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This
Just
In...

REQUIREMENTS

Understanding 401(k) Plan Fees and Expenses

 **Employers can add Roth 401(k) contributions to their retirement programs beginning January 1, 2006.** While Roth 401(k) accounts do not increase the annual limit on retirement account contributions (\$15,000 in 2006), they offer workers the option of making contributions on an after-tax basis. Employers can match these contributions on an after-tax basis. Unlike traditional plans, withdrawals at retirement will be completely tax free, not just tax-deferred, as long as withdrawals begin after five years and age 59½. Roth 401(k)s will likely benefit workers who expect to be in a high tax bracket when they retire, as well as young workers, since additional years of tax-deferred investing can help them make up the difference for having to pay taxes up front. Interested employers should act now to allow for sufficient participant education and plan elections.

 **High-priced gasoline is fueling new interest in transportation benefits,** including qualified transportation expense plans and carpooling arrangements. Employees can save 30 to 40 percent on out-of-pocket expenses on certain transit and parking costs associated with their commute to work by paying for those expenses with pre-tax dollars. Commonly used in major cities by commuters who take mass transit, the benefit also is available to workers who use carpools.

Among the many challenges plan sponsors face, one of the biggest is determining their 401(k) plan's total cost, including the cost of investment management, plan administration and participant services. Fees and costs associated with a retirement plan's investments are inevitable. However, ERISA requires that any compensation paid to any service provider — including an investment provider, manager or advisor — be reasonable.



Plan fees and expenses generally fall into three categories:

Investment management. A 401(k) plan's most significant expenses are typically associated with managing plan investments, which represent 70 to 80 percent of overall costs. Investment management fees generally are based on a percentage of assets invested and deducted directly from investment returns. These fees can vary widely, depending on the investment manager and the nature of the investment product.

The fees are also the most manageable and predictable costs to reduce, since employers can choose from multiple funds. Making relatively small changes in this area that can make a big difference in an employee's accumulated wealth: a one percent yearly fee over 20 years can reduce a participant's account balance by 18 percent!

Plan administration. Day-to-day operation of a plan involves expenses for basic administrative services — such as recordkeeping, accounting, legal and trustee services — that are necessary for administering the plan as a whole. One-time fees are typically related to start-ups, conversions and terminations of service. Ongoing fees include recurring expenses relating to continuing plan operation. Administrative costs may be deducted directly from investment returns, borne



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CDH Plans and the Pharmacy Benefit: Finding the Right Fit

Design is everything when it comes to structuring pharmacy benefits in consumer-directed healthcare (CDH) plans. Yet most employers — and many plan providers — have no experience formulating their drug benefits when usage is driven from the bottom up and traditional benefit structures no longer work. Here's how your CDH plan can make the most of your employee pharmacy benefits.

CDH plans typically combine a high-deductible health plan (HDHP) with a Health Reimbursement Arrangement (HRA) or a Health Savings Account (HSA). Employees can first use the funds in these accounts to pay for their medical and pharmacy expenses. Once those funds are depleted, they must meet a high deductible (upwards of \$1,000 for single coverage). After the deductible is met, traditional health care coverage kicks in.

HRAs vs. HSAs. The main differences between HRAs and HSAs have to do with contributions and portability. With an HSA, both employers and employees can make pre-tax contributions to a fully portable account, meaning a person can transfer the entire balance to a new employer. HRAs typically are unfunded accounts that employees access only when claims are filed, which makes it easy for employers to restrict HRAs to specific health care expenses. Unused HRA dollars generally revert back to the employer when an employee leaves or when the CDH plan is discontinued. HSAs, by contrast, belong solely to the employee, and are funded with real dollars.

Beginning January 1, 2006, HSA-based plans may no longer have a separate carved-out pharmacy arrangement, so that employees will have to use the same account for their medical and pharmaceutical expenses. This may be good news for employers that want to reduce prescription drug costs quickly by encouraging employees to look more closely at drug prices. However, critics fear that by combining medical and pharmacy spending into one fund, participants may be less likely to purchase certain medications and thus shirk medication compliance. That, in turn, could lead to higher medical expenses and more hospital visits.

HRA-based plans can work around this by carving out a portion of funds for preventive care and including certain drugs in so-called "first-dollar coverage." And while HSA-based plans generally cannot cover pharmaceuticals outside of the deductible, drugs that are used to prevent an illness can be covered before the high-deductible amount is met, according to Treasury Department guidance released earlier this year.

Thus, for employees with chronic conditions, employers can offer a CDH plan that combines a high-deductible PPO with an HRA — and has a separate deductible for prescription drugs. Participants would pay a separate, smaller deductible on prescription drugs (e.g., \$100 vs. \$2,000 for medical expenses), with the plan paying the majority of their prescription drug costs through a tiered coinsurance system.

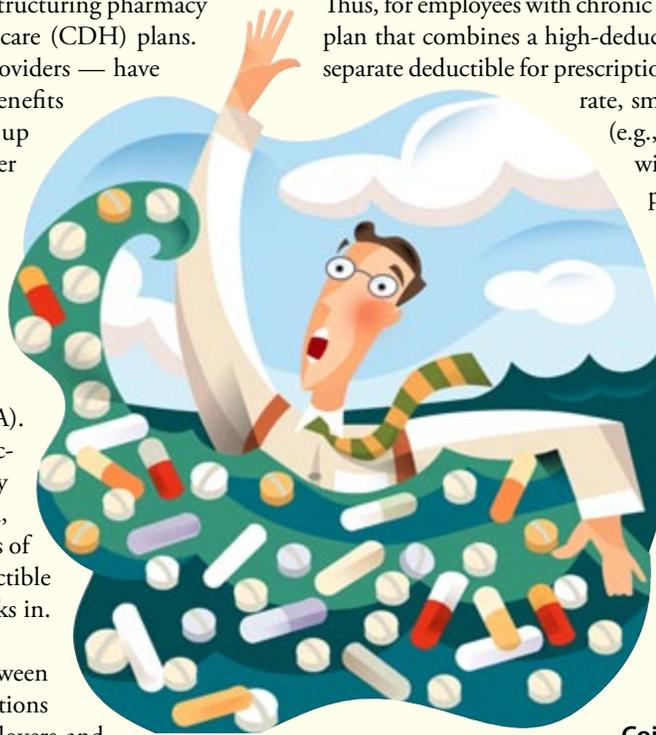
For nonchronic conditions, the copay and the balance above the copay would come out of the HRA until the deductible amount is met. After the deductible, drug coverage would be fully insured. This design works well for participants because nothing is different when they go to the pharmacy — they're still paying one of several copays — but they also understand that certain drugs are coming out of their HRA, which is there for more discretionary services.

Coinsurance. This design encourages employees to be better health care consumers by allowing them to see the actual cost of the drugs they are taking. Participants also have a separate out-of-pocket maximum (e.g., \$1,000 per person) for prescription drugs in addition to the deductible.

The approach is different from HRA or HSA models, where employees would first utilize those accounts and then have to satisfy the large deductible before the plan again begins paying a portion of prescription drug costs. Under the coinsurance model, the plan covers the majority of the prescription drug costs so employees can afford to take their medications. Combined with the insurer's disease management programs, this can enhance medication adherence.

Plans can also separate medications by therapeutic indication rather than by drug class. Employers can list certain chronic illnesses for which medications would be fully insured and the employee would be charged only a copayment. By focusing on the illness rather than the medication itself, the plan encourages appropriate utilization.

Information and incentives. Many plans, whether HRA-based or HSA-based, focus on providing participants with incentives and information to engage them in their health care decisions. Employers believe this can be equally as effective, or more so, than providing first-dollar coverage, which critics believe takes consumerism out of the pharmacy



Employee Vacation Time Benefits Employers Too

As the end of the year approaches, companies usually see a surge in requests for time off, driven either by the holidays or use-it-or-lose-it vacation-time provisions. That push is reinforced by employees' view that work/life balance is a critical factor affecting job satisfaction, according to a recent study by the Society for Human Resource Management. Yet data shows that the American vacation is shrinking — with adverse consequences for the workplace. Here's why time off is essential to worker productivity, and how you can encourage your employees to take the vacations they have earned.

It's no secret that Americans generally get less time off than their counterparts in other industrialized countries. Employees in European Union countries get four weeks of paid leave by law, for example, while most U.S. workers must work full-time for more than a year before earning two weeks of paid leave — a benefit that is not required by law.

These vacations are becoming even shorter as Americans take fewer days off than ever before. A 2005 survey conducted by Harris Interactive revealed that the average U.S. worker will leave three vacation days unused this year — up 50 percent from the two days given up in 2003. Heavy workloads, risk of termination, and employer attitudes toward vacation were the main reasons cited for skipping time off. And while nearly one-third of Americans do not use all their vacation days, most survey respondents said they feel rejuvenated when they do return to work after a vacation.

Worker health and productivity

Regular vacations lowered risk of death by almost 20 percent in middle-aged men, according to a study published in 2000 by the State University of New York at Oswego. Data from the Framingham Heart Study conducted over 20 years found that women who took two or more vacations a year cut their risk of a fatal heart attack by half. Evidence also shows that physical ailments can decrease or go away entirely during vacations, and they tend to stay away for a period after an employee returns to work.

Employee vacations benefit employers as well. Employee burnout rates decrease significantly during vacations and life satisfaction increases. After a vacation, many employees find their work more interesting and become more efficient at their jobs — and the rate of absenteeism actually decreases. Conversely, when people don't take the time off that they need, their health deteriorates — emotionally and physically — often resulting in medical expenses and more time away from the job than if the employee had taken some preventative rest time.

Workers worry about losing their jobs, and many feel that if they take a vacation, they could be replaced or someone could realize that they aren't really essential to their company. Sometimes there's an attitude in the workplace that it's the



“...data shows that the American vacation is shrinking — with adverse consequences for the workplace.”

lazy employees who take vacations. But taking time off has nothing to do with commitment, as workers are actually better employees when they do take time for themselves. Employers need to communicate that to their employees, and follow policies that are consistent with that message.

Time-off plans

With vacations shrinking, both workers and employers have begun to view flexible time-off plans as the best way to ensure that employees actually take days off when they need them. The typical paid-time-off program combines personal, sick and vacation days into one pool instead of more traditional vacation and sick leave packages. Some companies add on a number of paid holidays, with the total number of days off based primarily on tenure. Employees may “buy” or “sell” a certain number of additional days each year in order to take unpaid leave. Companies frequently permit rollovers into the following year, with a cap on the number of days that may be saved. Sixty-three percent of U.S. companies now use some form of flexible paid-leave bank, compared with 21 percent in 2000, according to the CCH 2004 Unscheduled Absence Survey.

Flexibility counts

Flexible time-off plans provide advantages to both workers and employers, and there is a positive correlation between these programs and employee

by the employer or charged directly against the assets of the plan. Some 401(k) providers bundle trustee and administrative costs into investment management fees, making them appear to be free. Ask your plan provider for a breakdown of those fees. Even if employers are not directly paying for trustee and administration costs, it doesn't mean that 401(k) plan services are priced competitively.

Calculating 401(k) Fees

- Asset-based:**
linked to amount of plan assets, expressed as percentages or basis points
- Per-person:**
tied to the number of eligible or actual plan participants
- Transaction-based:**
linked to a specific service or transaction
- Flat rate:**
fixed charge that doesn't vary with plan size

Participant services. There may be individual service fees associated with optional features offered under an individual account plan. Participant service fees may be charged separately to the accounts of those who choose to take advantage of a particular plan feature, such as taking a loan from the plan or executing participant investment directions.

Other fees may be linked to specific types of investments, particularly mutual funds. Revenue sharing occurs when a fund makes payments to a broker for the expenses it incurs to sell shares or provide other services. While these payments are frequently labeled "reimbursements," they nonetheless give the broker a greater incentive to sell the shares of that fund. Be sure to investigate these so-called hidden costs:

- ✦ **Commissions (loads)** are basically transaction costs for buying and selling shares. Ask your provider who receives these "finder's fees" for placing money in the fund or other investment, and what benefits they continue to receive.

- ✦ **12b-1 fees**, also called distribution payments, are annual fees charged by most funds to pay brokers' sales commissions, advertising and promotion expenses and costs related to account services. The 12b-1 fee is generally paid out of fund assets and typically ranges from 0.25 percent to 1 percent. You should have signed a disclosure form detailing the basis points charged as a 12b-1 fee for each fund in your plan.
- ✦ **Sub-transfer agent fees** are earmarked to pay the provider for participant servicing work it does on behalf of the fund. Expressed either as a percent of assets or as a per-participant fee, these payments can reach .65 percent of assets or \$18 per person per fund per year. You need to know if your providers are receiving sub-transfer agent or shareholder servicing revenues, and if so, if the revenues are offset against the costs as described in your service agreement. Check to see if you have signed a disclosure form that specifies each type of fee.

Due diligence

Plan sponsors should ask providers for an annual written statement describing all compensation — both direct and indirect — the provider receives for plan services. With these figures in hand, compare with other funds. Consistently monitor plan fees and expenses to determine whether they are fair in view of services received. You should also periodically monitor asset-based fees. Fees can grow with the size of your plan's assets, regardless of whether you receive any additional services.

Carefully evaluating plan fees and expenses are part of a plan fiduciary's duties. There is no law that requires disclosure of any revenue-sharing, so you may never know the exact total the provider gets from your plan. But you will have fulfilled your fiduciary responsibility by going through the process. And plan participants will have more financial security in retirement. □

benefit equation. Financial incentives for consumers to engage in better lifestyle behavior can include payments to complete a health risk assessment, enroll in "health coach" programs, and utilize Web-based information on prescription drug costs or other communications regarding participants' conditions.

Behavior toward pharmaceutical spending and usage doesn't change overnight. But the right pharmacy benefit can go a long way to helping you achieve better utilization and lower drug costs — without sacrificing health-care quality. If you would like more information on designing a CDH plan with the best pharmacy benefit for your employees, please contact us. □



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morale. Employees like the plans because there are times they need to be away without it being a reflection on their dedication to the job. The employer can eliminate situations where employees are calling in at the last minute pretending to be sick when in fact they could have called in ahead of time.

Most companies do require that all time off be pre-approved and, as a rule, limit the number of employees who may be out on a given day. This may make the situation a lot less flexible than it sounds, especially for employees without seniority. But employers say that having this control allows them to balance workers' time off so that it does not adversely affect productivity. While there will always be those who still call in at the last minute, these programs create an environment where employees receive more notice than under traditional plans.

Regular vacations are preventive medicine — they cut down on stress-related illness and save health care dollars. If you want to attract and keep loyal, committed and healthy employees, make sure your company supports time off, both in policy and in practice. □