Ancillary Benefit Plans—Day 1

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International Foundation OF EMPLOYEE BENEFIT PLANS

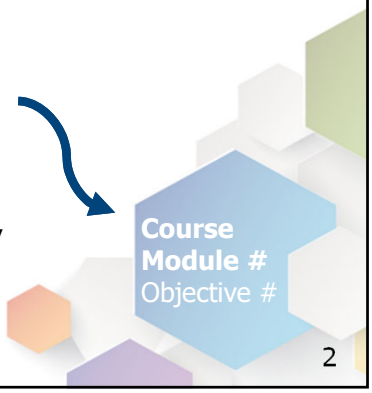
The CEBS Program

The International Foundation's highest educational achievement is its Certified Employee Benefits Specialist (CEBS) designation

The program is highly regarded by the industry and comprises five self-study courses (each with an exam) that provide deep technical knowledge of employee benefits. Most people complete the designation in about three years

Many people are intimidated by the program, but we would like to take some of that fear away. The CEBS icon that you will see in the corner of some slides indicates that the following topics overlap with CEBS content

While participation in employee benefits courses does not count towards getting the CEBS designation, this course may make the material feel more approachable if you decide to pursue the CEBS program in the future



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Introduction

- Tell us who you are and what you do
- Tell us what you want to get out of this course
- Tell us why someone would want to work for your organization

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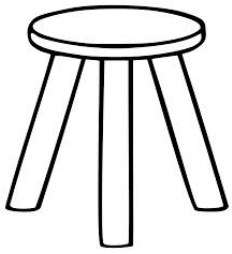
Agenda

- Why provide ancillary benefits?
- Benefit plan design
- Integrating and implementation considerations
- What's happening today
- Future



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Ancillary Benefits

- Ancillary benefits are insurance and benefit plans that help round out the health insurance component of an employee benefits program
- These benefits can be fully or partially sponsor funded or offered on a voluntary basis (employee pays for all the coverage)

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Holistic Benefits Approach

- If properly designed and communicated, the added options enable employees to make optimal choices for their families and finances

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Benefit Terms

- Voluntary as an ancillary benefit
- Discounted services
- Lifestyle benefits
- Work-style benefits
- In-house services
- Access to on-line benefits
- Overall considerations

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Ancillary and in Some Cases Voluntary Benefits Include (But Not Limited to):

- Group life insurance including accidental death and dismemberment insurance (AD&D)
- Disability coverage
- Enhanced paid time off benefits
- Dependent care, educational and adoption benefits
- Long-term care insurance
- Dental coverage
- Enhanced or stand-alone vision coverage
- Long-term care insurance
- Enhanced carved out benefits (*i.e.*, EAP)
- Pet insurance
- Hearing assistance
- Other voluntary benefits (*i.e.*, cancer policies, group property insurance)

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Terms and Framework

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Discount/In-House Services

Some Examples

Services

- Preferred banking/mortgage
- Real estate discount
- Financial planning discount
- Tax preparation
- Discount products (*e.g.*, vision)

On-Site Programs

- Company store
- Company services
- Meals to go
- Dry cleaning pick-up
- Prescription drug pick-up
- Sick child room
- Car maintenance

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Lifestyle Benefits

- Group auto and homeowner's insurance
- Excess liability "umbrella" insurance
- Identity theft protection
- Destination guidance (relocation)
- Pet health insurance
- Legal services
- Vacation club
- Credit union
- Cell phone and computer purchase program

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Work/Life Benefits

- Telecommuting
  - Access to PCs
  - Enhanced communications
  - Job-specific guidelines
- Flex hours
- Job sharing
  - Complementary positions
  - Realistic career expectations
- Space sharing
- Relaxed work environment
  - Casual dress
  - Raffles/group events
  - Maintaining a "fun" environment
  - Pet-friendly offices
- Accessibility to management
- Foreign assignments
- Sabbaticals
- Unlimited vacation/ vacation minimums

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In-House Services

- Travel planning
- Gifts during holiday seasons
- Gift wrapping
- Gifts on special days
- Mail service, especially during holidays
- Massage therapist in building
- Haircuts/stylists
- Housekeeping services
- Lawn care service
- On-site medical/dental clinic

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Access to Online Services

- **Work and life services**
  - Employer assistance
  - Services portal
  - Online library
  - Child, parent, elder care
- **After work services**
  - Some work/life assistance
  - Financial services
    - *e.g.*, CarFindUSA, ZipRealty
  - Family services
    - *e.g.*, AdoptionNetwork, AuPair Search
    - Sick childcare
  - Discount shopping

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Access to Online Services

- Product marketing
  - Auto/home insurance
  - Lawn services
  - LTC
  - Dental
  - Pet insurance

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Reasons Why Ancillary Benefits Are Gaining in Popularity

1. Voluntary benefits, such as gym memberships, help employees stay healthy and thus a happier and more productive employee
2. When employees can reduce stress, they can focus and produce more readily
3. Benefits, such as identity theft restoration and monitoring services, legal services, financial planning services and critical illness insurance tell employees that their employers care about their whole selves
4. Employees are more loyal employees when they are valued and perceive it as such
5. Opt-in benefits help meet both personal and professional goals and bridge the gap between insurance coverage and actual needs
6. Some voluntary benefits can be paid with pre-tax income

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Source: https://blog.ifebp.org/employee-attraction-and-retention-through-voluntary-benefits

Overall Considerations

- The employer should focus on:
  - Aligning workforce needs and business objectives
  - Targeting benefits
  - Calculating cost of "no cost" benefits
  - Developing communications
  - Meeting employees "where" they are

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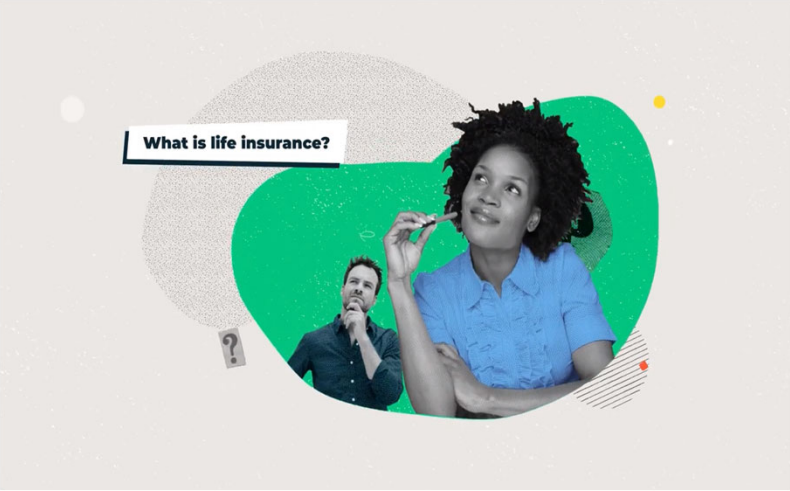
Life Insurance



Life Insurance 101

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Life Insurance

Before the value of a life insurance programs can be determined, we need to distinguish between the characteristics of term and whole life insurance

We also must be able to understand the advantages and disadvantages associated with group life insurance benefits

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Life Insurance Benefits

- Life insurance (for worker or dependents) is the most common type of voluntary benefit offered. In 2026, 74% of survey respondents offered this benefit

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Source: Employee Benefits Survey: 2026 Survey Report-Member Benefit

How Much Insurance to Own?

1. Human life value approach
2. Needs approach
3. Capital retention approach

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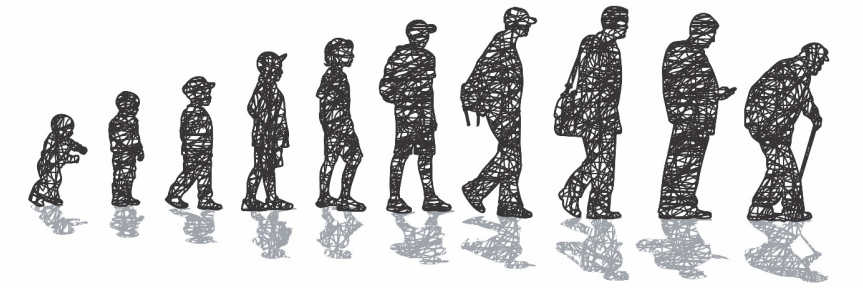
How Much Insurance to Own?

1. **Human life value approach:**
   - Present value of the family's future share of the deceased breadwinner's future earnings



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How Much Insurance to Own?

2. **Needs approach:**
   - The various family income, financial assets and needs are studied

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How Much Insurance to Own?

3. **Capital retention:**
   - Approach estimating the amount of life insurance to own; Preserves the capital needed to provide an income to the family

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Interactive Calculators

Employees may see:

- The need of **how much they should have**
- But if they then cannot see a way to afford meeting the need, **they may go without adequate coverage**
- **Opportunity cost of buying life insurance:**
  - The purchase of life insurance reduces the amount of discretionary income a family has for perceived and genuine immediate needs

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Review of Types of Programs

- Employee life insurance
- Supplemental life insurance
- Dependent life insurance
- Whole Life Insurance
- Group universal life (GUL)
  - Mandatory
  - Voluntary

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Types of Life Insurance

- Term
- Permanent
  - Whole life
  - UL (Universal life)
  - VL (Variable life)
  - VUL (Variable universal life)

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Types of Life Insurance

- Note: There are group versions (*i.e.*, group term, group universal life and group variable universal life) marketed. Here the master policy (contract is with the employer and the participants get certificates)
- There also may be individual policies sold to a group with some pricing or underwriting concessions but still are individual policies with no master employer contract

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Types of Life Insurance

- Although there is group ordinary (permanent) whole life and other whole life variations such as group paid up life and level premium group permanent group, they have not been aggressively marketed over the last 20 years, but many older policies sold are still in force
- These programs are beginning to make a comeback as people search for a way to increase the value of employer paid life insurance

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Term Insurance Variations

- Yearly renewable term
- Five-, ten-, 15-, or 20-year term
- Term to age 65: What happens then?
- Decreasing term
- Re-entry term: How is the rate determined if the insured's health changes?

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Uses of Term Insurance

- Income limited
- Temporary protection
- Sometimes conversion features
- Guaranteed future insurability
- Limitations of term insurance:
  - Not suitable for lifetime protection

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Ordinary (Permanent) Whole Life Insurance

- Provides lifetime protection to an age 100 (120 on many modern policies) and death claim certainty
- Lifetime protection
- Integrated cash value element
- But a limitation of ordinary life insurance is that some persons are under-insured after the policy is purchased since they do not purchase as much as they truly need due to the cost
- While in the past may have been sold as part of a group policy . . . For the past two decades has primarily been individual policies only

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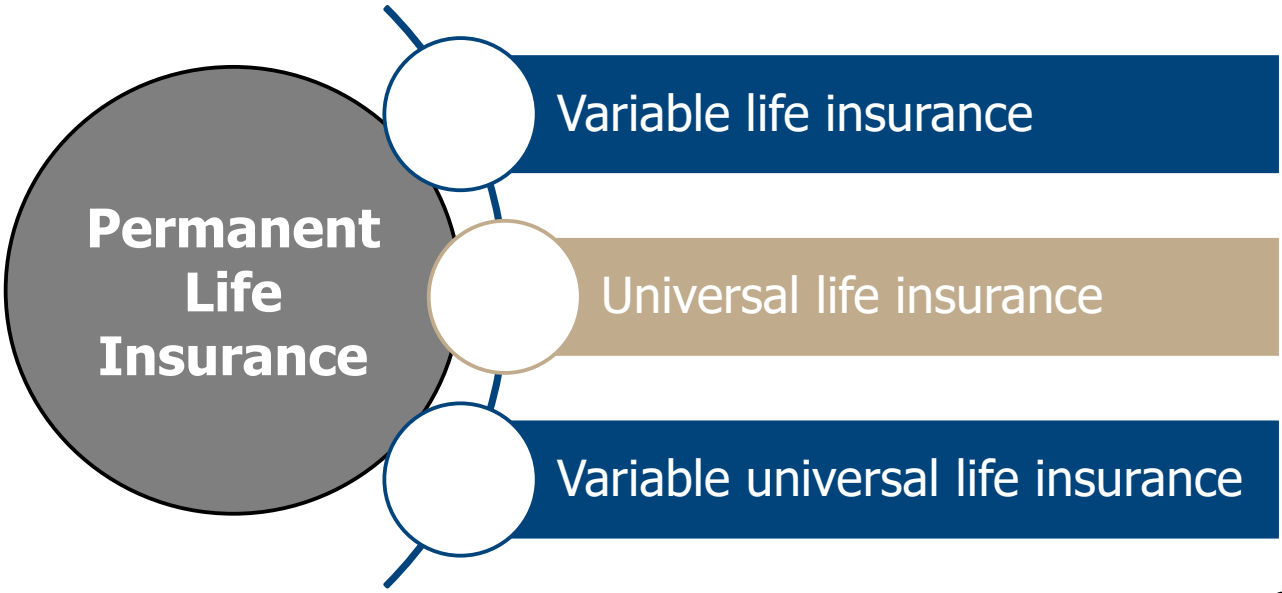
Variations of (Permanent) Life Insurance



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Variable Life

- Fixed premium policy:
  - A variable life policy is fundamentally a whole life policy with a fixed premium
- As such, there are no guarantees with respect to cash surrender value
- Death benefit and cash surrender values vary according to the investment experience of a separate account maintained by the insured

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Universal Life

- Flexible premium
- Provides lifetime protection
- Separates the protection and savings components with unbundled components of mortality, expenses and interest
- There are guarantees with respect to cash surrender value

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Universal Life: Flexibility

- Policyholder determines frequency and amount of premium payments
- Death benefit can be increased or decreased
- The policy options can be changed
- Cash can be added to the policy
- Loans and withdrawals are permitted
- Some policies permit additional insureds to be added to the policy
- Favorable income-tax treatment

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Universal Life: Limitations

- Some advertised rates of return are gross and not net rates
- A decline in interest rates has made illustrations of previous universal life policies misleading or inaccurate
- Mortality charges may be increased
- The flexibility of a universal life policy may also be a drawback in that the policy owner does not have a firm commitment to pay the premiums

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Variable Universal Life (VUL)

- Similar to a universal life policy with two exceptions:
  - Policy owner determines how premiums are to be invested
  - Policies do not have a minimum interest rate or cash value

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Group Universal Life (GUL)

- Master contract with certificates (not policies)
- Term-life coverage as a multiple of pay/earnings of insured
- Availability of side-fund investment
- Side-fund used for:
  - Tax sheltered investment
  - Loans
  - Premium payments
- Portability is available—No need to convert the certificate to a policy
- Popular with executive groups (*i.e.*, law firms for partners)

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Group Universal Life (GUL)

- May be employer coverage (for the base mortality and monthly fee)
- May be guaranteed to issue, or simplified issue
- Offers high flexibility with "little" employer cost
- Side-fund can be used to offset retirement costs
- Program may be completely portable
- Administration no longer complex, requiring third-party assistance
- However, history says, low percentage of employees actually utilize the side fund
- Program can compete against 401(k)
- Favorable tax advantages if structured correctly

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Group Life Mechanism

Noncontributory Plan Advantages

- All employees insured
- Simplicity of administration
- Economy of installation
- Greater control of the plan
- Potentially guarantee to issue to some amount and simplified underwriting up to yet another amount

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Group Life Mechanism

Contributory Plan Advantages

- Larger benefits possible
- Employees may have more control
- Greater employee interest
- May have more underwriting than noncontributory plans

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Group Mechanism

- Group insurance makes use of a master contract, and insured individuals receive a certificate of coverage outlined in the summary plan description
- The plan may last long beyond the lifetime or participation in the group of any one individual

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Factors to Consider

- Employee's needs
- Overall cost of the plan
- Non-discrimination requirement of the law
- The employee's ability to pay if the plan is contributory
- Underwriting concessions
- Who owns the insurance?

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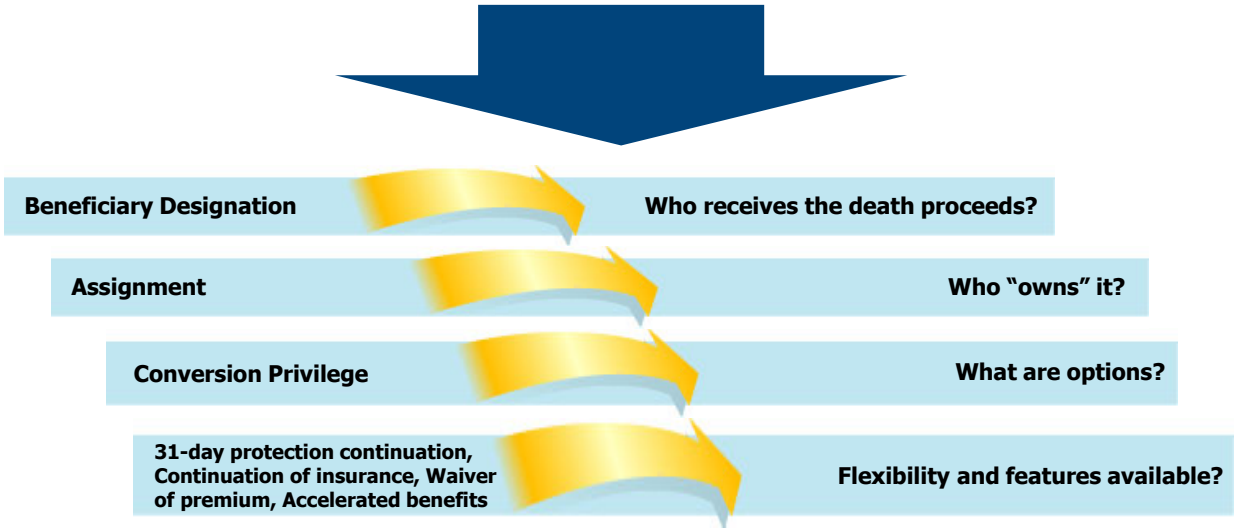
Group Term Life Insurance Provisions



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Dependent Group Life Term Insurance Coverage

- Dependent group term life insurance coverage:
  - There is tax regulation with respect to employer paid benefits allowable without tax implication, so often limited to $2,000 for the dependents to minimize potential imputed income

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Source: https://www.irs.gov/government-entities/federal-state-local-governments/group-term-life-insurance

Dependent Life Design

- Single sum amount
- Employee paid coverage defined by relationship:
  - $100,000 spouse
  - $10,000 child
- Multiple of pay

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Advantages of Coverage

- Traditionally offered by employers
- Relatively low-cost benefit
- Group products typically lower cost than individual coverage
- High potential benefit
- Ease of enrollment:
  - Often guaranteed issue, or
  - Guaranteed to issue if active at work, or
  - Simplified underwriting thresholds depending on amount

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Employer Advantages

- Employee morale and productivity may be enhanced
- Coverage is necessary for competitive reasons
- Life insurance protection is an aid in attaining good public employer and employee relations
- Big potential value for limited cost

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Employee Advantages

- Adds a layer of low-cost protection to personal savings
- Helps to reduce anxieties about the consequences of employee's possible premature death
- If non-discriminatory, employer contributions in employer pay all plans, for amounts of insurance less than $50,000 do not trigger income considerations
  - The excess is taxes according to what is called Table I

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IRS Table I—Cost Per $1,000 of Protection For One Month

Age	Cost
Under 25	$ .05
25 through 29	.06
30 through 34	.08
35 through 39	.09
40 through 44	.10
45 through 49	.15
50 through 54	.23
55 through 59	.43
60 through 64	.66
65 through 69	1.27
70 and older	2.06

The total cost to include in the employee's wages if by multiplying the monthly cost by the number of full months' coverage at that cost.

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Source: https://www.irs.gov/pub/irs-dft/p15b--dft.pdf

Additional Employee Advantages

- Payroll deduction, if contributory
- Usually has a conversion privilege
- May be portable, although the rates may change by class
- Liberal underwriting

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Disadvantages of Group Term Life

- The employee has no assurance that the employer will continue the group policy in force
- Coverage may be merely convertible, and not always portable (and even if portable, not necessarily at the same rate as the group had)
- There is no equity build up

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Considerations

- What is the purpose of life insurance?
  - To fund burial? Estate planning?
- What role should the employer play in this coverage?
- Should there be a minimum amount available?
- Should employees be restricted in the amounts they can select?
- Should this be an employee's sole source of coverage?
- What role should dependent life insurance have in employee planning?

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Sample Design

- Employee Life
  - Employer-paid benefit: 2x pay
  - Employee choice: 1x to 5x pay
    - Actual cost based upon age and pay
    - Selection of 1x pay generates a "credit"
- Dependent Life
  - Typically, not employer-sponsored
  - Employee-provided selection option

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Advantages of Coverage

- Traditionally offered by employers
- Relatively low-cost benefit
- Group products typically lower cost than individual coverage
- High potential benefit
- May be portable/convertible

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Reference Slide: Benefit Levels

	Basic Employee	Basic Employee	Optional Employee	Optional Employee	Dependents
Types of Coverage	Term	GUL	Term	GUL	(Usually with term)
Typical Benefits	Flat dollar Multiple of salary	Flat dollar Multiple of salary	Flat dollar Multiple of salary	Flat dollar Multiple of salary	Flat dollar
Typical Benefit Design	50K 1-2 x Salary (250K cap) Cap may be as high as 3 million depending on size of group)	1-5 x Salary—50K 1-5 x Salary	1-5 x Salary Multiple of 10K often caps of 500K	1-8 salary, Minus the basic multiples of 250K/500k, etc. Up to 5 million+, (Underwriting greater)	2,000-100,000 spouse 2,000-20,000 child

- Employer sets core coverage under flex
- Employee allowed to buy up on the term or GUL or buy down some of the term
- Most GUL carries do not encourage the buy down due to adverse selection and the high faces amounts involved

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Accidental Death and Dismemberment

- Provides a lump sum payment if there is death, or a portion of the body is lost as result of an accident
- Double Indemnity:
  - If one has life insurance and AD&D, and death occurs, both benefits are paid to beneficiaries
- Often an employer gives a base, and the individual can voluntarily choose supplemental coverage for oneself and eligible dependents by paying additional monthly premiums
- AD&D coverage never requires any proof of good health, and can be added or dropped at any time

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Enrichment Links

- Human Life Calculator:
  http://www.lifehappens.org/human-life-value-calculator/
- Permanent Insurance Overview:
  https://lifehappens.org/life-insurance-101/permanent-insurance/
- Employer's Tax Guide to Fringe Benefits
  https://www.irs.gov/pub/irs-pdf/p15b.pdf

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Learning Checkpoint: Life Insurance Card Game

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Disability Insurance and Workers' Compensation

Disability Insurance 101

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Disability Insurance (DI)

Support for people dealing with a disability can come from many places

It's important to understand the government requirements put on Social Security Disability Insurance (SSDI) benefits, as well as the typical provisions of group short-term and long-term disability policies and coverage

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The Dramatics of Disability

- Loss of income because of disability is among the most devastating losses a person can face
- Disability protection is undoubtedly among the most valuable of employee benefits
- At the same time, there are additional associated costs from disability

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Cost of Disability

Direct Costs	Indirect Costs	Administrative/Disability Management Costs
Sick Leave	Replacement workers	Claim management
FMLA	Training	Communication
State mandated leave	Overtime	Loss prevention
STD	Lost productivity	RTW programs
LTD	Other	EAP
Workers' Comp.		Health management
Related medical costs		Coordination and administration of state mandated paid leave with in-house disability programs
= Total Cost of Disability		

Source: The Total Financial Impact of Employee Absences(2008)
SHRM/Kronos Executive Summary: Total Financial Impact of Employee Absences in the U.S. (2014)

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The Dramatics of Disability

- Assuming a 3% annual increase in salary due to cost of living and promotions, a 40-year-old individual earning a gross salary of $50,000 will forego almost $1.9 million in today's dollars if he or she is disabled and is not able to return to work before the age of 65

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Source: BLS Employment Cost Index Data, U.S. Bureau of Labor Statistics, Employment Cost Index Summary

Disability Coverage Exposures and Objectives of Coverage

- Disability exposures (risks due to disability):
  - Disability—No income
  - Disability—Medical costs (before/after COBRA)
  - Funding retirement
- Three major objectives in offering disability benefits:
  1. Provide some level of income replacement to employees in the event of illness or injury
  2. Provide a competitive benefits package
  3. Provide a vehicle for getting employees back on the job at the appropriate time

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Overview of This Section

- The historical overview of disability income policies
- Public sector and private disability programs
  - Integration of these 2 programs
- Elements in plan design:
  - Factors affecting incidence of disability
  - Plan funding and management

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Key Term: Financial Impact of Disability Risk

- The risks of both short-term and long-term disability increase with age
- Disability is a ***low-incidence*** event in comparison to some other insurable events
- However, if one makes the same comparison in terms of ***impact***, disability is a dramatically more serious financial threat

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Current State and Federal Programs

- Social Security (SSDI/SSI)
- Old-Age, Survivors, and Disability Insurance (OASDI)
- Workers' compensation (WC)
- Veterans' benefits
- State retirement systems
- State-mandated (short term) plans

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Five Conditions to Qualify for Social Security DI (SSDI)?

1. The person is insured. Generally, this means the person has worked under Social Security five of last ten years
2. The person is under the age of 65
3. The person has been, or is expected to be, disabled for at least 12 months or has a condition that is viewed as resulting in death

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Five Conditions to Qualify for Social Security DI (SSDI)? *(continued)*

4. The person has filed an application for disability benefits
5. The person has met a five-month waiting program, unless exempted

(Note: The *amount factor* (PIA) is defined by Social Security. The amount is determined as if the worker were at *normal retirement age* (67 under current law-2026) and eligible for benefits in the *first* month of his or her waiting period)

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SSDI Compared to Supplemental Security Income (SSI) Program

- Although the SSDI and SSI programs are both administered by the Social Security Administration, their funding and eligibility differ

The SSDI program is funded by both employers and employee contributions while the SSI program is funded through general revenue of federal government

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SSDI Compared to Supplemental Security Income (SSI) Program

- As for eligibility, nearly all workers are eligible for disability income under the SSDI program
- The SSI program, however, is a need-based program that makes cash payments to disabled individuals who fall under designated income thresholds

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Disability in SSDI

- The currently available SSDI disability programs provide a modest, yet important, foundation of disability income protection to the working population of the United States and are likely to undergo significant changes as the federal government
  - State sponsored programs many also see government's need to attempt to deal with the programs' budget problems

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Disability and Social Security

- Social Security reforms include raising the eligibility age and eligibility criteria
- Social Security disability income benefits are available for both occupational and non-occupational
- Workers' compensation has already been changing
  - Some states have enacted reforms intended to lower costs and stabilize the market

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Disability and Other Programs

- Veterans' benefits continue to be a vital part of the disability plan makeup
- There are some state retirement systems (in lieu of Social Security) giving some disability coverage

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State-Mandated Short-Term Programs

- **Modest programs that provide or require employers to provide benefits for STDs to all workers**
- The 5 important features of the state mandated disability portion of the programs are:
  1. The eligibility point for disability benefits varies from immediate up to five years of service although some states require ten years of service
  2. The benefit levels frequently are based on a service-type formula, such as 2% of salary for each year of service times a final average salary up to a maximum percentage of salary, but some states use straight formulas
  3. Benefits usually are paid to the age of 65 and
  4. The definition of disability usually is permanent and total disability, similar to that of Social Security
  5. State mandated disability is being evaluated for mandate continuously

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Integration Issues

- Many private employer-sponsored group disability plans are integrated with state and federal programs
- The income replacement remitted under private plans usually reflects income replacement that was not available from state and federal public programs or is an addition to payments received under state and federal programs
- The most significant exception to this rule is the payment of veterans' disability income benefits
- These benefit levels normally are provided regardless of benefits received from other programs

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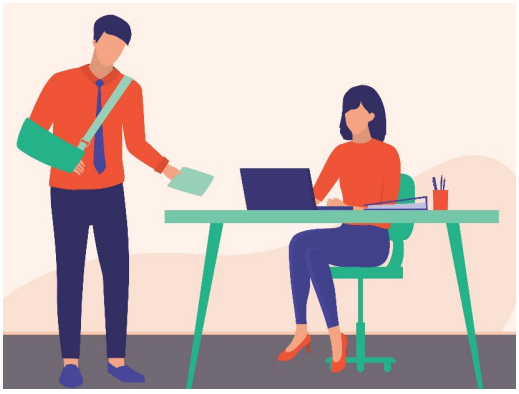
Disability Programs

- Sick leave
- Short term disability (STD)
- Long term disability (LTD)
- Integrated disability
- Voluntary disability



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Approaches in Design

- Sick leave: *i.e.*, ten days a year but they can accumulate
  - Some nonpublic plans do not allow the rollover
- Short term, historically, you had to have been ill a certain number of days (typically five) or were in a non-job related accident
  - The waiting periods before short-term benefits begin will vary among employers
  - The waiting periods along with the levels of income replacement tend to be structured to discourage malingering
  - Most STD plans pay a portion of income up to 26 weeks

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STD and LTD Comparison

	Short-Term Disability (STD) Insurance	Long-Term Disability (LTD) Insurance
Start of benefits and duration of coverage	STD benefits may start with the first day of disability but typically begin after no more than a week of disability. Benefits may last for only 90 days or up to 52 weeks	LTD benefits are usually designed to begin when STD benefits end and may last until normal retirement age
Definition of disability	STD benefits are based on the inability of the employee to perform their own occupation	Some LTD plans use the "own occupation" definition until the employee reaches normal retirement age. Other LTD plans use the "own occupation" definition for the first two years of disability. Still other LTD plans have more restrictive definitions from the start of disability

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STD and LTD Comparison *(Continued)*

	Short-Term Disability (STD) Insurance	Long-Term Disability (LTD) Insurance
Amount of benefit payment	STD plans vary with some paying 55% of income or less and others paying up to 100% of income	Most LTD plans pay between 60% and 70% of current or recent earnings
Cost of insurance	Many STD plans are provided at no cost to employees, which makes the benefits taxable and calls for a higher benefit percentage in order for the employee to maintain their standard of living	Some LTD plans are provided at no cost to employees, but most require the employee to pay some or all of the premiums. When the employee pays the full premium, the benefits are not taxable, which means a lower benefit percentage is needed to maintain the employee's standard of living

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Sick Leave Coordinated With Short-Term Disability

- If short-term disability pays, for example, 60%, some employers will allow employees to get the missing 40% (in this example) from the employee sick day bank
  - If the bank is empty, some employers even allow peer employees to donate vacation days to the bank to help a coworker
- Some criticism is that the employee may not be motivated to get back to work
  - Others say that the help results in a positive spirit which helps motivate worker to get back

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Taxation

- STD payments are considered wages and are subject to income tax, Social Security and unemployment taxes
- Traditionally, unlike STD benefits, true LTD benefits are not subject to Social Security and unemployment taxes in most cases

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Is LTD Taxable?

- LTD benefits are subject to federal taxes when the premiums are employer paid (pre-tax)
  - In the circumstances where the employees paid for a disability plan with their own after-tax (post tax) dollars, benefits are income tax free
- When a portion of the plan was paid by the employer and a portion by the employee with after-tax dollars, the proportion of plan benefits funded by the employer is taxable income

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Design Considerations

- Choice
  - Found more often with LTD rather than STD
  - Option offered in terms of benefit levels and benefit payment maximums
- Taxation
  - While employee contributions can be pre-tax, contributions made on after-tax basis avoids taxation of benefit payments received

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Common STD/LTD Replacement Ratios

- Most STD plans replace between 50% and 66.6% of income
  - A limited few do it off take-home pay
- LTD plans vary. Some replace 50% to 66.6% of gross income. Others replace from 75% to 80%

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Voluntary Disability Insurance (DI) Coverage

- Usually sponsored by employer and ***fully*** paid for by employees
- Voluntary disability coverage has increased in popularity, as workers better understand ***disability*** risks

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Group Size

- In general, individuals, small groups and extremely large groups tend to produce the highest incidence of disability
- Anti-selection (adverse selection) plays a significant role in incidence in small groups, (those disability prone may try to get disability coverage from a small group—Or even "create/form" a small group when they fear an impending disability)
- Some carriers feel that lack of internal employer controls are the attributable factors for extremely large groups having higher than average disability claims
- Many LTD carriers may require at least ten participants in a group plan and apply individual underwriting to small groups

89

Age as a Factor in DI Plan Design

- Age has a direct correlation to the incidence of disability, and the age of a group is the key factor in determining its disability income rates
- Not only do younger workers experience fewer incidences of disability than do older workers, but they also have greater motivation for both rehabilitation and retraining
- However, it is discriminatory under the ADEA

90

ADEA

- Age Discrimination in Employment Act (ADEA) to determine eligibility based on age:
  - There is no problem with determining eligibility based on years of service
  - This is not a discriminatory practice under ADEA since all employees have access to the plan once they have been employed for the predetermined amount of time

91

ADEA

- Under ADEA, benefit programs can define benefit periods without discriminating against the older employee
  - The contract can specify the maximum number of months of income replacement for other older employees
  - The key issue is that this benefit period must provide cost-equivalent benefits when compared to benefits of younger workers
- ADEA also specifies that employees aged 70 or older must receive a minimum of 12 months of disability benefits

92

Pre-Existing Clause

- Pre-existing condition exclusion clauses in LTD plans are used to minimize the risk of ADVERSE SELECTION while typical in short-term plans, they are common in LTD plans because of the increased exposure

93

Understanding Preexisting Clause

- Under a pre-existing condition exclusion clause, a plan might refuse to pay for a disability if the insured files a claim within 12 months after joining the plan and, in the three-month period before joining the plan, had been treated for the condition being claimed as a disability
  - *i.e.* If the individual received care, treatment or took prescribed medication during that three-month period for a condition that is now claimed as a disability, the insurer will not pay benefits

94

Gender Claim Frequency in DI

- Women have a higher incidence of disability than do men at younger ages but a lower incidence at older ages

95

Occupation DI Claim Frequency

- The relationship between occupation and claim frequency is less delineated, and claim frequency varies from one occupation to another
- It is true that blue-collar workers face more physical hazards on the job. However, adverse economic conditions or major changes in the job environment of professional groups can increase the incidence of disability for professional groups

96

Employer Issues in Funding LTD

- Risk in a disability income benefit plan
- Because LTD is a catastrophic coverage, employers must be extremely cautious when making decisions of whether to fully self-insure this kind of risk

97

Employer Issues in Funding LTD

- Factors that should be considered are:
  1. Size of the employee group
  2. Structure of the plan
     - Exposures
     - Stop-loss insurance
     - Special design components

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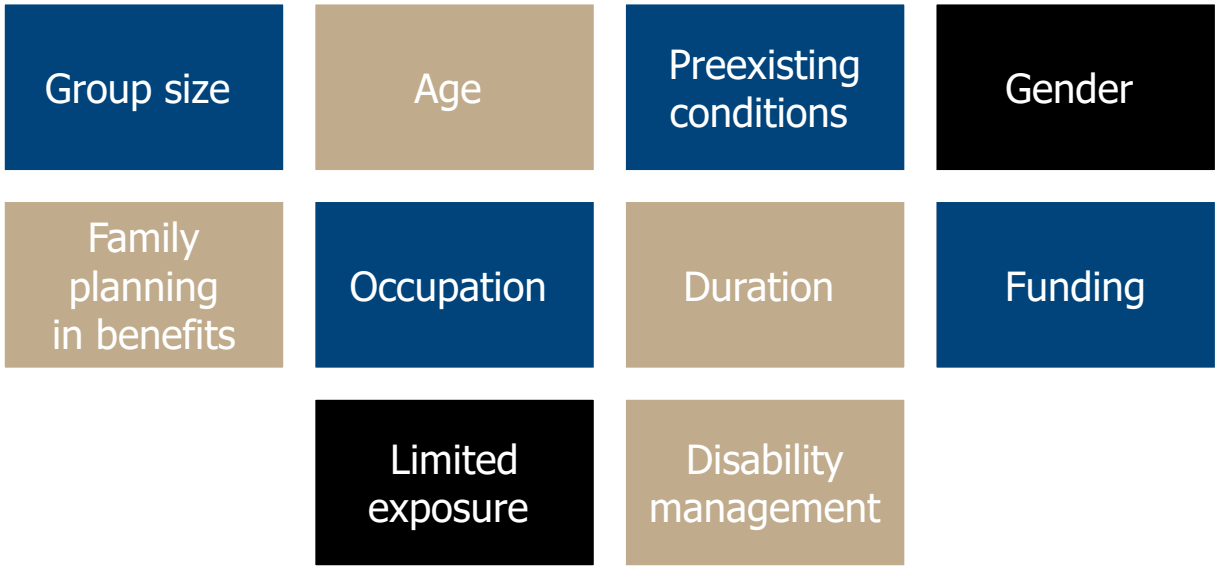
Elements in Plan Design



99

Disability and Workers' Compensation (WC)

- Workers' compensation is changing. Some states have enacted reforms intended to lower costs and stabilize the market. More recently, some states and businesses have turned to 24-hour coverage plans which integrate disability management, workers' compensation and group health insurance in a single program
- Workers' compensation programs provide the most comprehensive level of coverage. These apply only to work-related disabilities, which account for less than 10% of total disabilities that last for more than 90 days

100

Overview Concepts

- Workers' compensation programs provide:
  1. ***Cash benefits***,
  2. ***Medical care*** and
  3. ***Rehabilitation services*** to workers who experience work-related injuries
- Each state has a workers' compensation statute
- There are several federal programs
- Jurisdiction differences vary in ***weekly federal amounts*** and ***durations*** of cash benefits

101

Current WC "Principle"

- The employee only has to prove the injury is "work related"
- Employees usually cannot bring tort (pain and suffering suits) against their employer

102

Why States Control WC . . . Somewhat

- The U.S. Supreme Court's original narrow interpretation of the commerce clause to limit the ability of Congress to regulate matters those were not directly in interstate commerce
- But the Supreme Court changed its interpretation of the commerce clause in the 1930s so that the federal workers' compensation statute covering all private sector workers would be constitutional

103

Time-Off Programs

104

Key Concept

- Paid-time-off benefits have an impact on the employer's . . .
  1. Recruitment efforts
  2. Employee relations
  3. Productivity
  4. Profitability

105

Types of Time Off

There are various forms of time off offered to employees, some mandated by state or federal laws, others provided by employers as a part of a benefits package

- Holidays
- Vacation
- Paid time off (PTO) policies
- Medical absence (short- and long-term)
- Personal time
- Bereavement
- Jury duty
- Sabbaticals
- Forced leaves of absence (certain industries)

106

Time Off Considerations for Remote Workers

- Overworking Concerns-
  - When workers do not see their colleagues leave the office, they may not have a clue to call it a day
- Lack of clear boundaries to switch off work for personal life, especially if commission and bonus driven
- Communication challenges-
  - Addressing the need to respond immediately
- Team dynamics/interpersonal interactions can be hampered
- Guilt to take a stay vacation at home and workload
- Is it an issue with staff who do remote work while at a beach house and work on vacation?
- Optimal ways to access workload and personal needs balance

107

Learning Checkpoint: Discussion Activity-Handouts

- Unlimited Time Off: Blog (handout page 1)
- IFEBP 2026 Employee Benefits Survey-Paid Holidays Offered (on next slide and handout page 2)
- Paid Leave in the Workplace Survey: 2024 (booklet)

108

Survey Says

TABLE 65

Paid Holidays Offered*

	Overall n=384	Corporations n=319	Public Employers n=65
New Year's Day	98%	97%	100%
Martin Luther King Jr. Day	65%	60%	89%
Presidents' Day	44%	41%	57%
Cesar Chavez Day	1%	1%	2%
Good Friday	23%	24%	22%
Easter	13%	13%	11%
Easter Monday	3%	3%	3%
Memorial Day	92%	92%	97%
Juneteenth (June 19)	44%	41%	60%
Independence Day (July 4)	96%	95%	98%
Day after Independence Day (July 5)	13%	13%	8%
Labor Day	94%	94%	95%
Rosh Hashanah	2%	2%	2%
Yom Kippur	2%	2%	2%
Columbus Day/Indigenous Peoples' Day	13%	12%	17%
Veterans Day	32%	24%	69%
Thanksgiving Day	97%	97%	98%
Friday after Thanksgiving	70%	68%	82%
Christmas Eve	52%	52%	55%
Christmas Day	96%	95%	98%
Full week between Christmas Day and New Year's Eve	10%	9%	14%
Kwanzaa	0%	0%	0%
New Year's Eve	32%	33%	26%
None, no paid holidays offered	2%	2%	0%
Average (days)	*10*	*10*	*11*

*Respondents were asked to select all that apply.

Communicating Consumerism

110

Why Communicate?

- To protect
  - Legal compliance
- To inform
  - Call employees/participants to action
- To influence
  - Enhance employee/participant opinions
- To educate
  - Increase employee/participant understanding

111

Communication—In the Beginning . . .

- Used essentially to protect companies from legal exposure
- Heavy emphasis on legal language
- Little action required by employees
  - One benefits plan for all, no choice-making
- High levels of company loyalty (low skepticism)
- Little attention was paid to how employees learn or even how to reach them

112

The Evolution Begins—Flexible Benefits

- Increased understanding required as to how employees learn and how to reach them
- Employees called to action:
  - Benefit choice-making and investment options
- New ERISA guidelines ("in plain English")
- Cost containment drives benefit "takeaways"
- Downsizing diminishes loyalty
- Employees focus on "What's in it for ME?"

113

The Evolution Continues—Market-Driven Communication

- Information shifts from administrative bulk to marketing-oriented "fun" media
  - Gamification and personalization are in the forefront
- Message balance shifts from "mostly technical" to "mostly marketing"
- Employee opinions begin to drive plan/program design and messages
- Consumer-oriented graphic design is prominent

114

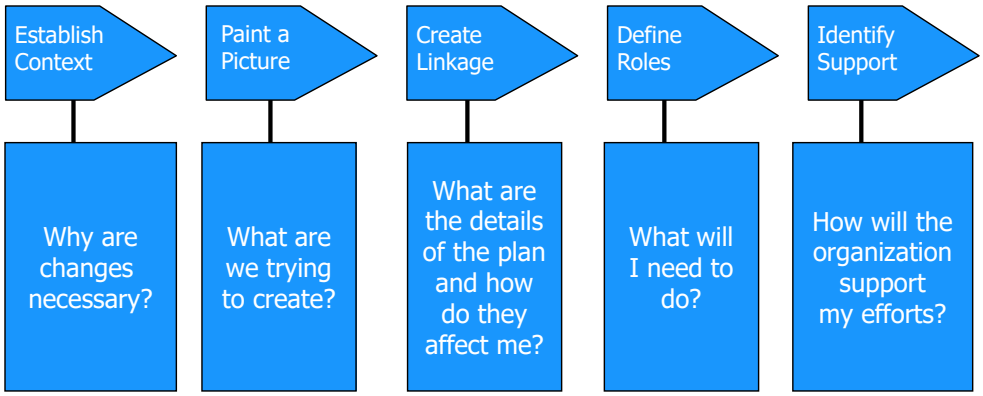
Communication Process

- Strategy road map
- Research
- Planning
- Development
- Training
- Other communication issues:
  - Start earlier
  - Communication more frequently

115

Communication Strategy Road Map

Successful communication follows this road map:



116

Employee/Management Research

- Proactive or reactive?
- Survey or focus groups or not at all?
- Online or paper?
- Do you want to know likes/dislikes?
  - Are you willing to change?
- Benefit trade-offs to measure employees' perceived value of various plans
  - Warning: There can be a BIG difference between perceived preferences and actual elections
- Are employees comfortable making choices?

117

Research

- Know your employee demographics
  - Age, family status, geography in relation to workplace, etc.
- Understand their learning styles
  - Visual, auditory, experiential

118

Communication Planning

- Key messages:
  - Do you have a vision, and can you communicate it?
    - About the business
    - About the strategy
    - About the benefits program
- Media possibilities:
  - Consider workforce, culture, logistics
  - Budget is also key
- Building a communications strategy
- How to measure effectiveness?

119

Strategic Communication Planning

- Make each message count:
  - What is the real objective?
    - Heighten awareness?
    - Introduce new plan provisions or processes?
    - Reduce misunderstanding or enrollment errors?
    - Streamline administrative processes?
    - Increase perceived value?

120

Communication Material Development

- Most employees in most industries expect digital communication
- The internet can deliver all your communication
  - Information: Generic and personal
  - Transactions
  - Pushed and pulled content
- Most organizations will need a variety of vehicles for the next few years
  - Should everything available over the web be available in paper?
  - What about social media?
  - Is voice response a necessary transaction alternative?
  - What production values should apply?

121

Share Out—Poll

Do you agree that you should continue to use paper?

A. Yes

B. No

122

Communication Tools

- Newsletters, brochures and handbooks
- Posters, postcards and flyers
- Memos, memos and more memos!
- Email and voicemail
- Video and voice response systems
- Internet/intranet
- Texting
- GAMIFICATION—New rule in Communication—MAKE IT FUN!

What other tools does your organization use?

123

Making More Effective Use of Available Dollars

- SPDs becoming more user-friendly:
  - If we have to pay for an SPD, let's make it a communication tool, not just a compliance tool
- Action-oriented enrollment materials:
  - Assume the employee won't read past page two
- Personalized communication:
  - It's all about "me"

124

Training Needs—Determine Audiences

- Benefit staff/line supervisors/managers: Who trains the trainer?
- Employee meeting trainers: Will you have meetings?
  - Active employees/retirees
- Management/union: Especially union leadership
- Spouses and families:
  - Reach them directly
- Out-of-area employees
- Employees with special informational needs (*e.g.*, hearing/vision impaired, employees with "mobile work sites")
- Carriers/vendors

125

Communication

- Information is often cumbersome due to legal requirements and technical details
- Most employees naturally avoid administrative information whenever possible
- Messages compete and conflict with all other information employees manage on a daily basis

126

In Other Words

When it comes to communication, you must assume you're behind before you even get started!

127

What Does Your Communication Accomplish?

Understanding?

Appreciation?

Effective use of programs?

or

A lot of "white noise" in an already cluttered workplace?

128

The Myth: More Communication = More Effective Communication

- Employers want employees to focus on what's critical
- Employees feel pressed for time at work and at home

But often employees are inundated with unnecessary, distracting information

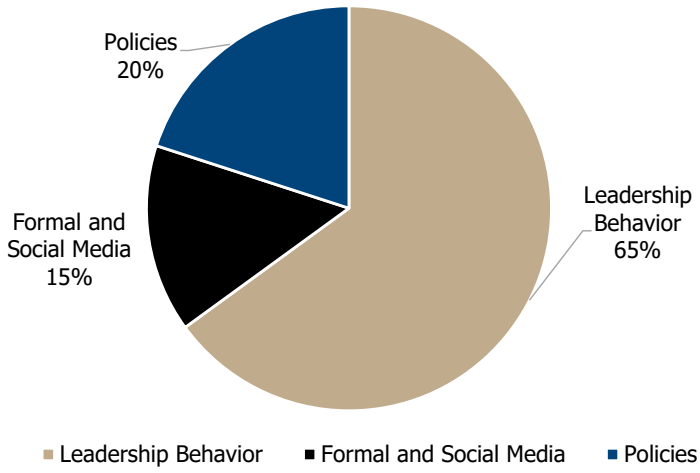
129

Four Steps to Communication Planning Success

- Eliminate "white noise"
- Separate critical information from administrative needs
- Design user-friendly media based on employee/ participant needs, not historic practice
- Develop a message philosophy

130

The Messages That Matter Most



The largest impact comes from your actual leadership behaviors (*i.e.*, your "say/do" connections)

131

Source: *Ken Blanchard, Situational Leadership II*

Communicating Change

How People React to Change:

- Need compelling reason
- Will feel awkward, uncomfortable
- Will think first about what they are losing
- May feel alone
- Will feel they do not have the resources
- Will revert if no pressure to change

Source: *Ken Blanchard, Situational Leadership II*

132

Managing Change—Ground Rules

- Involve people affected by the change in the change process
- Ensure presence of key skills required for participative design
  - Collaborative decision-making
  - Facilitative leadership
  - Win-win mentality
- Leadership commitment
- Long-term view with short-term milestones
- Communicate, communicate, communicate!

133

Learning Checkpoint: Create a Communication Plan*

*In activity booklet

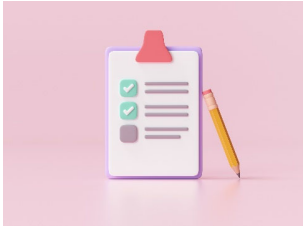
134

Communication Plan: Scenario*

You are a Benefits Manager in your organization's HR department. Open enrollment begins in one month, and employee participation in an ancillary benefit has been lower than expected

- Select one ancillary benefit (e.g., disability insurance, life insurance, accident insurance, critical illness insurance, hospital indemnity insurance, legal services, or identity theft protection)
- You will have 30 minutes to develop a brief communication strategy and 5 minutes to present it by answering the following questions

1. What benefits did you select?
2. Who is your target audience?
3. What are you three key strategies?
4. Which communication channels would you use?
5. Create a sample employee message
6. How would you measure success?



*In activity booklet

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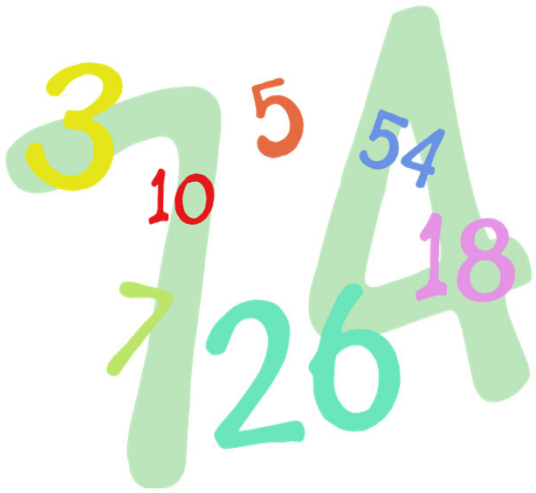
Choice/Decision-Based Benefits



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Flexible Benefits

- Flex, choice or decision-based programs, are programs that allows employees to choose benefits that are right for them and their families
- Typically, the employer provides a menu of benefits and some financial subsidy toward the cost of these benefits. Whether the employee will pay some of the cost of benefits depends on the employee's selection and the extent of the employer subsidy

137

Survey Says

TABLE 36

Types of Flexible Benefit Arrangements Offered*

	Overall n=449	Corporations n=299	Public Employers n=82	Multiemployer Plans n=68
Health care flexible spending account (FSA)	72%	81%	85%	18%
Pretax worker premium contributions/premium conversion plan/premium-only plan (POP)	16%	19%	17%	1%
Full-flex plan	9%	10%	6%	4%
None	16%	6%	7%	72%

*Respondents were asked to select all that apply.

138

Flexible Benefits

Employee Perspective

- A significant degree of choice (flexibility) in benefit programs or working conditions meets employees' needs

Employer Perspective

- A tool to maximize ***perceived*** value of employee benefit programs to employees for a given cost

139

Flexible Benefits

Why Flexible Benefits?

- Offers ***choice***
- Effective use of ***benefit dollars***
- Increases employee ***responsibility*** and ***awareness***
- Provides ***flexibility*** to diverse workforce

140

Flexible Benefits

Choice

- One size does not fit all
- Many factors influence needs and preferences:
  - Family situation
  - Age
  - Income
  - Health status
  - Risk tolerance
  - Seniority, tenure
  - Other

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Flexible Benefits

Benefit Dollars

- Company and employees manage cost
  - Company doesn't pay for benefits employees don't need
- Dollars spent are used to best advantage
- Maximizes tax-saving opportunities

142

Flexible Benefits

Responsibility

- Company and employees share responsibility
- Employees make choices within constraints imposed by the company

Awareness

- May raise employee awareness of benefits
- Employees can see the cost of benefits under some flex models
- May increase appreciation of what's offered
- May help explain the drivers of cost

143

Flexible Benefits

Flexibility

- Employees design their own benefit package to a point
- Can change selections annually
- If family situation changes during the year, certain changes can be made
- Company can change or add plans based on employee's interests and needs/competitive trends/company needs
- Effective tool for combining workforces in acquisition/merger situations

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How Flexible Benefits Works

Components of flexible benefits:

1. Core benefits:
   - Automatic—Company pays full cost
   - Required election—Employee may need to pay part of the cost (This is unusual)
2. Optional benefits:
   - Employees select to fit needs
3. Flex contributions:
   - Voluntary vs. Contributory
   - Employer-sponsored vs. Employer-paid

145

What Is Flexible Benefits?

Original Three Traditional Stages of Flexible Benefits

1. Pretax Employee Contributions
   - Introduces Section 125 of Tax Code

2. Spending Accounts
   - Section 125: Health Care
   - Section 129: Dependent Care

3. Choice of options in several "traditional" benefit plans; May include flex credits

146

What Is Flexible Benefits?

Emerged Three Stages of Flexible Benefits

1. Availability of "non-traditional" or ancillary benefits

2. Access to value-added products and services

3. Broad work/life tradeoffs

147

What Is Flexible Benefits?

Pre-tax Employee Contributions

- Saves federal and FICA taxes
- Saves state and local taxes in most places
- Payroll deduction
- Includes medical, dental, vision, AD&D, vacation buy/sell
- Disability insurance may be funded pre-tax or post-tax
- Employee life insurance may be pre-tax or post-tax
  - Imputed income implications

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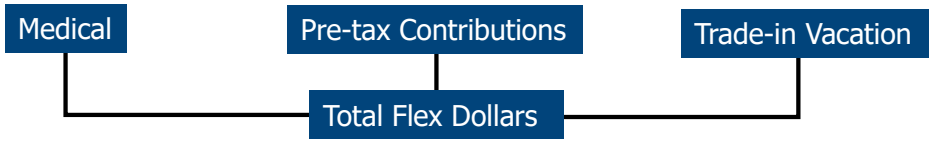
What Is Flexible Benefits?

Flex dollars can be used for:

Potential sources of flex dollars



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What Is Flexible Benefits?

Early Flexible Benefit Results

Companies obtained . . .

- Cost reduction from shifting costs to employees
- Some cost control through defined contribution approach
- Some employee credit for responding to employee needs
- Platform to address strategic benefit issues
- Is this really defined contribution?

150

What Is Flexible Benefits?

Early Flexible Benefit Results

Employees got . . .

- Costs shifted to them, but on a tax-effective basis
- Limited ability to tailor benefits
- Expanded menu of choices
- Suspicious about flex motivations
- Limited control over benefit dollars

151

Today . . .

Flexible benefits are common and accepted:

- Most large employers offer health care FSA
- Most offer dependent care FSA
- Most offer more than one type of plan
- Most at least one voluntary, or supplemental, benefit choice
- Other benefits?

152

Why Do Employers Look at Flexible Benefits?

- Primary objective for planning to implement a flexible benefits program:
  - Reduce current benefit costs
  - Offer employee choice
  - Remain competitive
- Reasons for not implementing a flexible benefits program:
  - Costs
  - Administrative problems
  - Union contract or objections
  - Doesn't fit organization's culture
  - Communication problems
  - Satisfied with current plan

153

How Can Employers Design Flexible Benefits to Affect Benefit Costs?

- Shift greater share of costs to employees
- Move employees into more cost-effective health care plans
- Reduce pressure to add new employer-paid benefits
- Reduce duplicate dependent coverage or make dependent coverage secondary if possible

154

Employee Reactions to Flexible Benefits

- Employees see the real drivers behind flex
  - Employers must be straightforward or risk loss of credibility
- Expect mixed employee reactions if the primary flex drive is cost reduction
- Enhanced opportunity for individualized customization of resources for dual wage earner (and benefit eligible) households

155

Share Out—Poll

Can you do all three?

- Give employees choices to better meet their personal situations
- Spend the same amount of employer benefit dollars
- Allow employees to "buy back" current coverage at the same contribution level

A. Yes
B. No

156

Principles of Flexible Benefits Implementation

- Overview and tax issues
- Advantages and disadvantages to both employees and employers
- Plan and design variations
- Operational issues involving including the credit valuation
- Requirements to be qualified including written form

157

Legal and Tax Impact of Concept

- In order for a cafeteria plan to be afforded favorable tax treatment, the plan must allow participants to choose between two or more benefits consisting of cash (or a taxable benefit that is treated as cash) and *qualified* benefits
- A plan cannot be designed to offer only a choice among qualified benefits, without the cash or cash *equivalent* component
- Without the cash component, the plan is not a cafeteria plan
- A salary-reduction agreement is *sufficient* to satisfy the cash requirement
- If a participant wanted to elect cash in a salary-reduction-only cafeteria plan, he or she would elect not to reduce his or her salary, thus receiving his or her total compensation in cash

158

Reasons for Popularity of Cafeteria

(Often Called Flexible Benefit Plans or Flex Plans)

1. The increasing costs of benefits
2. A diverse workforce with vastly differing employee benefit needs
3. Exception to the tax doctrine of constructive receipt:
   - Cafeteria plan participant can avoid taxation and instead receive tax-free benefits

159

Section 125

160

What Is a Flexible Spending Account?

Flexible Spending Accounts (FSA)

- Rules:
  - "Use it or lose it" extended 2½ months
  - Carryover rules of $680 (2026)
  - Employer can adopt a $500 tweak in lieu of above
  - Employer at risk under Health Care Account
  - Midyear changes only for certain life events
- Health Care

161

What Is a Flexible Spending Account?

- Historically, no IRS limit. Now most employees are limited to $3,400 (2026)
  - The health FSA pre-tax deduction limit is per employee
    - If the employer contributes to the health FSA, the employer's contribution is in addition to the amount that the employee can elect. Therefore, the employee can elect up to the maximum and still receive the employer's contribution. If an employer has adopted the up to $680 rollover (carryover for 2026) for the health FSA, any amount that rolls over into the new plan year does not affect the maximum election the employee can make
- FSA Grace Period:
  - If an employer flexible spending account plans includes a FSA grace period, this is a set amount of time during which time an employee household can use any unspent money in their FSA
    - The grace period can be up to a maximum of 2.5 months after the start of the new year, which would be March 15th. Any unused FSA balance would be lost after the grace period ends
- Dependent Care:
  - IRS limit of $7,500 per household or $3,750 for individuals or married and filing separately (2026)
- Commuter Benefits:
  - $340 per month for transit and $340 per month for parking (2026)

162

Internal Revenue Code (IRC) Section 125

- Section 125 governs cafeteria plan arrangements
- Other IRC sections apply to the underlying benefits funded within the cafeteria plan

163

Some Benefits May Not Be Included in a Cafeteria Plan

- Long-term care insurance **may not . . .**
- Whole life insurance **may not . . .**
- However, health savings account (HSA) funded through a cafeteria plan may be OK to accumulate interest and dividend growth and may be used to pay premiums for long-term care insurance or services

164

Employee Advantages

- Employees pay for benefit expenses on a tax-favored basis
- Contributions exempt from federal income tax, FICA, and FUTA
- Most state and local tax laws follow the federal tax treatment

165

Employee Disadvantages

- Benefit elections generally made prior to the beginning of the plan year
- Usually, the election is irrevocable during the entire period of coverage
- "Use it or lose it" forfeiture concerns
- Tax credit on personal tax return may be better for employee
- Potential slight reduction in Social Security benefits
- Potential slight reduction in accumulation of earnings-based pension

166

Employer Advantages

- The employer does not pay FICA/FUTA taxes on contributions
- Deferral amounts are not considered wages for payroll-based expenses
- Federal and usually state and local tax benefit
- Employee awareness of the overall value of their benefits
- Can control benefit costs by limiting employer contributions
- Makes passing on health care costs to employee a tad less painful

167

Employer Disadvantages

- Cost of administration and operation of such a plan
- Compliance with tax law provisions
- Need for written plan document
- Incurs cash flow risk
- Incur financial risk with some terminating
- Adverse selection
- Complex coverage and nondiscrimination testing

168

Premium Conversion/Premium-Only Plan (POP) Design Considerations

- No employer contributions or flexible credits
- The amount credited to an employee for opting out of coverage can be less than the actual cost of the coverage he or she is foregoing
- Used for medical insurance (including dental, vision and other types of medical coverage), sometimes GTL (up to $50,000)
- Former employer COBRA premium:
  - Note: Health FSAs may not reimburse individual or COBRA premiums
- Disability plans (but then benefits are taxable)

169

Cafeteria Plans That Include Full FSAs (Reimbursement Accounts)

- Bookkeeping accounts fund remaining part of employer's general assets
- FSAs are common for medical reimbursements, dependent-care and adoption assistance
- One account may not be used to reimburse expenses from another account

170

Full Flexible Benefit Plans (Full Choice)

- Gives participants an opportunity to select among a full range of benefits
- Employer determines a dollar value it wishes to earmark for the extra benefits portion
- Can be cash or credit

171

Core Benefit Within a Flexible Benefit Plan

- Establish some minimum level of (*i.e.*, health and life) benefit coverage
- Typically, a core benefit may require that the participant select some basic health coverage and a minimum level of life insurance
- Consideration of the public marketplace/exchange
- Goal: Employees not be underinsured

172

Demographic Factors

- Historically, low levels of participation defeated the purpose of establishing the plan and perhaps caused the plan to fail required nondiscrimination testing
- Higher paid employees value tax advantages
- Lower paid workers may sacrifice benefits to pay current bills
- Some plans now, the more you earn the more you pay

173

Communication

- Without proper communication, employees could view the cafeteria plan as a way for their employer to pay them less

174

ERISA Impact

- A cafeteria plan itself is *not* governed by the (ERISA) since not a welfare benefit plan. However, some of the *underlying* welfare benefits funded through a cafeteria plan are governed
- ERISA Section 3 defines a *welfare* benefit plan as any plan, fund or program which is established or maintained by an employer or employee organization
  - Note: Not all welfare benefit plans can be funded through a cafeteria plan

175

Learning Checkpoint: Kahoot Game—Historical Related Laws

176

Written Plan With Amendments Should Include

- Specific description of each benefit
- Employee eligibility and participation rules
- Procedures for making irrevocable of elections and period of coverage
- Manner in which contributions are made:
  - *i.e.*, Salary reduction agreement, non-elective employer contributions or a combination
- Max contributions levels
- The plan year
- Claims provision
- Use-it-or-lose-it rules spelled out

177

What Are Today's Trends?

- Supporting total compensation focus
- Addressing work/family issues
- Lesser (or no) core benefits
- Expanded choice (pre- and post-tax) and more meaningful choice
- Disclosure of true value of each option
- Changing employer motivations and business strategies
- Diverse plan design; Focus on creativity

178

Details, Details, Details

- Permissible and precluded benefits in an IRC Sec 125 plan
- Legal requirements, eligible groups, eligible participants
- Permissible and non-permissible changes
- Negative elections vs. Evergreen elections
- Impact of FMLA and USERRA and HEROES Act
- Specialized components of a flexible benefit plan
- Administration issues

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Permissible in a IRC Sec 125 Plan

- Employer-provided accident or health coverage under Internal Revenue Code (IRC) Sections 105 and 106
- This includes health, medical, hospitalization coverage, prescription plans, certain over-the-counter drugs, dental and vision programs, disability insurance and coverage under an accidental death and dismemberment (AD&D) policy
- Business travel accident plan, hospital indemnity or cancer policies and Medicare supplements (However, the later cannot usually be used with post employment HSA funds)
- Can be funded as can short- and long-term disability (although there are good reasons to fund disability policies outside of the cafeteria plan)
- It also includes reimbursement for health care expenses under a health care flexible spending account (FSA)

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Permissible in a IRC Sec 125 Plan *(continued)*

- Employer-provided group term life insurance coverage excludable from income under IRC Section 79 or includable in income solely because the benefit exceeds the $50,000 limit of IRC Section 79. Only the first $50,000 of coverage is nontaxable; Income is imputed on amounts in excess of $50,000 (Not too common for the excess to be in flex but still permissible)
- Employer-provided dependent care assistance under IRC Section 129 (very common)
- Employer-provided adoption assistance under IRC Sec. 137
- A 401(k) plan or purchase of retiree group term life insurance by participants employed by certain educational institutions described in IRC Section 170(b)(1)(A)(ii) is rare
- Contributions to a health savings account (HSA) under IRC Section 223

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Issue That Raises Lots of Ambiguity

- Individually owned accident or health insurance policies may be offered under a cafeteria plan, provided that the employer requires an accounting to ensure that the health insurance is in force and is being paid by the employees
- The plan may not reimburse the health insurance premiums under a health care FSA (no double-dipping), nor may it reimburse policies maintained by another employer

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Non-Permissible in IRC Sec 125 Plan

- Contributions to medical savings accounts under IRC Section 106(b)
- Qualified scholarships under IRC Section 117
- Educational assistance programs under IRC Section 127
- Certain fringe benefits under IRC Section 132
- Qualified long-term care insurance under IRC Section 7702B
- Archer medical savings accounts
- Athletic facilities/de minimis (minimal) benefits/dependent life insurance
- Employee discounts/lodging on the business premises
- Meals/moving expense reimbursements
- No-additional-cost services
- Parking and mass transit reimbursement
- Contributions to an IRC Section 529 college savings account
- Legal assistance or financial assistance
- Elective deferrals to a Section 403(b) plan
- Health reimbursement arrangements (HRAs)

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Eligible Groups

- Basically, any employer with employees who are subject to taxation under U.S. tax law is eligible to sponsor a cafeteria plan
- **But** self-employed individuals described in Section 401(c), including sole proprietors, partners in a partnership, and 2% or greater shareholders in an S-corporation are ineligible to participate in a cafeteria plan for themselves; However, they may sponsor a Section 125 plan for their bona fide employees

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Eligible Participants

- Spouses and dependents of employees cannot participate in a cafeteria plan
- However, the plan can be designed to provide benefits to family members via family coverage elected by the employee

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Salary Reduction Agreement

- A salary reduction agreement is made between an employee and an employer allowing the employee to defer salary and avoid constructive receipt of the compensation
- In lieu of paying the compensation to the employee, the employer contributes the amount agreed upon toward the cost of certain benefits
- The employer can pay for the benefits on a tax-favored basis. Under this arrangement, the employee is in essence buying the employee benefits on a pretax basis without the monies being considered constructively received

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Premium Conversion/Premium-Only Plan (POP) Design Considerations

- No employer contributions or flexible credits
- Used for medical insurance (including dental, vision and other types of medical coverage), sometimes GTL (up to $50,000)
- Former employer COBRA premium:
  - Note that health FSAs may not reimburse individual or COBRA premiums
- Disability plans (but then benefits are taxable)

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Salary Reduction Agreement

- Because the participant has entered into an agreement to forgo salary in lieu of benefits, the amounts that are deferred as contributions to the cafeteria plan are not considered wages for federal income tax purposes
- The deferred sums generally are also not subject to Federal Insurance Contributions Act (FICA-Social Security) or Federal Unemployment Tax Act (FUTA) taxes. However, sometimes state and local taxes apply
- In order for a salary reduction agreement to be valid, it must be entered into between the employer and the employee prior to the beginning of the period of coverage which usually is the plan year

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Negative Elections (Automatic Enrollment)

- Sometimes employers provide for automatic enrollment of their employees in certain benefits under a cafeteria plan
- This automatic enrollment is known as a negative election since no positive action is required on the part of the employee to effect enrollment in the benefit plan
- In order for a negative election to be valid, employees must receive reasonable notice of the automatic deferral and have the option to decline coverage each plan year

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Evergreen Elections (One Time Election)

- Once made, the evergreen election stays in force from plan year to plan year unless the participant elects to make a change during the applicable election period that would most often be the plan's annual open enrollment period
- While an evergreen election technically could be offered with respect to all benefits under a cafeteria plan, these types of elections are seldom used for reimbursement accounts, particularly for dependent care assistance, since expenditures in these types of accounts tend to change annually depending upon family circumstances

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Revoking Election

- Generally, a cafeteria plan participant may not revoke a benefit election during the period of coverage unless the revocation is attributable to the occurrence of certain permitted events
- There are some notable exceptions to this general rule
  - The Health Insurance Portability and Accountability Act (HIPAA) sets forth special enrollment rights
  - HIPAA requires group health plans, including those offered under a cafeteria plan, to permit individuals to make midyear benefit changes if change in status applies

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Change in Status Rules

- Within IRC Section 125 regulations, there are special change-in-status rules. Under the change-in-status rules, a plan may permit participants to revoke an election and make a new election. These rules allow changes with respect to accident and health coverage, dependent care expenses, group term life insurance, or adoption assistance if a permissible change in status occurs and the election change is "consistent" with the change in status

For this purpose, acceptable change-in-status events include changes related to the following:

- Legal marital status
- Number of dependents
- Employment status
- Place of work or residence
- Cases where the dependent satisfies, or ceases to satisfy, the requirements for eligibility
- Commencement or termination of an adoption proceeding for purposes of adoption assistance
- Enrollment in another group health plan, including Medicare (HSAs)

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HSA Rules

- If HSA contributions are made through salary reduction under a cafeteria plan, employees may prospectively elect, revoke or change salary-reduction elections for HSA contributions at any time during the plan year prospectively

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HSA Rules Impacting Medicare Eligibles

If you are <u>enrolled</u> in Medicare Part A*, B and/or D you can no longer contribute to your HSA

- The month you enroll in Medicare (typically the month of your 65th birthday), the account overseer switches the contributing balance to your HSA to zero dollars per month

*Part A is automatic; you must disenroll if you don't want it

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Consistent Benefit Election Change

- According to IRC Section 125 regulations, an election change is considered to be "consistent" if that change is on account of and corresponds with a change-in-status event that affects eligibility for coverage
- If a change in status results in an increase or decrease in the number of an employee's family members or dependents who may benefit from coverage under the plan, the eligibility requirement is satisfied
- Election changes must be made on a prospective basis only
- No retrospective changes generally are permissible

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Impact of FMLA on Benefit Elections

- A participant who takes unpaid FMLA leave must be allowed by the cafeteria plan sponsor to revoke an existing election for all health plan coverage for the remainder of the coverage period notwithstanding any contrary rules stated in the cafeteria plan document
- A participant who takes FMLA leave may revoke elections for non-health benefits only under the same rules that apply to participants taking non-FMLA leave
- In either case, the participant may choose to be reinstated in the plan upon return from FMLA leave on the same terms and conditions as were in force prior to the taking of FMLA leave

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Impact of USERRA Leave on Benefits

- Participant who takes leave of absence under USERRA (Employment and Reemployment Rights Act) may elect to continue participation in the plan during the period of leave
- Amounts previously deferred that would otherwise continue to be deferred under this section, if the participant were still employed
  - May be paid to the plan as:
    - A single lump sum at the beginning of each year
    - At the beginning of the expected leave-of-absence period or
    - In the form of monthly payments

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Impact of HEART Provisions

- The HEART Act enhanced the USERRA protections
- Among its enhancements, it permits plan sponsors to allow an employee called to active duty for a certain duration to receive a distribution of the unused balance of his or her health care FSA
  - Side note: It has potential impact on nonvested retirement portion as well and has some unique provisions related to the military paid death benefit including the servicemen group life insurance and death gratuity and is very key legislation

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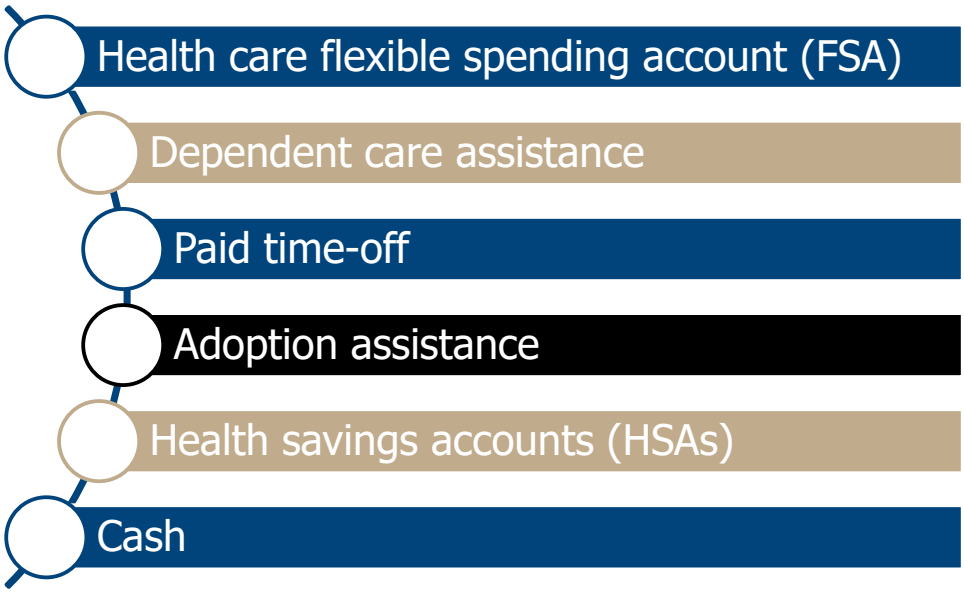
Flexible Benefit Design Considerations



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Workings of a FSA

- A health care FSA is a plan that meets the qualification requirements under IRC Section 105
- If the plan is maintained as part of a cafeteria plan, additional requirements set forth in the regulations also must be satisfied

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Dependent Care FSA

- A dependent care assistance, under IRC Section 129, the participant's spouse also must be employed, a full-time student or physically or mentally incapable of self-care
- Dependent care assistance plans either can be offered on a standalone basis or as part of a cafeteria plan
- When offered under a cafeteria plan, they must meet all the requirements of both IRC Sections 125 and 129
- A dependent care assistance plan offers participants the ability to pay for the first $5,000 of dependent care assistance on a tax-free basis

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Dependent Care FSA *(continued)*

- Dependent care assistance plan must be in writing
- The plan must disclose the availability and terms of the dependent care assistance plan
- To claim the expense as an exclusion from income, the participant must report to the plan administrator the name, address and taxpayer identification number of the dependent care provider
- On or before each January 31, the expenses incurred by the employee for dependent care assistance benefits in the preceding calendar year must be reported on the employee's Form W-2

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Dependent Care: Details, Details, Details

- Eligible expenses include child-care centers that care for six or more children, caregivers for a disabled spouse, baby-sitters, nursery schools, day camps and household expenses provided that a portion of these expenses is incurred to ensure a qualifying dependent's well-being and protection
- Care cannot be provided by a person for whom a personal tax exemption is taken on the participant's tax return. If the caregiver is a child of the participant, he or she must be at least age 19
- The name, address and employer identification number of the service provider must also be provided

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Elective and a Non-Elective Paid Time Off Option

- *Non-elective* paid time is for those days that are not subject to an election by the employee
- If an employee's total paid time-off is two weeks but he or she can sell back only one week, this employee has one week of nonelective paid time-off and one week of elective paid time-off
- The rationale for prohibiting paid time-off days from being carried over from one year to the next is because this would be an impermissible deferral of compensation

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HSA Basics

- Health savings accounts (HSAs) are employee-owned trust or custodial accounts for reimbursement of medical expenses
- HSAs may be funded with employee salary deferrals or employer contributions through a cafeteria plan
- Employers may contribute to HSAs but may be limited by the cafeteria plan nondiscrimination rules
- Contributions to an HSA only are permitted in months that the participant has, as his or her only health coverage, a qualified high-deductible health insurance plan
  - Note: FSA grace periods, carryover provisions
- The overall limits on contributions to an HSA are the same whether or not the HSA is funded inside or outside a cafeteria plan

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Review: Cash Defined

Two conditions must be met for a payment to be considered cash within a cafeteria plan:

- First, the benefit must be one that is not specifically prohibited by IRC Section 125
- Second, the benefit must be provided on a taxable basis
  - This can be accomplished in one of two ways:
    - Either the participant can pay for the benefit on an after-tax basis or
    - The employer can pay for the benefit and report the cost of the benefit as taxable income to the employee

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Practical Administrative Procedures

- Before a plan reimburses an expense under a health care FSA, an independent third party must substantiate the claim
- The third party may be an insurance company or a canceled check evidencing an expense has been paid and the substantiation may take the form of an explanation of benefits (EOB) certificate or receipt from the doctor's office
- The written statement must include, at a minimum, the date the expense was incurred and the amount and nature of the expense
- The statement also must certify that the expense will not be reimbursed by any other health coverage
- Unused funds, left by participants in their FSA and DCA accounts at the end of the plan year:
  - May not be refunded to plan participants by the plan sponsor
  - Must be forfeited and become the property of the plan sponsor

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Use of Forfeited Funds

- Funds in a health care FSA that are unused during the plan year are forfeited by plan participants and then become the property of the employer
- Some employers keep the money, others use it to pay plan expenses, or in the past, may even have given it to a charity
- **Experience gains may be:**
  - Retained by the employer
  - Used to reduce administrative expenses of the cafeteria plan
  - Returned to employees:
    - Note: While it would be allowable for an employer to equally divide these funds among all employees, the money cannot be refunded to the employees who incurred the forfeitures
  - Used to reduce employees' required salary reduction amounts
  - Note: The regulations describe procedures for allocating experience gains on a "reasonable and uniform basis"

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Administrative Issues

- Coverage and nondiscrimination testing
  - Overall cafeteria plan tests
    - Eligibility test
    - Contributions and benefits test
  - Key employee concentration test
- Nondiscrimination tests for underlying benefits
- Simple cafeteria plans
- ERISA
  - Reporting and disclosure
  - Fiduciary requirements

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More Administration Issues

- Taxation
- Trust requirements
- Reporting and disclosure
- Fiduciary requirements
- Summary plan description and plan communication

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Key Takeaways

Your Feedback Is Important. Please Scan This QR Code.

Day One Evaluation