Employee Benefits Report

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Cash Balance Plans: The Best of Both Worlds?

Pension plans fall into one of two categories: defined benefit plans or defined contribution plans. A cash balance plan has features of both. They can also be simpler to administer than some other plans. Is a cash balance plan right for your firm?

With a defined benefit plan, each eligible employee receives a specified benefit at retirement. A defined contribution plan, by contrast, specifies the amount of contributions the employer will make toward eligible employees' retirement accounts. The actual amount of retirement benefits a defined contribution plan will provide to an employee depends on the amount of employer contributions, the amount of employee contributions, and the investment performance of the account.

Although considered a defined benefit plan, a cash balance plan defines the benefit the em-

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This Just In…

Expatriates face a higher risk for mental health problems than their U.S. counterparts, found a joint study by Chestnut Global Partners (CGP) and the Truman Group. In fact, "Studies estimate that American expatriates have rates of assignment failure as high as 40%, which often results from stress caused by cultural differences and demanding workloads," says study co-author Dave Sharar, Ph.D., managing director of Chestnut Global Partners.

In the study survey:

- **Three times as many expatriates as U.S.-based workers expressed feelings of being trapped or depressed.**
- **Twice as many expatriates as U.S.-based workers expressed feelings of being anxious or nervous.**
- **Expatriates used alcohol and drugs at higher rates and in**

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ployee receives upon retirement in terms of a stated account balance, making it similar to a defined contribution plan in that respect.

How Do Cash Balance Plans Work?

In a typical cash balance plan, each participant's account receives an annual "pay credit" (such as 5 percent of compensation from the employer) and an "interest credit" (either a fixed rate or a variable rate linked to an index). Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants. Thus, the investment risks are borne solely by the employer.

When a participant becomes entitled to receive benefits under a cash balance plan, the benefits will be defined in terms of an account balance. For example, assume that a participant has an account balance of $100,000 when he or she reaches age 65. If the participant decides to retire at that time, he or she would have the right to an annuity based on that account balance. Such an annuity might be approximately $8,500 per year for life. In many cash balance plans, however, the participant could instead choose (with consent from his or her spouse) to take a lump sum benefit equal to the $100,000 account balance.

If a participant receives a lump sum distribution, that distribution generally can be rolled over into an IRA or to another employer's plan if that plan accepts rollovers.

The benefits in most cash balance plans, as in most traditional defined benefit plans, are protected, with certain limitations, by federal insurance provided through the Pension Benefit Guaranty Corporation.

Cash Balance Plans vs. Traditional Pension Plans

Both traditional defined benefit plans and cash balance plans must offer payment of an employee's benefit in the form of a series of payments for life. However, traditional defined benefit plans define an employee's benefit as a series of monthly payments for life to begin at retirement, while cash balance plans define the benefit in terms of a stated account balance. These accounts are often referred to as "hypothetical accounts" because they do not reflect actual contributions to an account or actual gains and losses allocable to the account.

greater amounts than their U.S. counterparts, and with more negative consequences. This puts more of them in high- to moderate-risk groups for alcohol and substance abuse problems than their U.S. counterparts.

The study pointed out the importance of family dynamics in expatriate assignments, and cited partner resistance (47%) and family adjustment (32%) as the top challenges. The authors concluded that passive employee assistance programs are insufficient; "Proactive outreach to 'check-in' with expatriates and spouses by phone and e-mail is key to linking them with needed mental health services."

Cash Balance Plans vs. 401(k) Plans

There are four major differences between typical cash balance plans and 401(k) plans:

a) **Participation —** Participation in typical cash balance plans generally does not depend on the workers contributing part of their compensation to the plan; however, participation in a 401(k) plan does depend, in whole or in part, on an employee choosing to contribute to the plan.

b) **Investment Risks —** The employer or its appointed investment manager handles cash balance plan investments, and the employer bears the risk. Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants. By contrast, 401(k) plans often permit participants to direct their own investments within certain categories. Under 401(k) plans, participants bear the risks and rewards of investment choices.

c) **Life Annuities —** Unlike 401(k) plans, cash balance plans must offer employees the ability to receive their benefits in the form of lifetime annuities.

d) **Federal Guarantee —** Since they are defined benefit plans, the benefits promised by cash balance plans are usually insured by a federal agency, the Pension Benefit Guaranty Corporation (PBGC). If a defined benefit plan is terminated with insufficient funds to pay all promised benefits, the PBGC has authority to assume trust-

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eeship of the plan and to begin to pay pension benefits up to the limits set by law. Defined contribution plans, including 401(k) plans, are not insured by the PBGC.

Pros and Cons of Cash Balance Plans

Pros: Cash balance plans can simplify plan administration for the employer. In a typical plan, the employer credits each participant's account with a percentage of his/her pay (such as 5 percent) and an interest credit.

Cash balance plans also allow rollovers before age 65, so vested workers can take their benefit in a lump sum payment when they go. That makes cash balance plans attractive to today's more mobile employees. Employers report having adopted the plans to improve their competitive edge in hiring.

Converting a traditional defined benefit plan to a cash balance plan eliminates the early retirement subsidy of traditional plans.

Cons: Cash balance plans do not guarantee savings for employers. Because the retirement benefit is predefined, the employer must deal with any shortfall that results from poor investment performance, just as it may benefit from any gain. Contributions to the plan are determined actuarially and are not strictly up to the employer. You can terminate or amend the plan, but you cannot reduce the benefit that plan participants have already earned.

For more information on cash balance plans, please contact us.

Vision Care: A Clear Choice

According to the most recent U.S. Department of Labor National Compensation Survey, just 26 percent of workers in private industry had access to employer-provided vision care benefits. In comparison, 70 percent had access to healthcare benefits, 68 percent had access to outpatient prescription drug benefits and 45 percent had access to dental benefits.

Companies that don't offer vision benefits may want to rethink their strategy. Vision disorders carry a hefty price tag for employers. They can result in a marked decrease in productivity, costing businesses an estimated $8 billion annually, according to a report by the Vision Council of America (VCA).

"Uncorrected vision problems are costing employers billions of dollars," said Ed Greene, CEO of VCA. "Direct medical costs associated with vision disorders exceed similar medical expenditures for breast cancer, lung cancer and HIV, yet few Americans get regular eye exams or have vision coverage in their health plans," said Greene.

The employees most at risk for developing vision problems that affect their work performance include engineers, construction workers, stockbrokers, software developers, accountants and administrative assistants. The VCA report found that an estimated 11 million Americans have uncorrected vision problems, ranging from refractive errors (near- or far-sightedness) to sight-threatening diseases such as glaucoma or age-related macular degeneration. Nearly 90 percent of those who use a computer at least three hours a day suffer vision problems associated with computer-related eye strain.

Another study cited in the *Journal of the American Optometric Association* found that in the presence of very little visual degradation, such as glare on a monitor, employees show an efficiency decline of four percent to 19 percent in accomplishing standard tasks. Translating that percentage into dollars, just a four percent productivity increase for an employee earning $30,000 per year would be worth $1,200. And here may be the most telling statistic of the VCA report: employers gain as much as $7 for every $1 spent on vision coverage.

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Types of Vision Benefits

Employers can offer vision benefits through vision insurance or a discount vision plan. Typically, vision insurance provides enrollees with eye care services in exchange for an annual premium, a yearly deductible for each enrolled member, and a copayment each time a member accesses a service. A discount vision plan provides eye care at discounted rates after the employer pays an annual premium or membership fee. The participant pays the total bill, less the applicable discount, at the time of service. Both kinds of vision plans can be custom-designed to meet the different requirements of a wide range of customers, including small and medium-sized businesses, nonprofits, associations, school districts and unions.

Vision insurance generally covers the following basic services:

- Annual eye examinations, including dilation
- Eyeglass frames
- Eyeglass lenses
- Contact lenses
- LASIK and PRK vision correction at discounted rates.

Group vision insurance costs vary, but typically premiums range between $5 and $15 per employee per month, depending on benefits selected. For both employees and employers, vision care costs only a fraction of the cost of vision problems or impairment. For more information, please contact us. ■

Save Money with a Dependent Audit

Although employers have no obligation to subsidize dependent coverage, many do. By dropping coverage for ineligible dependents, your firm saves that premium contribution. Even if you don't subsidize dependent coverage, having ineligible dependents on your benefit rolls will likely increase your utilization (and costs), since those people most likely to use health insurance are the most likely to buy it.

IOMA, the Institute of Management and Administration, reported that an audit of a large plan can generally expect to find 10 - 15 percent of covered dependents are ineligible; smaller plans might uncover an ineligible rate of 5 percent. Here are the steps to conducting your firm's eligibility audit.

1. **Employees.** Review the eligibility criteria outlined in your health plan documents. If your plan covers only full-time employees, make sure all enrollees meet the service requirement. Allowing some employees with reduced hours to retain coverage and not others is discriminatory and could lead to lawsuits.

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2 COBRA beneficiaries. Make sure any COBRA beneficiaries meet eligibility criteria — beneficiaries can generally continue coverage under COBRA for up to 18 additional months after a “qualifying event” changes their employment or dependent status. If COBRA beneficiaries fail to pay premiums on time, you can remove them from your plan.

3 Dependents. Next, review your health plan’s criteria for dependent eligibility. Does the definition of “family member” meet current state and federal laws? Some areas to pay attention to include: Who qualifies as a spouse? Do you need to cover same-sex spouses or domestic partners? When does a person no longer qualify as a spouse — after legal separation or after divorce?

4 Amnesty period. Many employers conducting eligibility audits offer an amnesty period, typically 30 to 90 days, in which employees can drop ineligible dependents from their plan without penalty. If you offer an amnesty period, inform employees of the criteria for dependent coverage eligibility and whom is enrolled as a dependent under their plan.

5 The audit. After the amnesty period, you may elect to audit all employees or conduct a random audit, depending on the number of enrollees. In an audit, your plan administrator or consultant would look for inconsistencies, such as benefit checks being sent to a spouse at a different address. Because the auditor will have to ask questions about dependents and other personal matters, you may wish to hire a consultant to eliminate any suggestion of discrimination.

6 Cleanup. When the audit turns up dependents whose status is questionable, you can require documentation to prove the dependent’s eligibility. These might include marriage certificates, joint federal tax returns, municipal or state registration of domestic partnership or civil union, partnership affidavit, birth certificate, adoption certificate, guardianship documents or a divorce decree showing custody.

7 Maintenance. To keep your benefit rolls clean, require employees to provide proof of eligibility upon enrollment. Then schedule regular audits. The premium savings could more than cover the cost of an audit.

8 New rules for young adults. The Affordable Care Act requires plans and issuers that offer dependent coverage to make coverage available until a child reaches age 26, regardless of whether the child is married, living with the parent, financially dependent on the parent or eligible to enroll in his/her own employer’s plan. (Until 2014, “grandfathered” group plans do not have to offer dependent coverage up to age 26 to young adults eligible for group coverage outside their parent’s plan.)

9 Cost-sharing. If dependent health costs are becoming too burdensome, have employees share a larger portion of the premium cost. Between 2011 and 2012, nearly half of companies surveyed by Towers Watson and the National Business Group on Health (NBGH) increased employee contributions in tiers with dependent coverage, and about a quarter surcharged employees for spousal coverage.

10 Plan design. Account-based arrangements, such as health savings accounts (HSAs) and health reimbursement arrangements (HRAs), and premium reimbursement plans (PRPs) can give employees more control over their benefit choices, while controlling employer costs. For more information on these options, please contact us.

Audit Alert!

When conducting a dependent audit, please be aware that the Affordable Care Act prohibits health plans from rescinding coverage, except in the event of fraud, intentional misrepresentation of material fact or failure to pay premiums on time. "Rescission" generally means to cancel with some retroactive effect.

The U.S. Department of Labor (DOL) expressly states that the prohibition "is not limited to rescissions based on fraudulent or intentional misrepresentations about prior medical history." Employers can cancel coverage due to some plan errors (such as mistakenly covering a part-time employee) prospectively, but cannot retroactively rescind coverage unless there was some fraud or intentional misrepresentation by the employee." In other words, you cannot cancel coverage back to the date the event occurred, whether it was a reduction in hours, divorce or other event that caused the employee or dependent to become ineligible for coverage. You also cannot charge back premiums for an employee or dependent mistakenly left on the rolls if no fraud or failure to pay amounts due occurred.

The DOL also notes that, "On the other hand…some employers' human resource departments may reconcile lists of eligible individuals with their plan or issuer via data feed only once per month. If a plan covers only active employees (subject to the COBRA continuation coverage provisions) and an employee pays no premiums for coverage after termination of employment, the Departments do not consider the retroactive elimination of coverage back to the date of termination of employment, due to delay in administrative record-keeping, to be a rescission."

Even when a rescission is justified, the law requires you to give employees a minimum of 30 days' notice before rescinding coverage.

Take-away points:

- ✔ Ensure plan documents clearly state who is eligible for coverage.
- ✔ Include a statement in enrollment documents that says attempting to enroll a dependent who does not meet eligibility requirements will be treated as fraud or material misrepresentation and subject to rescission.
- ✔ Require documentation for dependent coverage.
- ✔ Conduct regular eligibility audits.

For advice, please contact us or an employment attorney.

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