used by virtually all organizations (98%) to introduce the flexible program. Attendance at first-year meetings was voluntary for just under half (48%) of the programs. Organizations with less than 1,000 employees eligible for the flexible program are more likely to have mandatory meetings, while larger organizations are more likely to have voluntary meetings.

Type of Employee Meetings

First Year



Attendance at the voluntary meetings is generally high: on average, 63% of all eligible employees attend. Employees at manufacturing organizations are more likely to attend voluntary meetings than are employees at service organizations, based on reported attendance.

In subsequent plan years, fewer organizations (15%) have mandatory meetings, while more conduct voluntary meetings (63%). Twenty-two percent do not use meetings at all in subsequent years. On average, 43% of employees attend optional meetings in subsequent plan years.

Communication Planning and Preparation

First-year communication campaigns require several months of lead time. The average number of months required for planning the communication campaign and preparing the materials is six months. Planning time ranges from a minimum of one month to a maximum of 24 months. The distribution is shown below.

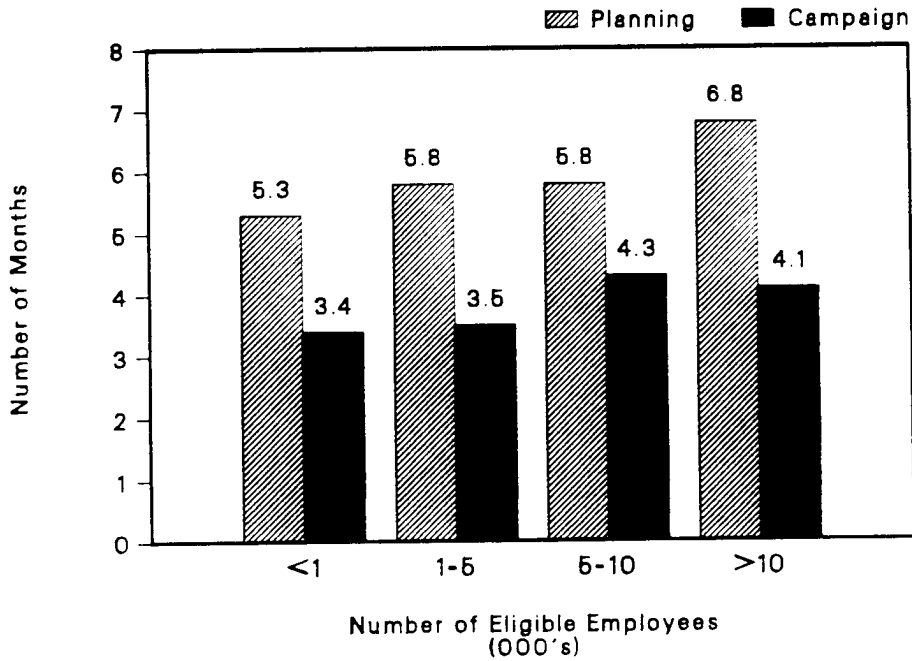
Table 19: First-Year Communication Preparation

<u>Months</u>	<u>Percent of Organizations</u>
3 or less	26%
4 – 6	48%
7 – 9	14%
10 or more	12%

The time required for first-year communication planning varies somewhat by size of the eligible population. Not surprising, organizations with 10,000 or more eligible employees have the longest preparation time frame, averaging seven months. This compares to five months for organizations with less than 1,000 employees.

The duration of the communication campaign (from initial announcement to enrollment) varies slightly for different sizes of organizations, as shown below. The average number of months required to present the entire campaign is four months.

First-Year Communication Timing



In subsequent years, the communication planning time drops to an average of three months. The duration of the campaign averages two months, but ranges from one to six.

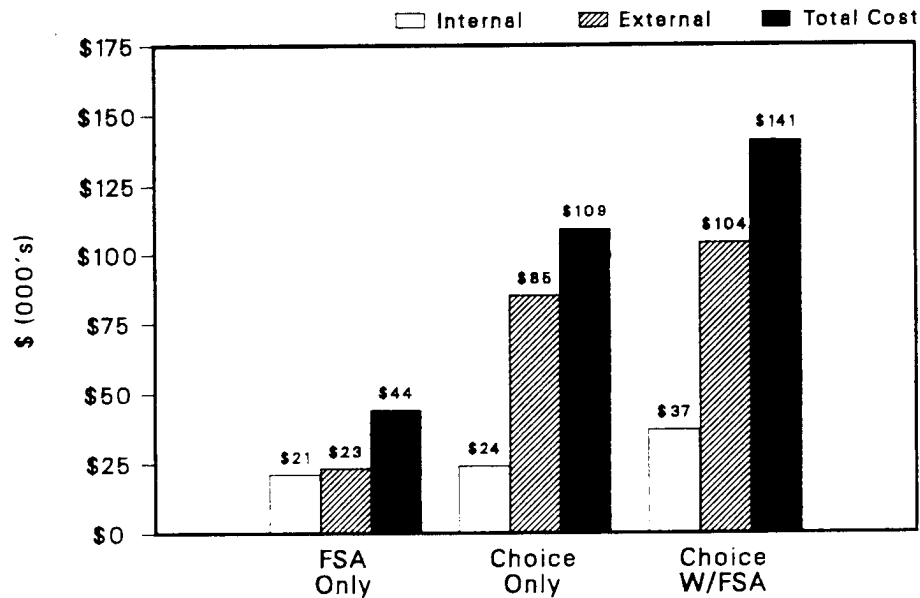
Table 20: Ongoing Communication

Months	Preparation	Duration
1	19%	33%
2	27%	35%
3	29%	22%
4	14%	6%
5 or more	11%	4%

Communication Costs

Communication planning and production costs increase with the complexity of the flexible program. The graph below shows the average internal (done in-house), external (using consultants or outside producers), and total cost for each type of flexible program.

First-Year Average Communication Costs



Although there is substantial variation from organization to organization, first-year communication costs decrease with the size of the eligible population.

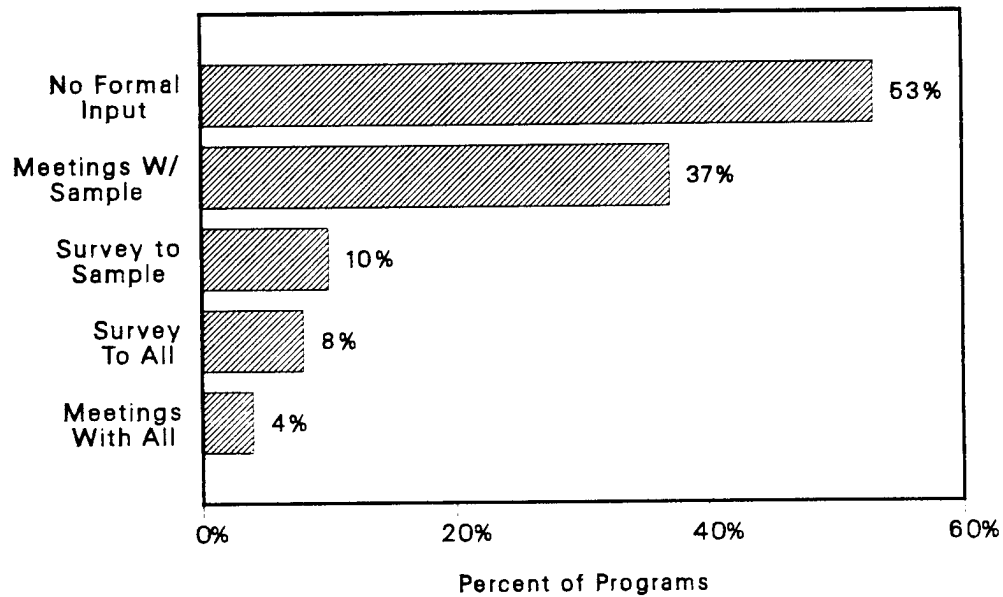
Table 21: Average Cost per Employee

Eligible Population	Total Cost per Employee
Less than 1,000	\$49.40
1,001 – 5,000	\$28.00
5,001 – 10,000	\$23.50
10,001 or More	\$15.80

Employee Involvement

The majority of organizations do not formally gather employee input prior to implementing a flexible program. For those programs asking for employee comments, this information is usually collected from meetings with sample groups of employees. A few organizations (4%) meet with all employees, while 1% meet with all bargaining employees. Some organizations use a combination of methods.

Employee Involvement in Design



Employee Reactions

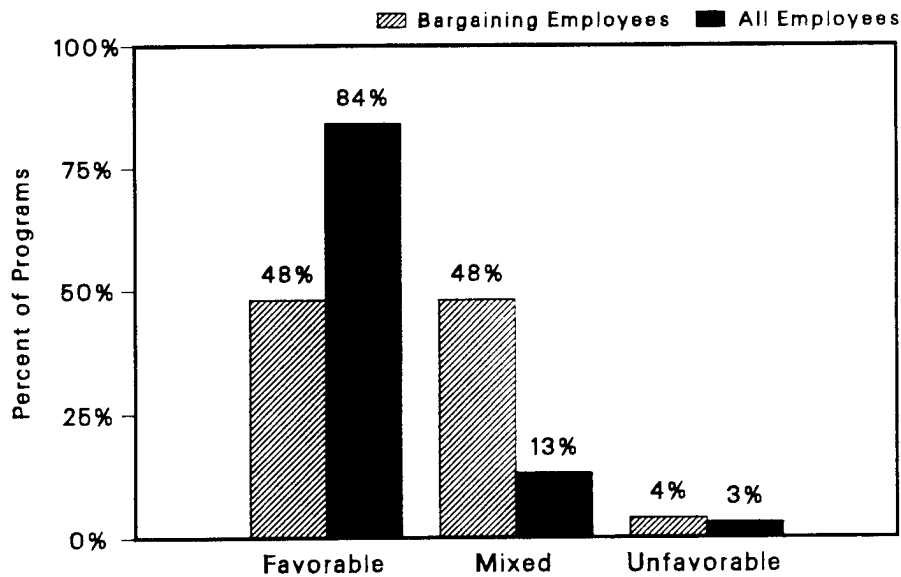
Overall, employee reactions to choicemaking programs are positive. Eighty-four percent of programs were rated as being met with very favorable or somewhat favorable responses.

Employee reactions did not vary with the size of the organization, nor by type of industry.

Twenty-seven survey organizations presently include bargaining employees in their choicemaking program. Of these, 48% report mostly positive reactions.

Employee Reactions

Choicemaking



III. Spending Accounts





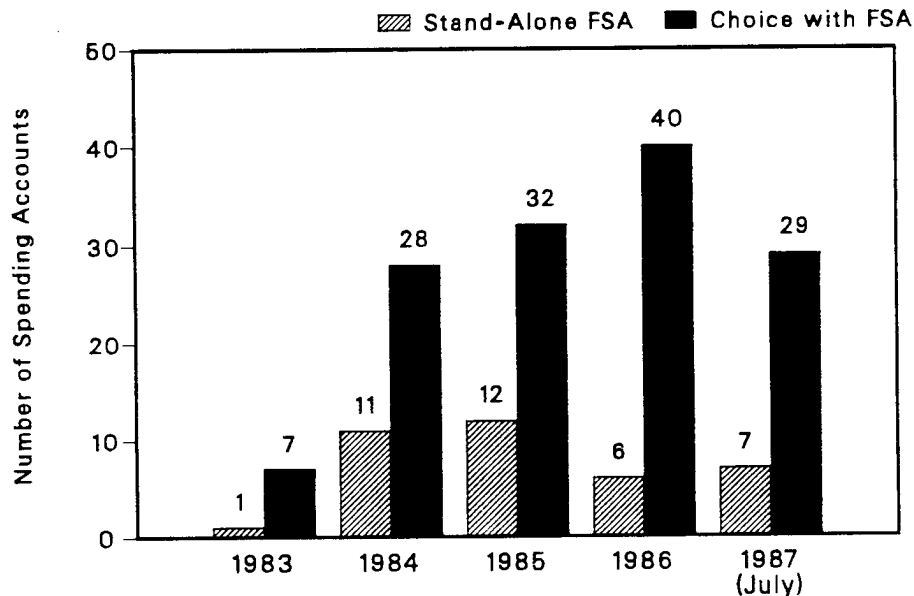
III. Spending Accounts

This section presents findings on spending accounts. Data from the 40 flexible programs which consist of only a spending account has been combined with data from the 144 spending accounts that are part of a choicemaking program. However, in discussing administration and communication, the stand-alone spending account programs will be discussed separately.

Effective Dates

Most organizations are implementing the spending account in conjunction with a choicemaking program. Stand-alone spending accounts are less common now than they were two years ago. The number and type of spending accounts implemented each year from 1983 to 1987 are shown below to demonstrate this trend.

Spending Accounts by Year of Implementation

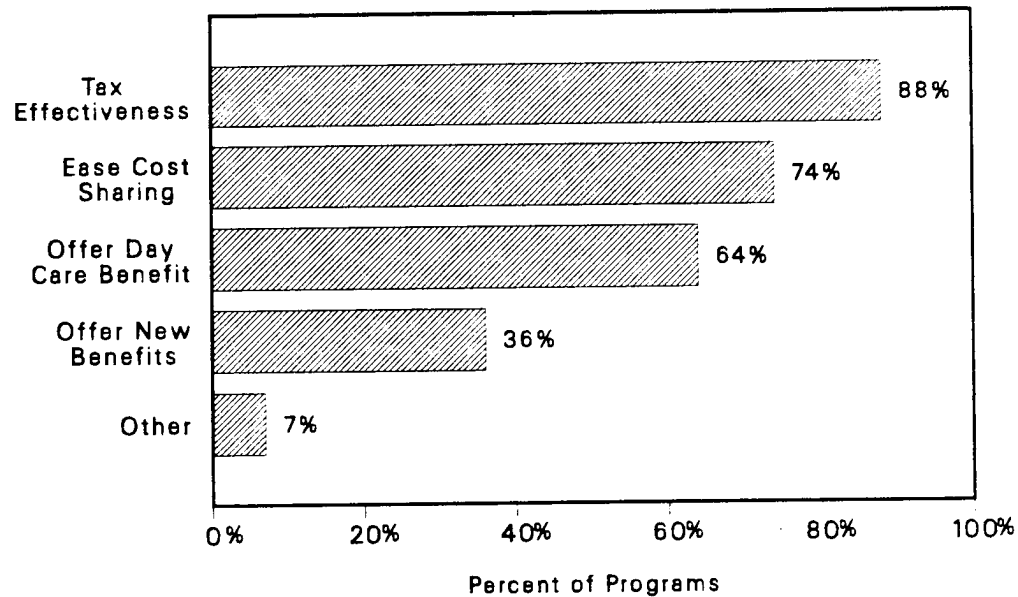


Program Objectives

The primary reason for offering a spending account is to maximize the tax efficiency of benefits. Lessening the impact of medical deductibles or copayments was cited by 74% of organizations as the reason for offering a health care spending account. Meeting employee demands for a dependent day care benefit was the primary reason for offering a dependent care account.

These objectives do vary by industry. For example, offering new medical benefits is cited as an objective by 60% of health care organizations, but only 26% of financial institutions.

Spending Account Objectives

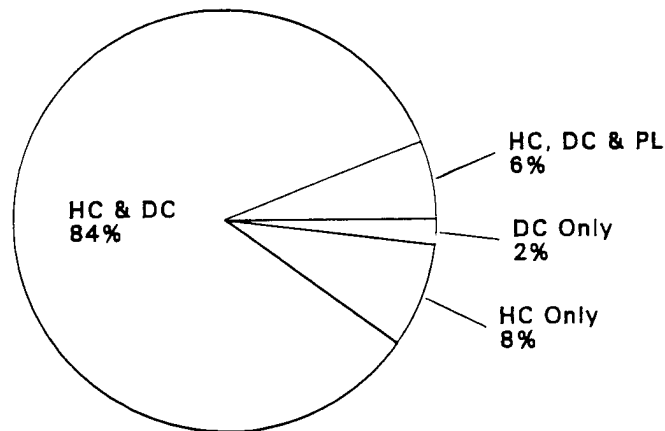


Design Overview

Types of Spending Accounts Offered

Spending accounts can be used to reimburse health care, dependent day care, or personal legal expenses. An organization can offer any or all of these accounts. However, of the 184 organizations that offer a spending account, most offer both a health care and a dependent care account. Very few offer a personal legal account. And, as shown below, only 6% provide a combination of all three accounts: health care (HC), dependent care (DC), and personal legal (PL).

Types of Spending Accounts Offered



Sources of Funds

Employee salary reduction is the predominant source of funds for stand-alone spending accounts. Few are funded solely by employer contributions, while 17% are funded by both employee and employer contributions.

Table 22: Stand-Alone Spending Account Funds

Employee Salary Reduction	68%
Employer Contribution	15%
Both	17%

Spending accounts that are offered as part of a choicemaking plan are funded by a variety of methods. Unused flexible credits and choosing lower levels of coverage (benefit trade-off) are increasingly common sources of funds.

Table 23: Choicemaking Spending Account Funds

Employee Salary Reduction	94%
Employer Contribution	44%
Trade-Off Among Benefits	39%

Eligibility Requirements

Program Eligibility

Virtually all stand-alone spending account programs are offered to full-time salaried and/or exempt employees. Non-bargaining hourly employees are covered in 68% of programs, while bargaining hourly are eligible in 18%.

These eligibility requirements are similar to those of choicemaking programs. Ten percent of spending account programs include all part-time employees. The most common requirement for participation is working 20 or more hours per week.

Table 24: Full-Time Eligibility Requirements

Full-Time Salaried/Exempt	98%
Non-Bargaining Hourly	68%
Bargaining Hourly	18%

Table 25: Part-Time Eligibility Requirements

All Part-Timers	10%
Must Work 20 or More Hours/Week	28%
Must Work 30 or More Hours/Week	10%
Other Restrictions	8%
Not Eligible	44%

New Employee Eligibility

Less than half (38%) of organizations with spending accounts allow new hires to participate immediately. The duration of the waiting period is shown below.

Table 26: Waiting Period for New Employees

<u>Waiting Period Ends:</u>	<u>Percent of Spending Accounts</u>
At Next Annual Enrollment	38%
First of Month After 30 Days of Service	16%
First of Month After 90 Days of Service	16%
Other Waiting Period	30%

Contribution Maximums

An organization can specify a separate contribution maximum for each spending account, and/or a total maximum for all dollars contributed.

Most programs (79%) place an annual limit on total employee contributions to the spending accounts. This compares with 49% in the 1986 survey. This might be a reflection of organizations' concern over passing the new Section 89 nondiscrimination tests. The average total maximum for all spending accounts is \$7,820.

Table 27: Total Contribution Maximums

Less than \$6,000	20%
\$6,000 to \$8,000	35%
\$8,001 to \$10,000	14%
\$10,001 or More	31%

Of the 181 health care spending accounts, 76% have a separate dollar maximum on contributions. The average contribution limit is \$3,515.

Of the 169 dependent care spending accounts, 80% specify a separate contribution maximum. Dependent care account contribution limits are higher, with an average limit of \$4,753.

Over three-fourths (76%) of organizations with a dependent care spending account set their contribution limit at \$5,000, the maximum imposed by the Tax Reform Act. Some dependent care accounts (16%) state a limit between \$4,000 and \$5,000, while 8% have a limit lower than \$4,000.

Finally, 73% of legal spending accounts have a separate maximum. Personal legal account contribution maximums are the lowest, averaging \$3,188.

To demonstrate the wide range of practices, a comparison of contribution limits for each type of account is shown below.

Table 28: Contribution Limits by Account Type

Dollar Limit	Health Care	Dependent Care	Personal Legal
Less than \$1,000	4%	0%	0%
\$1,000 – \$1,999	12%	3%	37%
\$2,000 – \$2,999	31%	2%	13%
\$3,000 – \$3,999	12%	3%	0%
\$4,000 – \$4,999	7%	16%	13%
\$5,000 – \$5,999	20%	76%	24%
\$6,000 – \$7,499	10%	N/A	13%
\$7,500 or More	4%	N/A	0%

To help simplify the Section 89 nondiscrimination tests, 9% of programs with spending accounts will offer specific “contribution options” (e.g., only allowing contributions in multiples of \$200) for spending accounts in the future.

Contribution Changes

Section 125 regulations require that spending account contributions can be changed only in the event of a "change in family status."

Events that enable an employee to change spending account contributions are similar to those recognized for benefit election changes (see Table 17). However, fewer spending accounts allow changes due to loss of the spouse's coverage than do choicemaking programs (62% vs. 83%).

Table 29: Permissible Events for New Elections

Birth or Death of Dependent	93%
Marriage/Divorce of Employee	92%
Adoption of Child	87%
Change of Employment Status of Spouse	70%
Loss of Coverage by Spouse	62%
Part-Time to Full-Time Status Change	46%
Full-Time to Part-Time Status Change	42%
Retirement of Spouse	40%
Switching Divisions Within the Organization	7%
Other Event	4%

Participation and Contribution Rates

The repetition of previous questions on spending account participation and contribution data allows some trends to be identified:

- The number of employees participating in a health care account increases with time, as does the amount of their contribution.
- Participation in a dependent care account, however, levels off at around 4% of eligible employees, while the average contribution amount increases from year to year.
- Personal legal spending accounts are offered by very few organizations, and participation rates are low (2% of eligible employees).
- Stand-alone health care spending accounts have higher participation and contribution rates than those spending accounts which are offered as part of a choicemaking program.
- Stand-alone spending accounts also reported lower forfeitures than choicemaking plans for both the health care and the dependent care account.

Selected data on 1986 and 1987 participation and contribution rates for each type of spending account are presented on the following page.

Dependent Care Accounts

For the 1986 plan year:

- The average participation rate was 4% of eligible employees.
- The average contribution per participating employee was \$2,197.
- The average forfeiture per participant was \$18.

For the 1987 plan year, the participation and contribution patterns were similar to those in 1986.

- The average participation rate was 4% of eligible employees.
- The average contribution per contributing employee was \$1,964.

It should be noted, however, that the higher contribution amounts for the 1986 plan year do not mean that contributions dropped in 1987. Respondents for these two plan years are not a constant sample.

Dependent care account participation rates vary by industry. In both the 1986 and 1987 plan years, the financial services industry reported the highest participation, with an average of 7% of eligible employees participating. This rate may reflect a higher number of dual income families requiring day care.

Health Care Accounts

For the 1986 plan year:

- The average participation rate was 26% of eligible employees.
- The average contribution per participating employee was \$483.
- The average forfeiture per participant was \$33.

For the 1987 plan year, these numbers were about the same:

- The average participation rate was 25% of eligible employees.
- The average contribution per participating employee was \$523.

Personal Legal Accounts

In this survey group, no manufacturing organization offers a personal legal spending account. These accounts are usually offered by financial services, health care, and insurance companies.

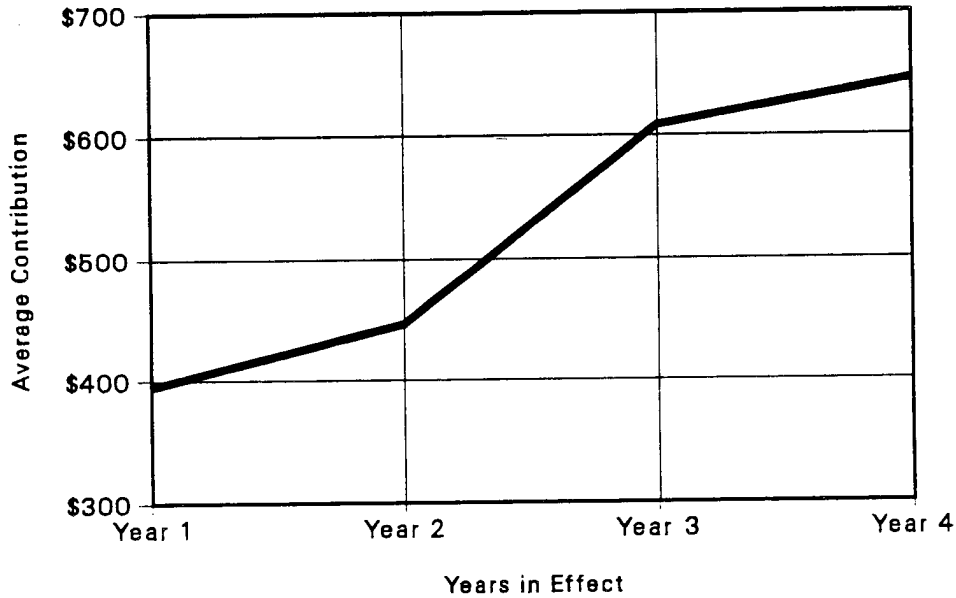
In the 1986 plan year, the average participation rate was 1% of eligible employees, with an average contribution of \$613. The average forfeiture per participant in 1986 was \$22.

The companies supplying data on personal legal accounts for the 1987 plan year reported an average participation rate of 2%. Dollars contributed averaged \$443.

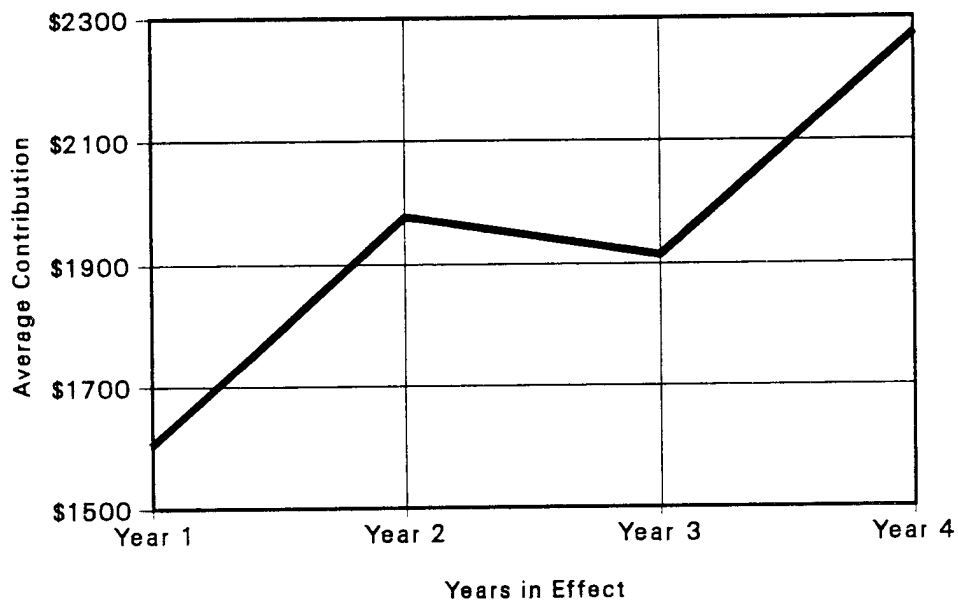
It should be noted that, because of the small number of personal legal spending accounts, and the corresponding low number of respondents, this data is probably not representative of widespread contribution and participation patterns.

There is an apparent "learning curve" which affects both health care and dependent care contributions. Employee contributions increase with the age of the plan, according to data from the 1987 survey.

Health Care Account Contribution Trends



Dependent Care Account Contribution Trends



Stand-Alone Spending Accounts

An analysis of participation and contribution rates for programs consisting of only a spending account shows some differences from spending accounts included in broad choicemaking programs.

For example, stand-alone spending accounts report higher contributions to the health care and personal legal account than do spending accounts that are part of a choicemaking plan. Participation in the health care spending account is also higher for stand-alone programs.

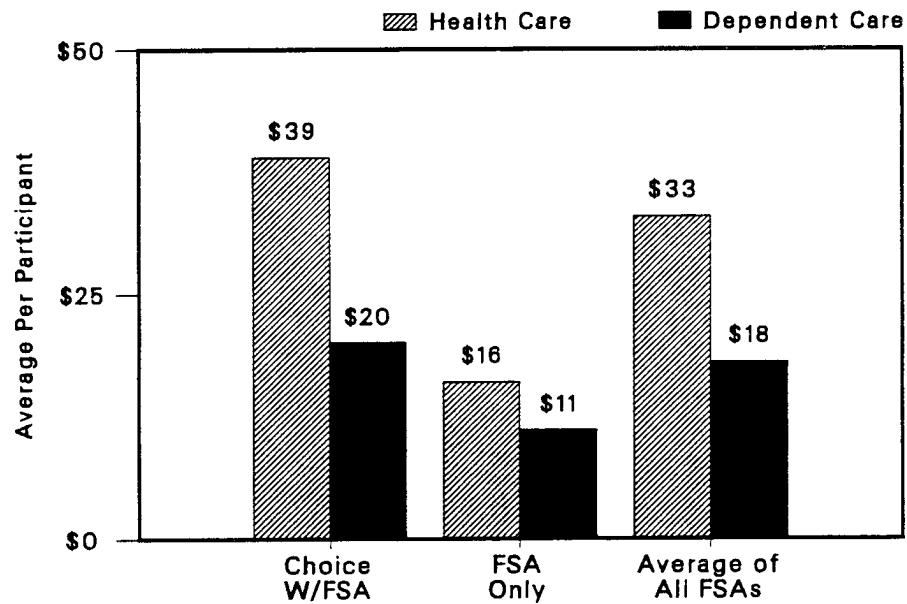
Such variation may be explained by the fact that the stand-alone communication program focuses solely on spending accounts, rather than on both choicemaking and spending accounts. Participation in the dependent and personal legal accounts are less variable, perhaps because fewer employees incur these types of expenses.

Table 30: 1987 Participation and Contribution Rates

	Choicemaking With Spending Accounts	Stand-Alone Spending Accounts	All Spending Accounts
<u>Health Care</u>			
Average Participation	23%	31%	25%
Average Contribution	\$ 489	\$ 653	\$ 523
<u>Dependent Care</u>			
Average Participation	4%	3%	4%
Average Contribution	\$2,000	\$1,820	\$1,964
<u>Personal Legal</u>			
Average Participation	2%	2%	2%
Average Contribution	\$ 392	\$ 753	\$ 443

Forfeitures also differ by type of spending account program. Generally speaking, employers with stand-alone spending accounts report lower forfeitures than those with spending accounts that are part of a choicemaking program. Again, this variation may be explained by a communication campaign which focuses only on the spending account.

1986 Forfeitures

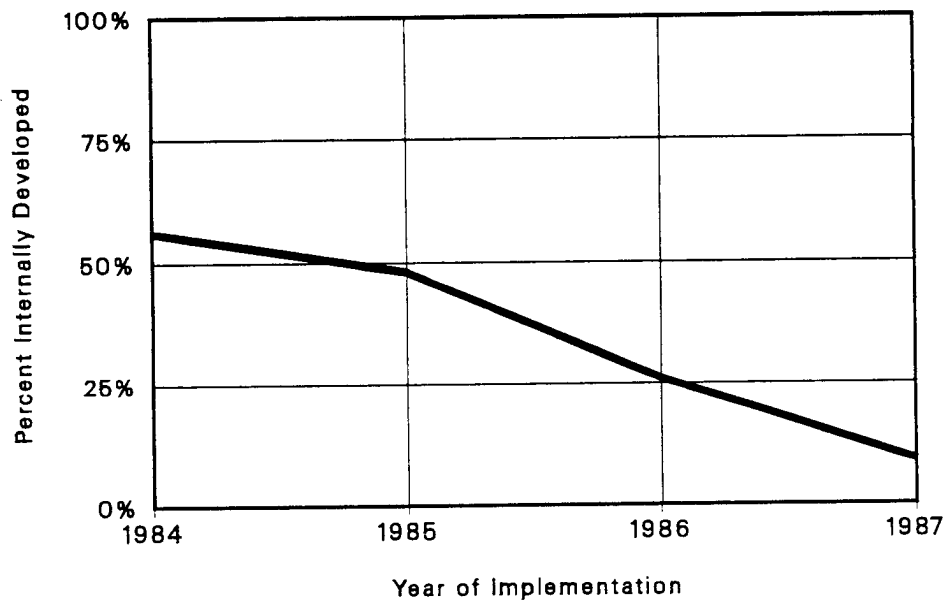


Administration

While the majority of spending accounts (57%) are still administered internally, fewer companies (38%) are developing their own administration system. More are using external processing services, (42%), while 19% purchase software to administer their programs internally.

Prior to 1984, all survey organizations developed their spending account administration system internally. The availability of administrative software may be contributing to the continuing increase in the number of spending accounts. The graph below illustrates the trend away from internal systems development and towards purchasing of software for spending accounts implemented in recent years.

Internally Developed FSA Administration Systems



Administration Costs

System development costs were under \$10,000 for almost half of the stand-alone spending accounts. As found with most benefit administration systems, the cost increases with the number of eligible employees.

Ongoing administration costs, for some sizes of organizations, were higher than the set-up costs. This may be due to different payment arrangements for spending account recordkeeping services used. The table below shows the various payment arrangements.

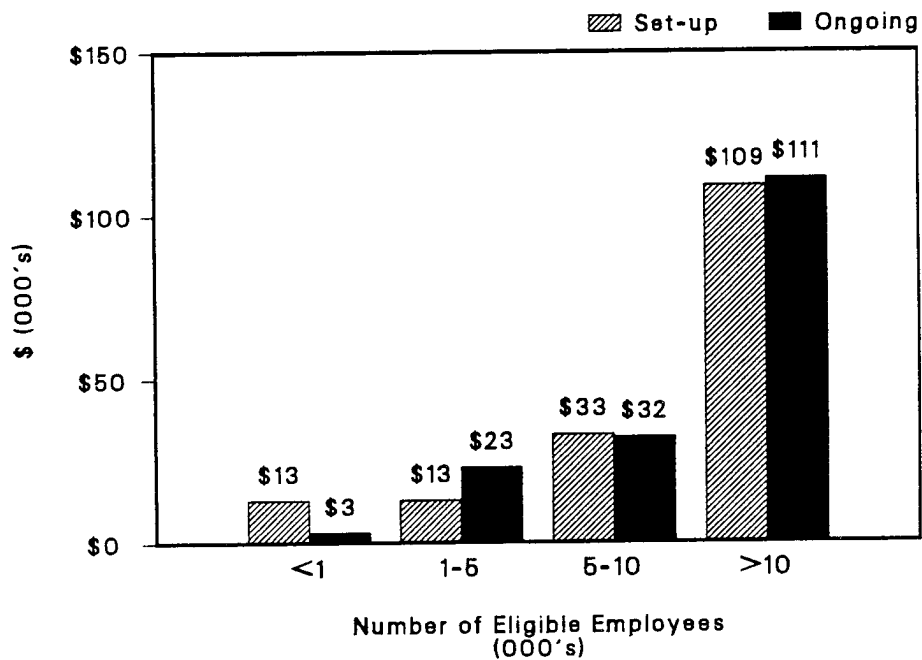
Table 31: Payment for Recordkeeping Services

Internal System	52%
Per Participant	21%
Per Check	16%
Flat Annual Fee	11%

Average administration set-up and ongoing costs for all spending accounts are shown below.

Administration Costs (in thousands)

Spending Accounts



Administrative Procedures

To reduce excessive paperwork, almost two-thirds (65%) of organizations require a minimum dollar amount before a claim will be processed. Most specify that claims be at least \$25 (25%) or \$50 (28%). Very few (7%) employers require that spending account claims be \$100 or more before they are submitted.

Monthly reimbursement from the spending account is the procedure used by 49% of the programs. A few (13%) have no limitation on the number of times an employee can receive payment. And some organizations pay claims from the dependent care account every week, but pay medical claims once a month.

Table 32: Frequency of Reimbursement

No Limit	13%
Weekly	10%
Bi-Weekly	10%
Twice a Month	9%
Monthly	49%
Quarterly	8%
Twice a Year	1%

Almost three-fourths (73%) of organizations allow terminated employees to file claims against their spending account through the end of the plan year. Another 24% will pay only those claims for expenses incurred while an active employee. And 3% will not accept claims from a terminated employee.

Forfeited Funds

Most organizations (68%) revert forfeited funds back to the employer. Of these, about half use the money for a specific purpose, like an employee wellness program. Other uses of forfeitures include donating these dollars to charity, or using them to increase credits on a per capita basis the following year.

Table 33: Disposition of Forfeited Funds

Revert to Employer's General Assets	36%
Revert to Employer for a Specific Purpose	32%
Donate to Charity	9%
Increase Next Plan Year's Credits for All Employees (Per Capita)	8%
Increase Next Year's Credits for Spending Account Participants (Per Capita)	7%
Other	8%

Administrative Personnel Requirements

The majority (60%) of spending accounts do not require any additional employees for program administration. This figure includes both stand-alone spending accounts as well as those that are administered separately from the rest of the flexible program.

Of those organizations that add staff, most add fewer than one full-time employee. Initial and ongoing administration staffing requirements are shown below for spending account administration.

Table 34: Administrative Staffing

<u>Full-Time Equivalents</u>	<u>Additional Employees Required</u>	<u>Total Employees Required</u>
0	60%	15%
0.5	18%	24%
1.0	14%	25%
1.5	1%	5%
2.0	4%	15%
3 or More	3%	16%

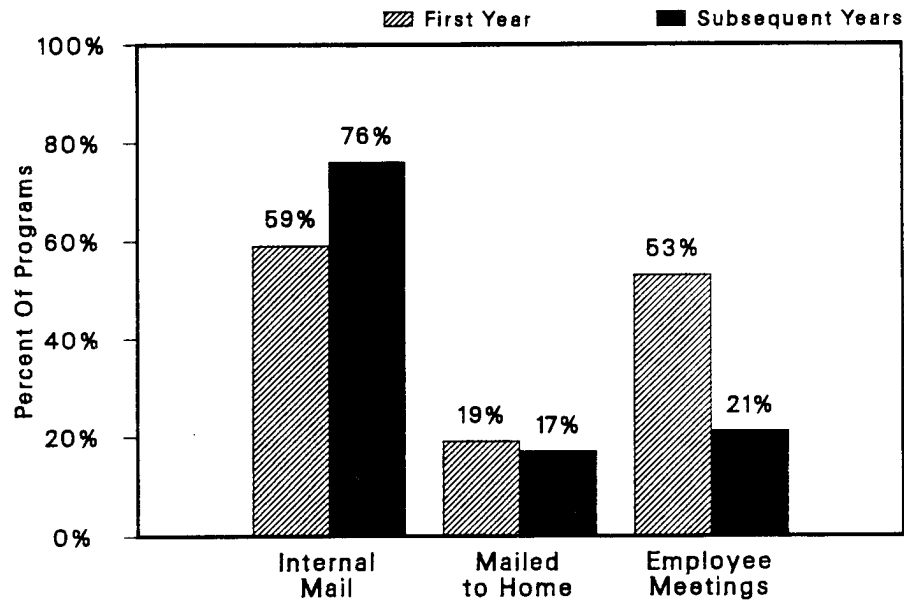
As more organizations switch from manual recordkeeping to computerized administration, the number of total employees required to administer the spending account declines. Presently, 64% of organizations require one or fewer employees for ongoing administration.

Enrollment Procedures

Enrollment procedures for stand-alone spending account programs differ from procedures for a choicemaking program. For example, enrollment materials are more likely to be distributed at work than mailed to the employee's home. The most common methods for distribution are shown below, for both initial and subsequent enrollment periods.

Distribution of Enrollment Materials

Spending Accounts



Enrollment Errors

The error rate on election forms for first year participation in the spending account is lower than that reported by choicemaking programs. On average, 10% of enrollment forms are returned with errors during initial enrollment, and this decreases to 6% in subsequent enrollments.

Default Election Procedures

Stand-alone spending accounts, because they are an optional benefit, require different procedures than choicemaking programs when an employee does not return an enrollment form.

Interestingly, not all organizations assume that the absence of an enrollment form means the employee does not wish to participate in the spending account. Almost a third follow-up on an individual basis to confirm the decision.

Table 35: Default Election Procedures

Individual Follow-Up	27%
Assign Previous Year's Options	15%
No Spending Account	50%
Other	8%

Communication

This section uses data from programs which consist of only a spending account. It is assumed that other spending accounts are communicated as part of the flexible program and, therefore, do not have separate communication policies.

Communication Media

Programs consisting of only a spending account use different types of media to introduce the program than do choicemaking plans (see Table 19). Personalized enrollment material, for example, is used less frequently.

In subsequent plan years, fewer types of media are used, with the exception of election confirmation reports, payroll stuffers, benefit statements and interactive computer software.

Table 36: Spending Account Communication Media

	<u>First Year</u>	<u>Subsequent Years</u>
Highlights Brochure	82%	62%
Newsletters	68%	52%
Bulletin Board Notices, Posters	56%	52%
Summary Plan Descriptions	56%	55%
Claim Kit	44%	28%
Personalized Enrollment Materials	41%	31%
Enrollment Workbook/Worksheet	38%	34%
Sound/Slide Show	38%	17%
Election Confirmation Report	35%	45%
Videotape Presentation	24%	3%
Payroll Stuffer	21%	24%
Hotline/Information Center	21%	14%
Benefit Statements	15%	38%
Interactive Computer Software	3%	7%

Employee meetings are voluntary for two-thirds of the stand-alone spending account programs. Twenty-seven percent make meetings mandatory, while 7% do not use employee meetings at all to introduce the spending account.

Attendance at voluntary meetings varies significantly from organization to organization. On average, about half of eligible employees attend a meeting.

In subsequent plan years, many organizations hold voluntary meetings (50%), while 33% do not hold meetings. Seventeen percent have mandatory attendance requirements for meetings.

Communication Planning and Preparation

Planning for spending account communication can take anywhere from one to six months. Over half (52%) require one to three months for the preparation of materials to introduce the spending account. The average time spent on planning and preparation, however, was four months.

Table 37: First-Year Communication Planning

<u>Months</u>	<u>Percent of Spending Account Programs</u>
1	7%
2	17%
3	28%
4	10%
5	7%
6 or More	31%

Interestingly, the duration of the communication campaign averages three months, only one month less than the campaign for a choice-making program. And in subsequent plan years, the number of months for the campaign averages two months for spending accounts, the same as for choicemaking programs.

Communication Costs

Spending account communication costs are significantly less than the cost of communicating a choicemaking program (see page 41). On a per-employee basis, the average cost is \$5.05 for first-year communication.

Organizations with stand-alone spending accounts spent, on average, \$44,000 to introduce the spending account. Internal costs were about equal to external costs.

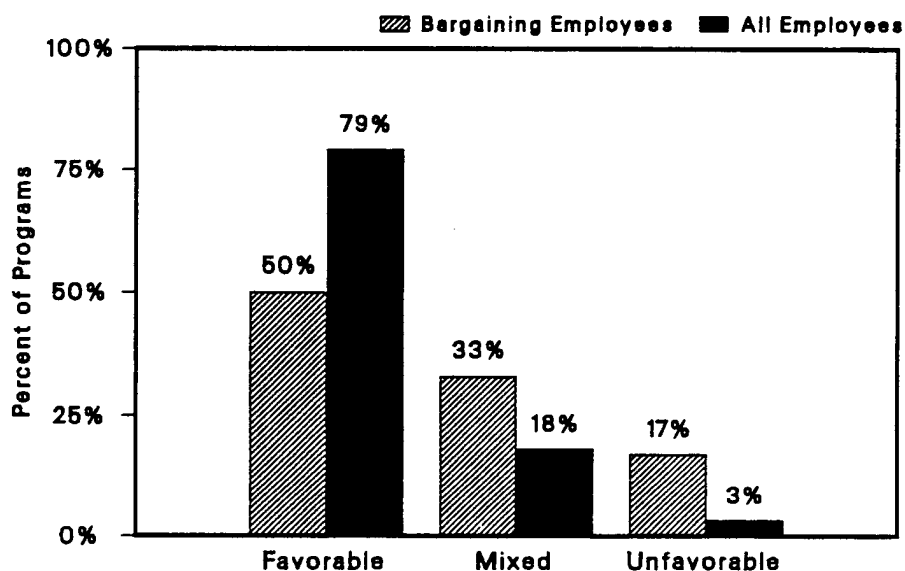
In subsequent years, ongoing communication costs average \$11,000. Again, internal costs were half of total expenditures.

Employee Reactions

Employee reactions to stand-alone spending account programs, while positive, are slightly less positive when compared to reactions to a choicemaking plan with a spending account. Choicemaking programs with spending accounts tend to get more mixed, but fewer negative, reactions. This may be due to the complexity surrounding the concept of choice.

Employee Reactions

Spending Accounts





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8687 East Via de Ventura
Scottsdale, Arizona 85258
(602) 994-1373
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