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This Just In

Congress considering pension reform. As this issue went to press, the Senate and House were both considering pension reform bills. Agenda items include pension funding and raising premiums plan sponsors pay to the Pension Benefit Guaranty Corp., or PBGC. For more information on pension reform, please see P. 4.

More than one-third of employers offer their employees a choice of health plans. Nearly two-thirds of employees with choices opt for PPO plans, while 20 percent chose an HMO or EPO (exclusive provider organization) plan.

In 2003-2005, annual deductibles for single coverage averaged $323 under PPO plans, $71 under HMOs and $602 under traditional fee-for-service plans, according to the Kaiser Family Foundation.

Employers that contribute to employees' HSAs must ensure contributions for all eligible individuals are comparable. The IRS has proposed a regulation that would deem contributions to health savings accounts comparable if they are either the same dollar amount or the same percentage of the deductible for eligible individuals with the same category of coverage (i.e., single or family). The proposed regulations also clarify that contributions to the HSAs of independent contractors, sole proprietors and partners in a partnership are not taken into account under the comparability rules.

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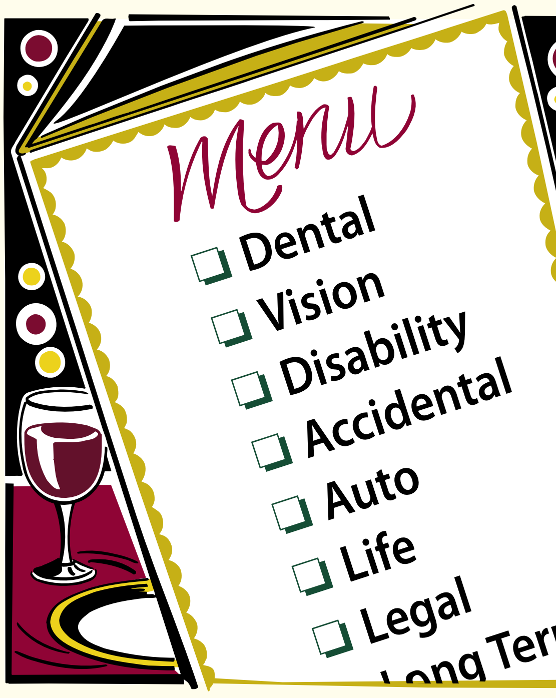
Benefits Administration

Voluntary Benefits Offer Many Advantages, Some Pitfalls

As we reported in our last issue, experts are predicting group health premium increases will increase an average of 10-12 percent in 2006. After many years of health premium inflation, voluntary benefits have emerged as one solution to help employers provide benefits without going broke in the process.



Voluntary benefits can do two things for your benefit program: they can give smaller employers, who might not be able to afford benefits, a way to provide a variety of benefits at no cost. For other employers, it provides a way to enhance the employer-provided benefit program. In fact, the 2004 MetLife Study of Employee Benefit Trends found employers almost evenly split on why they offered voluntary benefits. Nearly half (44 percent) said they offer voluntary benefits to meet their employees' diverse benefits needs economically. Nearly the same percentage (44 percent) said voluntary benefits help them enhance their overall benefits program cost-effectively.

What are voluntary benefits?

Under a voluntary benefit program, the employer offers employees a menu of benefits; employees pay for the ones they want through payroll deduction. The employee pays some or all of the cost and the benefits provider handles all administration and provides all needed education materials. Voluntary medical plans, such as cancer insurance, have no minimum participation requirements, unlike employer-sponsored medical coverage.

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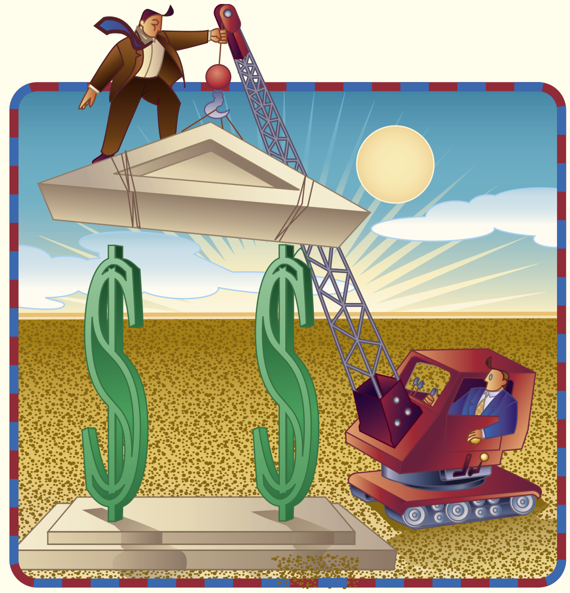
Life Insurance: The Foundation of a Benefit Program



According to the Bureau of Labor Statistics, 51 percent of all employees in private industry had access to life insurance through their employer. Nearly all eligible employees (48 percent of all employees) participated in their employer's program, vouching for the popularity of employer-provided life insurance.

Most employers provide employee life coverage through group term life policies. Under any true group insurance program, one policy, issued to the employer, covers all employees; covered individuals receive a certificate. Term life policies differ from "permanent" life policies, such as whole life or universal life, in that they provide benefits only if the insured dies during the policy term. They do not build any cash value or redemption value. Policy terms under group policies are usually one year; under individual policies, terms are usually five years or 10 years.

Unlike many other group policies, coverage under group life policies often is no cheaper than under an individual policy, at least for a healthy individual. However, group life is written on a "guaranteed issue" basis, which means that eligible employees can obtain the "guaranteed issue" amount of coverage without medical underwriting if they sign up during the enrollment period. This means that all your employees can obtain at least some coverage, even those whose health would make buying individual coverage prohibitively expensive or impossible.

Tax implications

The IRS allows employees to exclude the cost of the first $50,000 of employer-provided group term life insurance coverage from income, if the policy is "carried directly or indirectly by the employer." This includes policies for which the employer pays any cost, or policies where the employer arranges for premium payments and premiums paid by at least one employee subsidize those paid by at least one other employee.

Individuals can also exclude the cost of employer-provided group-term life insurance on the life of a spouse or dependent if coverage does not exceed $2,000. This coverage is excluded as a de minimis fringe benefit.* Employers can deduct the cost of group term life premiums, as long as they are not the direct or indirect beneficiary of the policy.

*A "de minimis" fringe benefit is any property or service that you provide to an employee that has so little value (taking into account how frequently you provide similar benefits to your employees) that accounting for it would be unreasonable or administratively impracticable.

Limits and features

Employers can tailor a group term life benefit to their needs and budget. According to the Bureau of Labor Statistics, most employees with life insurance benefits (89 percent) do not have to contribute toward this benefit. Most employees (53 percent) had plans that provide benefits as a multiple of earnings. White collar workers most commonly had coverage that would pay two times annual earnings, while those in service occupations had coverage that would pay one times annual earnings. Thirty-five percent of workers had "flat dollar amount" coverage, which pays the same specified amount for any covered employee.

Group term life policies offer many options, which may vary by insurer or by state. Look for a policy that offers a **conversion option**, which allows employees to convert their group term life coverage to an individual term policy without undergoing a medical exam when either their employment or the benefit plan terminates. To take advantage of this option, insureds have to apply and make a premium payment within a period of time specified in the policy. (Some states require policies to be convertible.)

Other valuable options are **waiver of premium,** which waives premium payments for an employee who becomes totally disabled, usually up to retirement age. A **living benefit option** allows employees with a terminal illness to receive a portion of their death benefit in advance, to help cover medical costs.

Although group term life cannot take the place of individual policies in an individual's financial portfolio, employees value their life insurance coverage. You can add to the value by offering, in addition to your basic group term life coverage, additional coverage on a voluntary (employee-paid) basis. In a survey conducted by LIMRA International for Allstate Insurance Company, 25 percent of adults surveyed said they should have more coverage. Voluntary benefits are a cost-effective and convenient way to provide these employees the additional coverage they want.

For more information on setting up a life insurance benefit for your employees, please call us. ❑

BENEFITS – continued from Page 1

Voluntary benefits include:

- Dental insurance.
- Vision insurance.
- Long-term care insurance.
- Short-term disability insurance.
- Long-term disability insurance.
- Accidental death and dismemberment insurance.
- Life insurance. Options include term life insurance, interest-sensitive whole life (variable life) and dependent life coverages.
- Supplemental health coverages, including cancer/specified disease insurance, critical care insurance and hospital indemnity plans, which pay specified flat amounts.
- Group auto and homeowners insurance.
- Nontraditional benefits, such as prepaid legal services, pet insurance and more.

Advantages of voluntary benefits

The MetLife survey indicated employees like voluntary benefits. Even in plans where employees pay 100 percent of premiums, they get the benefit of group buying power to purchase benefits they wouldn't be able to obtain on their own. Sixty-two percent of employees said payroll deduction for voluntary benefits was "convenient." Half of employees surveyed said they thought voluntary plans offered better rates (than individual plans) and that being able to "sign up for insurance without going through a medical exam" was a strong selling point.

With their advantages and low- or no cost for employers, offering voluntary benefits might sound like a no-brainer. However, employers do have some important issues to consider before adding voluntary benefits:

A Does the voluntary program provide real value? Employees are likely to view a voluntary program as employer-sanctioned. If the program provides little real value, it could create a negative impression of the rest of your benefits program. Things to beware of include certain discount programs, such as dental discount cards, which might provide only limited discounts. Under some of these programs, "participating" providers have no obligation to honor the cards.

B Does the voluntary program enhance existing offerings? If you provide group life to employees that pays one or two times salary, a voluntary life insurance plan with a higher benefit could provide real value to employees who need a higher benefit but who might not qualify for individual coverage.

C Does ERISA apply to the program? ERISA, the federal law governing employee benefits, applies to most group life and health programs unless they meet all four of these conditions:

1. The employer or employee organization makes no contributions.
2. Participation is completely voluntary.
3. The employer or organization does not endorse the program. This could include using company logos on promotional/informational material, encouraging employees to sign up, or even negotiating with the insurer for better terms for your employees. You can permit the insurer to publicize the program to employees or members, collect premiums through payroll deductions and remit them to the insurer.
4. The employer accepts no payment in connection with the program, other than reasonable compensation for administrative services in connection with payroll deductions.

Even in plans where employees pay 100 percent of premiums, they get the benefit of group buying power to purchase benefits they wouldn't be able to obtain on their own.

When ERISA applies to a benefit program, it gives the sponsor additional responsibilities. The sponsor or its designated administrator must file an annual Form 5500, provide participants with important information about plan features and funding, act as a fiduciary in the management and control of plan assets and establish a grievance and appeals process for benefit disputes. In addition, ERISA gives participants the right to sue for benefits and breaches of fiduciary duty.

Although the responsibilities imposed by ERISA are not onerous, the failure of your insurer or administrator to do any of the above for your plan could expose your firm, as plan sponsor, to fiduciary liability. Before offering any voluntary benefits, we recommend talking with an experienced benefit consultant to see how they fit into the rest of your benefit program. For more information on employee benefits—voluntary and other—please call us. ❑

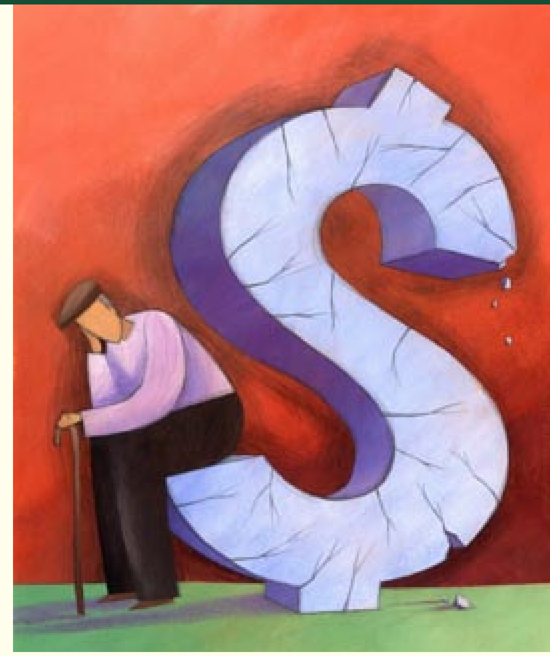
The IRS's proposed "comparability regulations" would prohibit employers from conditioning employer contributions to employees' health savings account on their participation in health assessments, disease management programsor wellness programs. The rules would allow employers to give cash and other incentives, but not to tie eligibility for HSA contributions to employee participation in these programs. Employers worry this rule could stifle creative health plan design.

As this issue went to press, the regulation had not met with final approval. For more information using health incentives in your health plan design, see our December 2005 issue.

Massachusetts would mete out penalties, such as losing their drivers license, to individuals who failed to buy health insurance. Both the governor and House have proposed two separate plans that would require state residents to carry health insurance. The governor's proposal would require insurers to offer low-cost plans, whose premiums would be about $200 per month. The state would offer subsidies to residents making up to $28,710 per year.

Massachusetts' Legislature is considering a bill that would require businesses that don't provide employees health coverage to pay a tax of 5 to 7 percent on payroll to fund expanded health insurance options. The bill would apply to employers with 10 or more employees. Employees who failed to buy insurance would be subject to penalties. Employer groups have come out against the plan, but some analysts note that the proposal would benefit those that currently pay more than 7 percent of payroll to fund employee health coverage. Reducing the number of uninsured would reduce the unreimbursed costs that providers pass along to members of insured groups.

Pension Reform:
Why We Need It Now



In early 2005, the U.S. Department of Labor estimated total underfunding in the U.S. defined benefit pension system exceeded $450 billion. When a single-employer pension plan terminates, the Pension Benefit Guaranty Corporation's (PBGC) single-employer insurance program steps in to pay plan beneficiaries the "basic benefits" earned before the plan ended. This includes pension benefits at normal retirement age, most early retirement benefits, annuity benefits for survivors of plan participants and disability benefits for disabilities that occurred before the date the plan ended. The program, which had a $7.7 billion surplus in 2001, had a $23.3 billion deficit at the end of 2004.

Plan terminations often have serious consequences for plan participants. For example, Bethlehem Steel's plan had promised almost $8 billion in benefits when it terminated, but had only $3.5 billion in assets. The PBGC will pay for almost $4 billion in unfunded benefits, but Bethlehem retirees will receive half a billion dollars less than promised because of the legal limits of PBGC's guarantee. Some participants will receive less than half of their promised benefit.

Other, more recent, plan terminations and restructurings have increased calls for legislation to tackle pension reform. As this issue went to press in early December, the Senate had approved the Pension Security and Transparency Act of 2005. The House had extended its deadline to consider a similar bill, the Pension Protection Act of 2005.

Both bills would take measures to strengthen underfunded plans. They would establish new minimum funding standards for single-employer and multiemployer defined benefit pension plans, including requiring plan administrators to diversify funds invested. They would also take steps to strengthen the PBGC, including increasing the premiums employers pay into the fund. Both bills would also require plan sponsors to make disclosures about their pension liabilities in annual reports and to plan participants and beneficiaries.

Who pension reform would affect

These bills would protect the defined benefit pension plans of 44.4 million American workers and retirees. And although only about one percent of American employers currently have active defined benefit pension plans, the bills would make changes to the law that could encourage employers to preserve these plans rather than eliminating them altogether. The laws would deem hybrid pension plans, such as cash balance plans, "nondiscriminatory as to age" if they comply with certain requirements.

Although federal law already prohibits employers from discriminating against older employees, including in benefits, questions of age discrimination have arisen when employers convert traditional defined benefit plans to cash balance plans. In some instances, benefits a participant earned under the old formula may exceed the amount that the participant would be eligible for under the cash balance plan formula. In this situation, the participant might not earn any additional benefits until benefits under the cash balance plan formula exceed the benefit earned under the old formula. This is commonly referred to as "wear away." "Wear away" is one of the issues being closely studied by the EEOC, IRS and the U.S. Department of Labor for its implications for older employees.

Defined contribution plans, such as 401(k)s, do not create the same funding liabilities for employers that defined benefit plans do. For that reason, they have grown in popularity in recent years. However, hybrid plans offer more security for beneficiaries and might do a better job of rewarding longevity and encouraging loyalty. For more information on your pension plan options, please call us. ❑

"…questions of age discrimination have arisen when employers convert traditional defined benefit plans to cash balance plans."

Cash balance plans

Although it is technically a defined benefit plan, a cash balance plan shares some features with defined contribution plans, and shares some of the advantages of both.

As with defined contribution plan, the benefits an employee receives at retirement are defined in terms of the balance of his/her account. But as with a traditional defined benefit plan, the employer makes contributions for participants. In a typical plan, the employer credits a certain percent of the employee's pay each year, plus an interest credit, to the employee's account. The employer can invest these amounts as it sees fit, and increases and decreases in investments do not directly affect participants' benefits.

When participants are entitled to receive benefits under a cash balance plan, he or she can convert the account balance into an annuity or (under some plans) take a lump sum distribution.