

Staff Up: Hiring for Start Ups

What to do about employee benefits

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Agenda

- Why even offer employee benefits?
- Benefits are a form of compensation
- Defined contribution vs. defined benefit
- Core benefits
- Administration and compliance
- Working with an advisor

Why even offer employee benefits?

The opportunity

- The following are the reasons most typically cited for offering employee benefits:
 - Attract and retain talented employees.
 - The tax advantages afforded employee benefits.
 - Align compensation packages with those offered in the marketplace.
 - By achieving higher levels of employee morale absenteeism and presenteeism are reduced and productivity is thereby enhanced.
 - Employees often will accept better benefits in lieu of a higher wage - can be a savings to the business.

Why even offer employee benefits?

The challenges

- Most employees unfortunately are unaware of the “buried treasure” represented by the amount their employer contributes toward their benefits along with the associated tax savings.
- They are also often mistaken about what benefits actually cost – that is, they frequently underestimate employer costs and overestimate their own share.

Why even offer employee benefits? The solution to the challenges

The 3 Cs

Communicate,
Communicate, and then...
Communicate



Benefits are a form of compensation

- The U.S. Bureau of Labor Statistics (bls.gov) each month publishes its “Employment Cost Index” report measuring the changes in compensation costs for US employers.
- The March 2011 report, released at the end of last month, states that wages and salaries make up about 70% of total compensation costs, and benefits the remaining 30%.
- Put another way, benefits on average cost > 40%

Benefits are a form of compensation

- The BLS data includes, as employee benefits, everything other than direct wages. This would include items such as employer subsidies of insurance and retirement plans, paid-time off (holidays, sick days, and vacations), etc.
- When structuring compensation and benefits packages start-ups need to balance their business cash flow and human capital needs.
- Benchmarking of pay and benefits is highly recommended. For help turn to your professional advisors and any trade associations you belong to.

Defined contribution vs. defined benefit

- These terms are most commonly used to describe retirement plan arrangements, but they're also appropriate to use when describing how one might go about subsidizing the cost of other plans.
- The key, particularly for start-ups, is to develop a “benefits budget” that is informed by benchmarking and other reliable sources of advice.

Defined contribution vs. defined benefit

**Think DEFINED
CONTRIBUTION!**



Core benefits

- Core benefits are employee benefit plans sponsored by employers.
- The employer's "sponsorship" is by virtue of the payment of expenses associated with implementing and administering the plans (most typically through 3rd parties), the provision of subsidies or partial reimbursements of the insurance premiums (in the case of insurance plans), or simply providing access to coverage at the employees' expense.

Core benefits

- Here are some examples of core benefit plans:

Health insurance	Life and accidental death & dismemberment (AD&D) insurance
Dental insurance	Vision insurance
Short term disability insurance	Long term disability insurance
Section 125 – premium only, individual premium account, health care, dependent care, transit, parking, etc.	Retirement plans

Core benefits – Health insurance

- Two ways for small start-ups to buy health insurance:
 - Small employer group market
 - Individual market

Core benefits – Health insurance

- In Illinois the small employer group market is subject to rules promulgated around the Small Employer Health Insurance Rating Act (SEHIRA – (215 ILCS 93)).
- SEHIRA applies to employers with 2-50 total employees, full or part-time.
- Rates are subject to a maximum rate-up of 67% over the best rate available from the insurance company based purely on demographics
- A small group's health status is determined from information that's disclosed on the new "Illinois Standard Health Employee Application" (<http://insurance.illinois.gov/healthapp/>).

Core benefits – Health insurance

- The insurance companies operating in this market space in the Chicago area are Aetna, Assurant Health, Blue Cross Blue Shield of Illinois, Coventry, Humana, and UnitedHealthcare.
- Insurance companies cannot turn small employer groups down, but with smaller employer groups (i.e. 5 or less employees) one individual with a chronic condition can result in a maximum rate-up for the group. This kind of outcome can make the insurance premiums unaffordable for the business. There is a workaround to this that we will cover later, though.

Core benefits – Health insurance

- The small employer group market is heavily regulated, and there are many coverage mandates on such plans in Illinois which drive premium costs up.
- No preexisting condition limitations may be imposed in the case of employees who have “prior creditable coverage” before becoming covered under a small employer group plan.
- Because of the federal Affordable Care Act (aka “ObamaCare”) children under the age of 19 are now no longer subject to preexisting condition limitations under any circumstance. In 2014 this preex prohibition will be extended to adults.

Core benefits – Health insurance

- In the case of a start-up with just a few employees where someone has a chronic condition a possible “workaround” is to forego the small employer group market and instead buy coverage for everyone in the individual market.
- Under current law the issuance of coverage in the individual market is NOT guaranteed. Therefore, because of preexisting conditions one may be declined, rated up, or have specific known conditions excluded from coverage. However, the health insurance risk pool in Illinois – The Illinois Comprehensive Health Insurance Plan (“ICHIP”) – provides coverage options for anyone who is unable to purchase coverage on a “standard” basis.

Core benefits – Health insurance

- Those who are reasonably healthy are able to buy insurance in the individual market, and those who have preexisting medical conditions that preclude them from buying such coverage are able to buy reasonably affordable coverage through ICHIP.
- Some of the advantages of this approach are the following:
 - True portability of coverage – Individual policies are issued to the insured and NOT to the group. Therefore, these policies are not tied to one's employment.
 - The employer is spared of administering coverage continuation requirements under state or federal law.
 - The tax-favored status of employment-based health insurance can be replicated through setting up “Individual Premium Accounts” under a Section 125 plan.

Core benefits – Health insurance

- Individual policies do not have all of the coverage mandates that one sees with the small employer group plans, so this helps with affordability.
- The design of individual policies is subject to the discretion of the policyholder. Each individual may select the levels of deductibles, out-of-pocket limits, copays (if any), etc. that he / she wants in the policy. This is in stark contrast to a “one-size-fits-all” approach that one has in the small employer group market.
- Individual policies are age-rated, typically in 5-year age brackets. Contrast this to rating under small employer group plans which is typically “composite-rated” based on the group’s demographics.



Core benefits – Health insurance

- **Coverage options:**
 - **Small employer group market:** Typically arranged as a dual or triple option for employees to choose from at the point of enrollment. It is up to the employer to determine how the 2 or 3 coverage options are subsidized.
 - HMO, PPO, and HDHP (high deductible health plan) are typical triple option offerings.
 - The HDHP is usually an “HSA-qualified” plan that enables one to offer HSAs (health savings accounts) for managing the risk of the higher deductible.



Core benefits – Health insurance

- Coverage options:
 - HMOs are falling out of favor because there is no longer much, if any, cost savings associated with them. PPOs are the most common plan that is offered.
 - In the Chicago market HRAs (health reimbursement arrangements) are becoming increasingly popular. An HRA is typically paired with a higher deductible PPO plan that has office visit and prescription copays. The HRA is funded by the employer to “buy down” the deductible, and it is either administered by the insurance company or a third party administrator.



Core benefits – Health insurance

Health savings accounts (HSAs)

Health savings accounts (HSAs) are the “next big thing” to happen to health insurance in the United States.

HSAs were included in the 2003 Medicare Modernization Act, a federal law. Although they’ve been around since January 1, 2004, legislative and regulatory changes since then have made these accounts more attractive than ever before.

Core benefits – Health insurance

Health savings accounts (HSAs)

- HSAs provide a means for consumers to “own” their health care by over time accumulating monies in a tax-free account which may either be used to currently reimburse health care expenses or be saved for the future.
- Under federal law one may have an HSA provided they are enrolled in a qualified health plan.

Core benefits – Health insurance

Health savings accounts (HSAs)

The qualified health plan (in 2011)

- Minimum annual deductibles are \$1,200 for self-only coverage and \$2,400 for family coverage.
- Annual out-of-pocket expenses (deductibles, co-payments and other amounts, but not premiums) in 2011 may not exceed \$5,950 for self-only coverage and \$11,900 for family coverage.
- Below the deductibles copays for office visits and prescription drugs are not permitted.



Core benefits – Health insurance

Health savings accounts (HSAs)

Prescription coverage: Under the qualified health plan, even though prescriptions are subject to the deductible, nevertheless members receive the health plan's negotiated (reduced) price at the point of dispensing.

When prescriptions are filled, one may access HSA funds to pay for them through the (typically free) debit card associated with the account (provided the account has sufficient funds).

Core benefits – Health insurance

Health savings accounts (HSAs)

The 2011 HSA contribution limits

- In 2011 anyone under the age of 65 with self-only coverage under an “HSA-qualified plan” may fund up to \$3,050, and those with family coverage up to \$6,150, either on a pre-tax basis through an employment-based Section 125 plan or as an “above-the-line” deduction on one’s tax return.
- Further, anyone who is 55 or older may make an annual “catch-up contribution” of \$1,000.

Core benefits – Health insurance

Health savings accounts (HSAs)

Employers may make tax-free contributions to employees' HSAs. Any such contributions are subject to the overall account contribution limits noted above. In other words, any combination of employer and employee funding of one's account may not exceed these overall annual contribution limits.

Core benefits – Health insurance

Health savings accounts (HSAs)

All monies contributed to HSAs – whether such contributions are made by one’s employer or the accountholder - are from Day 1 **owned** by the accountholder. In sharp contrast, there is never any real “ownership” of funds in a healthcare flexible spending account (FSA).

Core benefits – Health insurance

Health savings accounts (HSAs)

Under HSA rules one may “use it (the account) or save it”. There is no requirement with HSAs like there is under the healthcare FSA rules to spend the account prior to the end of the plan year or forfeit the remaining balance. Under FSAs this is commonly referred to as the “use it or lose it” rule.



Core benefits – Health insurance

Health savings accounts (HSAs)

With HSAs one may only spend what is in the account. Conversely, healthcare FSAs have a “prefunded account rule” that requires one’s employer to fund eligible claims upfront up to the employee’s annual deferral election even if the funds contributed to date are not sufficient to fund the claim.



Core benefits – Health insurance

Health savings accounts (HSAs)

Even though one may only spend what is in one's HSA, the workaround when one has a large expense in month 1 or 2 of the first year and little or no money yet in the account is to either take money out of savings or use a credit card to pay for the expense. Then as funds are contributed to the HSA one may simply reimburse himself / herself for the expense after the fact.

Core benefits – Health insurance

Health savings accounts (HSAs)

Prior to the age of 65 monies may be withdrawn tax-free provided they are used for qualified medical expenses.

Once a person reaches 65, monies held in account may either be used to generate income (which is taxable like an IRA) OR be used to tax-free reimburse health care expenses, including the cost of Medicare premiums for B and D and long term care insurance.

Core benefits – Health insurance

Health savings accounts (HSAs)

If funds are withdrawn under one's age of 65 for any reason other than to pay for or reimburse qualified medical expenses there is a 20% non-deductible tax penalty that's assessed in addition to the entire distribution being subject to income taxes.

Core benefits – Health insurance

Health savings accounts (HSAs)

There are several Chicago area HSA custodians that offer free accounts with the following types of features:

- Interest bearing account
- No minimum deposit
- No monthly fee provided there is a valid email address associated with the account
- Free debit card
- Free online banking
- Free bill payment
- Free eStatements

Core benefits – Health insurance

Health savings accounts (HSAs)

- When using a network provider you will not know the actual amount of the bill until that provider first electronically bills your health insurance plan. These days about 80% of physician claims are auto-adjudicated, and something on the order of 95%+ of claims processed are typically turned around within 10 business days.
- Once this occurs an Explanation of Benefits (EOB) form is generated and posted to the member portal. Otherwise you can always wait for the EOB to arrive by mail.
- Once you and your physician know the actual amount of the bill, that is when payment reasonably can be made.

Core benefits – Health insurance

Health savings accounts (HSAs)

- If you sufficiently fund your HSA, you may...
 - Utilize the free debit card that comes with the account,
 - Pay the provider by check (from the account) – Note: Checks are available for an additional cost, or
 - Pay the provider with another credit card or check and reimburse yourself from your HSA through BillPay or by writing a check.

Core benefits – Health insurance

Small Business Health Care Tax Credit

- The Small Business Health Care Tax Credit is available to employers with less than 25 FTEs earning average annual wages less than \$50,000. Employers must pay at least half the cost of single coverage for their employees. The tax credit was:
 - Developed to encourage small businesses and tax-exempt organizations to offer health insurance coverage.
 - Targeted specifically to organizations that employ moderate- and low-income workers.
 - May enable eligible employers to expand their benefit plans to include specialty benefits, and potentially offer a richer plan to their employees.

Core benefits – Health insurance

Small Business Health Care Tax Credit

- UnitedHealthcare offers an excellent online modeling tool at <http://bit.ly/hDrqgX> around this tax credit. It can help determine one's eligibility for the credit based on:
 - Number of FTEs employed.
 - The average annual wages of FTEs.
 - Annual employer premium payments.
 - If the employer meets eligibility requirements, this tool then uses the state-specific average premium amount to calculate the estimated credit amount.
- The maximum credit is worth up to 35% of a company's premium costs (25% for tax exempt employers). The credit gradually phases out for employers with 10-25 FTEs with average wages between \$25,000 and \$50,000.

Core benefits – Life insurance

- In 2011 the purchase of group life and accidental death and dismemberment (AD&D) insurance as an employer-paid benefit for start-ups is not as common as has been in years past.
- When provided as employer-paid benefit most small businesses will pay for either a flat dollar amount of coverage (like \$25,000) for all eligible employees, or maybe tie the benefit to one's annual wages, such as 1 x's salary / wages.
- A trend we are seeing is the offering of an option to employees to buy life insurance with little or no medical underwriting as a voluntary, employee-paid benefit through payroll deduction. The voluntary coverage is typically portable after the employee's separation from service.

Core benefits – Dental insurance

- Because of the high cost of health insurance, the prevailing trend among small employers is away from subsidizing dental coverage to simply providing access to a plan through payroll deduction.
- Employees' premiums for dental insurance may be run through a Section 125 "premium only" plan, saving the payroll taxes for the employer and employees and federal and state income tax for employees.
- There are several insurance companies that offer voluntary dental plans in the Chicago market. Typical monthly rates for a dental HMO are \$15 for single coverage units and \$50 for families. PPO plans are \$30 for single coverage and \$90-\$95 for families.

Core benefits – Vision insurance

- Like dental insurance, vision plans are typically offered as a voluntary, employee-paid benefit by simply providing access to a plan through a Section 125 “premium only” plan.
- There are several insurance companies that offer voluntary vision plans in the Chicago market. Typical monthly rates are \$7 for single coverage and \$15-16 for families.
- Benefits under such plans are maybe a \$10 copay for an exam and a \$25 copay for materials (i.e., lenses and frames).



Core benefits – Disability insurance

Short term disability (STD) insurance

- Most small employers do not offer short term disability insurance. Most typically they have some kind of very short term sick pay arrangement as part of their paid time-off (PTO) policy.
- If STD insurance is offered, most small employers offer a voluntary plan with benefits paid at 60% of wages after 2 weeks of disability, and benefits usually end after 6 months.

Core benefits – Disability insurance

Long term disability (LTD) insurance

- LTD coverage is very important. Like higher deductible health insurance it helps one manage the risk of a catastrophic event, in this case the long term loss of one's ability to earn a living because of a disability.
- If a disability plan is in any way subsidized from a cost perspective it is usually an LTD plan because of 1) the valuable financial protection that is afforded and 2) the reasonable cost for such. A typical annual premium is \$250-\$300 per employee.

Core benefits – Section 125

- Every small employer client of ours either has a premium only plan (to shelter employees' contributions toward health, dental, vision, and HSA) or an individual premium account (for clients who tax-free reimburse a portion of their employees' individual health insurance).
- Many of our larger clients, typically with over 20-25 employees, sponsor Section 125 plans to tax-free reimburse health care, dependent care, transit, and parking expenses. These plans are administered by TPAs (third party administrators) for a fee.

Core benefits – Retirement plans

- **SIMPLE IRA** — A savings incentive match plan for employees, better known as a SIMPLE IRA, is easy to set up and might be a good choice if you have employees and want to let them make their own contributions. As the employer, you're still required to make a small matching contribution of 1% to 3% of each employee's compensation, including your own.
- For 2011 eligible employees may contribute 100% of their income up to a limit of \$11,500. Participants who are 50 or older can make an additional \$2,500 "catch-up" contribution for 2010.
- A SIMPLE plan must be in existence by October 1 of the year for which contributions are claimed. You have until the due date of the tax return plus extensions to deposit employer contributions.

Core benefits – Retirement plans

- **SEP-IRA or QRP (Keogh).** SEP = “simplified employee pension” / QRP = “qualified retirement plan” (aka Keogh). With a SEP-IRA or QRP the employer makes the contributions (employees can't contribute), and the tax-deductible contribution limits are much higher than with a SIMPLE IRA: 25% of employee compensation (20% of net self-employment income for the owner) up to a \$49,000 limit for 2011.
- One may set up a SEP-IRA as late as the date the tax return is due (including extensions) for the year in which you claim the tax-deductible employer contribution. However, a QRP has to be in existence by December 31 of the year for which contributions are claimed, though contributions themselves may be deposited as late as the due date (plus extensions) for that year's tax return.

Core benefits – Retirement plans

- **Individual 401(k).** An Individual 401(k) offers benefits similar to a traditional 401(k), but requires less administration. These plans allow for contributions up to 25% of compensation (20% of net self-employment income for the owner) and an additional \$16,500 salary deferral (for 2011), to the maximum limit of \$49,000 (maximum of \$54,500, including the 2011 catch-up contribution of \$5,500 for those 50 or older).

An employer has to establish an Individual 401(k) before the end of the year, but can make contributions by the tax-filing deadline, including extensions.

Administration and compliance

- In 2011 employers are not mandated by the government to offer employee benefits. In 2014 there is coming into play an employer mandate for providing health insurance for employers with 50 or more employees, but that is not going to apply to most of you.
- Earlier in this presentation we address the reasons for offering employee benefits. The BIG RUB with doing such, though, is the additional administrative burden and compliance complexities that are associated.

Administration

- Basically here we are talking about employee benefit communication, enrollment, payroll, and billing. Point is if you don't offer benefits, then you have less administration, obviously, to deal with.
- Small employers that offer employee benefits often get into trouble because of a lack of attention to detail around these administrative functions.
- Make sure you have a good accountant, payroll service, and / or employee benefit advisor to help you minimize the pain that's associated. Also, talk to your insurance agent about employee benefit liability coverage. It is inexpensive and invaluable.

Compliance

- Small employer group health insurance plans are subject to either or both state / federal coverage continuation requirements.
- Firms with less than 20 employees are subject to the Illinois coverage continuation requirements found at <http://insurance.illinois.gov/HealthInsurance/continueL.pdf>.
- If you have 20 or more employees, your health, dental, vision, and flexible spending account (FSA) plans are subject to the federal COBRA continuation law.
- We recommend that these compliance requirements be outsourced to a professional third party administrator to ensure one's compliance.

Working with an advisor

- Given the ever-changing employee benefit landscape one is well served by hiring a competent, professional advisor.
- In the start-up / small employer space employee benefit advisors are typically paid sales commissions / broker fees by the insurance companies and third party administrators the broker / advisor places business with.
- When looking for an advisor be sure to look for professionals who take their businesses seriously through continuing education and involvement in national trades like the National Association of Health Underwriters (NAHU), the National Association of Insurance & Financial Advisors (NAIFA), Society for Human Resource Management (SHRM), etc.

Questions?

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