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This
Just
In...

EMPLOYEE BENEFITS

Popular FSAs Fit the Needs of Employers and Employees

★ Does your employee financial education program include a clearly articulated mission? Targeted outreach? Adequate resources? And timely follow up and evaluation? Most successful programs have these characteristics, according to a study by the Institute for Socio-Financial Studies. The study also cited accessibility – allowing time off to attend programs – and relevant, culturally sensitive curriculum. Community partnering, such as enlisting a mortgage banker to help design the course and supply teachers, also works. The institute studied 90 companies and organizations to develop its list of effective practices. You'll find a summary of the report at <http://isfs.org/exec-sum.html>.

★ **Deductibility limits for long-term care insurance premiums increase nearly five percent this year.** The new maximum deductible amounts for LTC premiums depend on the insured's age at the end of the tax year: \$270 (40 or less); \$510 (41-50); \$1,020 (51-60); \$2,720 (61-70); and \$3,400 (70+). Any premium above these limits is not considered medical expense. Insureds can receive up to \$240 per diem tax-free from qualified long-term care insurance contracts. Employers who pay employees' LTC premiums under a group or individual policy can deduct the entire amount, even if it exceeds the age-based limits. Employer-paid premiums are also tax-free for employees.

It's all about flexibility. That's why small and mid-sized employers are increasingly offering flexible spending accounts (FSAs) to their employees. FSAs allow employees to use pretax dollars to pay for certain medical and other personal expenses that aren't covered by insurance. As small businesses face double-digit increases in health care premiums and rising out-of-pocket costs, FSAs provide one way of maintaining benefits for employees while keeping costs down.



There are two types of employer-established plans: health-care FSAs and dependent care FSAs. Both reimburse employees for specific qualified expenses, but as the names imply, the former reimburses health care expenses, including any insurance deductibles and copayments, and the latter reimburses dependent care expenses, such as daycare or sitter fees.

Here's how FSAs work: The employee contributes to the account through payroll deduction and can withdraw funds as reimbursement for eligible expenses. Because the money is exempt from federal, state, and payroll taxes, employees can save 25 percent or more on medical and other costs. Employers may contribute to these accounts as well.

Twenty-five percent of employers with 10 or more employees offered a health-care FSA in 2004, up from 23 percent the prior year, with an average of 36 percent of eligible employees participating, according to a recent survey by Mercer Human Resource Consulting. Contributions averaged \$1,295, up from \$1,136 in 2003. While there's no legal limit to contributions to the accounts, many employers set it at around \$3,000 to \$5,000 an employee.



**EMPLOYEE
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REPORT**

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Is it Time to Rethink Retiree Benefits?

As baby boomers begin to retire, companies struggling to control rising medical costs have asked their retirees to pay more – and plan to do so again in 2005. A recent survey by the Kaiser Family Foundation and Hewitt Associates found that 79 percent of employers increased their retirees' contributions for premiums in 2004 and 85 percent expect to do the same this year. And the number of companies that are eliminating subsidized health benefits entirely for future retirees is rising.

Here's what's happening with runaway retirement health costs, and what you can do to manage them:

- ✱ **Carve-outs.** Many companies are "carving out" retirees from their active employee populations and insuring them with a group Medicare carve-out plan. This type of plan integrates benefits with Medicare to provide a level of benefits similar to that received by active employees. Medicare provides primary benefits, while the group plan acts as secondary payer. The move to treat current and former workers differently reflects a desire to leave health benefits in place for those who have already retired despite several consecutive years of double-digit cost hikes. Without the higher risk factors and higher claim levels seniors bring, costs for active employees can drop significantly.

In many cases, it's a win-win situation; by participating in a group medical plan sponsored by their former employers, retirees usually enjoy more stable benefit packages and costs than they would under an individual program, as well as the increased attention that comes from companies that specialize in providing customer care for the elderly. And many employer-sponsored group insurance plans don't require health screenings and a lengthy application process as long as the retiree has been insured for at least six months prior to the start of the new plan.

- ✱ **Cost-sharing.** Employers continue to shift more of the costs they formerly covered to their retirees. The Kaiser/Hewitt survey revealed that for 2004, more than half of surveyed companies increased copays for services and/or prescription drugs, 37 percent raised deductibles for health care services, and 29 percent raised out-of-pocket limits on retirees' obliga-

tions. An increasing number of companies have begun to offer access to group health benefits with retirees paying all costs. While cost-shifting may be the easiest short-term solution to cutting expenses, employers should balance this strategy with other measures.



Recent health care inflation rates mean that virtually all the plans with employer-spending caps will hit the caps within the next five years.

- ✱ **Outsourcing.** It costs money to develop programs, educate and enroll retirees, provide customer care, maintain benefit Web sites and handle policy administration. Add in the administrative burden caused by dealing with multiple vendors and retirees and it's clear to see why outsourcing often makes financial and managerial sense. By outsourcing, companies can also increase productivity as HR personnel can devote more time to supporting the active employees who make the products, provide services and generate revenue.

- ✱ **Expenditure caps.** Employers can also limit the amount that the company will pay toward annual retiree medical premiums. More than half of employers surveyed by Kaiser/Hewitt imposed financial caps on their firms' contributions on at least one retiree health plan offered in 2004. Such caps often require retirees to absorb a greater share of costs once the cap is reached, although some firms soften the impact of the cap on retirees by offering additional, lower-cost plan options.

Caps for future retirees are often lower than current ones. Recent health care inflation rates mean that virtually all the plans with employer-spending caps will hit the caps within the next five years. Once a plan hits the employer contribution cap, all subsequent cost increases will likely be passed on to the retirees covered by the plan. As a result, the caps will shift a much larger share of future premium costs to retirees.

- ✱ **Minimum service requirements.** Some companies are raising the number of years of service required for retirees to be eligible for benefits. They are also tying the employer's portion of the retiree health

Preparing for the Medicare Drug Benefit

The 2003 Medicare Modernization Act (MMA) created a new Medicare drug benefit to begin in 2006. It established financial incentives for businesses to continue providing drug coverage to eligible retirees. Firms that provide coverage at least as generous as that available through Medicare are eligible for tax-free subsidies equal to 28 percent of retirees' drug costs.

With the MMA drug benefit becoming effective less than a year from now, many employers intend to stay the course, at least in 2006. A large majority of companies responding to the Kaiser/Hewitt survey intend to continue offering retiree coverage, with most of these planning to accept the 28 percent subsidy for eligible retirees. □

Perk Up Your Benefits Package

– Voluntarily

Skyrocketing health care costs and shrinking retirement accounts aren't the only issues that worry workers. As companies look for new and economical benefits to offer employees, they're discovering that relatively low-cost extras can solve some of their workers' concerns. In the world of traditional employee benefits such as group health insurance, long-term care and retirement plans, some of these newer benefits may seem a little unusual. But advocates say that voluntary benefits and other perks respond to real needs – and make a significant difference in employees' appreciation and company loyalty. Here are a few to consider:

Identity theft protection. Most victims of identity theft don't realize their problem for six months or more; when they do, they spend from 50 to 175 hours restoring their name and credit history, according to data from California Public Interest Research. Some companies offer a loss prevention education program to train employees about the latest self-protection techniques, weekly credit alerts and 24/7 assistance with identity and credit recovery. The insurance component reimburses employees for lost income and expenses resulting from identity theft, with certain coverage limits. Typical premiums range from \$12 to \$18 per employee per month.

Pet health insurance. Available from specialty insurers as individual coverage for more than 20 years, pet health insurance is now available on a group basis from a variety of insurers. Most of the pet insurance plans available are discount plans; some carriers offer indemnity plans that cover all routine medical problems and injuries. There is a set deductible and policyholders can choose any licensed veterinarian to provide care. Premiums generally begin at \$10 per month per pet and vary according to species, age of pet and level of coverage for dogs and cats, with special underwriting for exotic pets such as birds.

Legal service plans. These programs provide access to a lawyer's services for legal matters of the employee, spouse and dependent children. The level of service and access varies widely depending upon the provider and the premium paid. Some plans include a limited number of hours of consultation and courtroom time from a local plan attorney. Other plans simply offer a discount on the attorney's normal hourly rates.

Discount buying service. Employers can offer this program as a resource for employees and retirees. Those who purchase items and pay for them through payroll deduction usually get a favorable finance rate in addition to convenience. The types of items offered by such a service are generally limited to computers, electronics, appliances, cameras and automobiles. This type of plan works best for those who cannot afford to pay cash for these types of items.

Unlike traditional group benefits, voluntary programs entail no employer contributions. The employer sponsors the plan, but the employee pays all of the premiums, sometimes on a pre-tax basis (for



qualified benefit plans only). While traditional group benefits demand high levels of participation, typically 75 percent, voluntary programs require only 20 percent participation or may have no requirements. And voluntary benefits can fulfill the current demand for more personalized benefits. By offering more choices, employers provide employees with the opportunity to tailor their benefits package to meet their unique needs. Choice helps employers attract and retain good employees. And many voluntary benefits can continue on an individual basis even after separation from the company.

Disadvantages are minimal, with some companies citing administrative burden as the top concern. Employers looking to steer clear of enhanced plan fiduciary responsibilities under ERISA must be careful not to endorse any voluntary plan. In most cases, the employer serves as a gatekeeper, rather than approving a particular product. For more information, please call us. □

Return of perks? As some companies keep a tight rein on costs, others believe that spending money on employees pays off. Not only are employees happier and more productive, companies save big by keeping employee turnover costs low. And that's critical, considering that industry studies cite replacement costs per employee at about 1.5 times that employee's annual salary.

Observers say that perks might play a stronger role if the local economy rebounds and workers have more job options. Workers obviously won't stay with a company just because there's an on-site travel agency or free food in the cafeteria, but if it's part of a company's overall strategy of doing more for employees, perks can make a difference. □

Here are the basic considerations for FSAs:

✓ **Contributions.** Employees elect how much to put into the account at the beginning of the year, although they do not have to contribute all the money at that time. Once the set-aside amount has been designated – generally during the annual open enrollment period – employees may not change the designation nor drop out of the plan during the year unless there is a change in family status. The entire health care FSA contribution, less any amounts previously reimbursed, must be available at all times to reimburse expenses.

✓ **Claims.** Some FSAs establish a minimum that participants must meet before a claim will be paid, usually \$25 or \$50. The plan only pays claims incurred during the plan year, but plan administrators often allow a “grace period” of 90 to 120 days after the end of the year for participants to submit claims. If an FSA participant is entitled to COBRA benefits, and that person elects to continue as an account participant, you must continue to honor the claims and accept payments.

✓ **Use it or lose it.** By law, the employee forfeits any unspent funds in the account at the end of the year. Recent proposals by Congress to ease this “use it or lose it” rule by allowing participants to carry up to \$500 over to the next year have so far been unsuccessful. Research by Mercer Human Resource Consulting reveals that about three percent of FSA contributions are forfeited each year. Employers benefit from this, typically using the money to cover administrative costs.

✓ **Eligible expenses.** Health-care FSA reimbursable expenses include deductibles, copays or coinsurance as well as expenses for diagnosis, treatment or prevention of disease, if prescribed by a physician. The costs of prescription drugs, certain over-the-counter medications, hearing aids, vision care and orthodontia and chiropractic services may also qualify. Employees who participate in a dependent-care FSA plan can generally receive reimbursement of expenses for day care, before- or after-school programs, and babysitting for dependent children under age 13. Expenses for a disabled parent an employee claims as a dependent are also eligible.

Risk Note

Paperwork alert: If your qualified retirement plan requires an automatic rollover for terminated participants with benefits less than \$5,000, you must file an amendment by March 28, 2005. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) requires any automatic rollover of benefits of between \$1,000 and \$5,000 to be rolled over into an IRA, unless the participant elects a lump sum distribution. Plans can still distribute benefits of \$1,000 or less directly to the participant. The law does not require rollovers—employers can retain accounts of \$5,000 or less, which will add to administrative expenses. □



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✓ **Cafeteria plans.** Small businesses may also provide health and dependent care FSA coverage as part of a more comprehensive package of benefits under a Section 125 plan, usually referred to as a cafeteria plan. This type of plan can cut your payroll tax bill, and will save employees both payroll and income taxes. Many employers that sponsor cafeteria plans hire a third-party administrator to manage the paperwork. Some plans must file their own annual tax return, a Form 5500. It's a purely informational return that results in no tax liability, but you can be fined for failing to file it.

The cafeteria plan allows employees to select from a menu of tax-free benefits. Each employee can select something different, or mix and match benefits to meet their own unique needs. The employee pays for the benefits with salary reduction elections through an irrevocable election made at the beginning of the year. As with FSAs, any unused monies revert to the employer, not the employee. Cafeteria plans currently cover benefits such as premiums for group term life, health and dental insurance, disability income and accident insurance costs, qualified dependent care costs (up to \$5,000) and contributions to 401(k) plans. Of course, you can choose which benefits to offer.

FSAs and cafeteria plans provide a host of opportunities for employers to provide enhanced benefits to employees without the associated cost. But only an individual analysis can provide you with the right mix of plans for your staff. If you're interested in learning more, please call us. □

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benefit premium to the worker's length of service at retirement. According to a recent Watson Wyatt survey, less than one-third of benefit plans had service-related contributions for current retirees under age 65, but nearly two-thirds of plans did so for future retirees.

✳ **Phased retirement.** Retirees' need for greater financial security as well as access to health care and other benefits has also piqued interest in phased retirement arrangements. Companies offer employees at or near retirement age the chance to reduce their work hours and/or job responsibilities, providing a transition from full-time employment to full-time retirement. Employees may begin receiving a portion of their monthly pension payments while reducing the number of hours they work. Although current tax law prohibits inservice withdrawals from traditional defined benefit plans, other retirement savings plans, such as 401(k)s, can be structured to allow withdrawals earlier than normal retirement age.

Under a work-after-retirement arrangement, retirees return to work for their plan-affiliated employer a specified time – generally 30 or 60 days – after their effective retirement date. They continue to receive full retirement benefits, but accrue no more. Plans establish upper limits on hours and earnings during reemployment. The returning worker usually continues to accrue service credit, but benefits are suspended until the retiree ceases employment. This limits the employer's exposure to further benefit accruals and can reduce costs.

The success of these arrangements will ultimately depend on plan design. The good news is that strategies such as carve-outs, cost sharing, outsourcing and phased retirement can help companies keep their promises without breaking the bank. For more information on controlling retiree health costs, please call us. □