A Guide to Understanding Employee Benefits

An Honors Thesis (HONRS 499)

By

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April, 2010

Expected Graduation Date
May 8, 2010

Abstract

In response to the growing competitiveness in today's workforce, employee benefits have become a greater part of employee compensation and recruiting practices. Employee benefits include all benefits and services, other than wages for time worked, that employees receive from their employers. Employee benefits include health insurance, retirement plans, disability income insurance, life insurance, dental insurance, and other forms of payments and services such as bonuses and personal time off. Because of the growing importance of employee benefits, it is important for employees to understand what benefits they are offered, how the benefits work, and where their money is going. In response to this need, I give brief descriptions of the most accepted benefits. Following the descriptions, I discuss and analyze an employee benefit plan offered by Thrivent Financial for Lutherans. The analysis gives a real life example of plans seen by thousands of employees and offers further understanding of employee benefit plans.

Acknowledgements

I want to thank Dr. Barb Stedman for directing me as I started my thesis. She was extremely helpful in describing what I must do to complete my thesis and also in brainstorming a topic.

I would also like to thank Dr. Kevin Gatzlaff for being my thesis advisor. He was exceptionally beneficial in answering my questions about employee benefits and correcting my work. Without his positive attitude, encouragement, and technical expertise in the area of employee benefits, I would not have become interested in employee benefits. He was a great asset while writing my thesis.

I would also like to thank my father, Carl Etzler. He is a financial representative for Thrivent Financial for Lutherans and was helpful in explaining his employee benefits package.

Lastly, I would like to thank my friends, Bethany Magill and Brody Norris, for taking time to proofread my thesis.

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Introduction

Employee benefits include all benefits and services, other than wages for time worked, that employees receive from their employers. Employee benefits can be broken down into three separate categories:

1. Legally mandated government programs
    - Social Security
    - Medicare
    - Unemployment compensation insurance
    - Worker's compensation insurance
    - Disability insurance
2. Payments for private insurance
    - Health insurance
    - Retirement plans
    - Disability income insurance
    - Life insurance
    - Dental insurance
3. Miscellaneous payments and services
    - Holidays
    - Vacations
    - Personal time off with pay
    - Personal time off without pay (Family Leave)
    - Bonuses
    - Financial planning programs

The first category, also referred to as social insurance, is specifically for legally required payments for government sponsored programs. These government mandated benefits will not be discussed within the thesis because they are required of every employer in the United States. Instead, category two, payments for private insurance, and category three, miscellaneous payments and services, will be discussed due to their growing significance for prospective employees. This will constitute Part One of the thesis.

Part Two of the thesis will consist of an analysis of the employee benefit package offered to employees of Thrivent Financial for Lutherans. The employer, Thrivent Financial for Lutherans, was chosen because it is the company that I have worked for as an intern for three consecutive summers. The employee benefit package will be identified, examined, and used as a further explanation for Part One of the thesis.

Part One

Payments for Private Insurance

Payments for private insurance include the following group coverages: health insurance, retirement plans, disability income insurance, life insurance, and dental insurance.

Health Insurance

Health insurance is broken up into three types of coverages. The first is traditional insurance, which allows employees freedom to choose health care providers. Traditional insurance includes basic medical expense and major medical. The second is managed care, which controls access to providers and emphasizes cost-effective health care. Managed care includes health maintenance organizations (HMOs), preferred provider organizations (PPOs), and point-of-service plans (POSs). The third type is consumer directed health plans (CDHPs) which gives employees increased choices and responsibility when selecting medical expense coverage.

In order to be covered under an employer sponsored medical expense plan an employee must be in a covered classification, must satisfy a probationary period, and must be a full-time employee. In most cases, part-time employees are not eligible for health benefits. Dependents such as an employee's spouse and unmarried children, if covered, are offered the same health benefits as the employee. Contributions by the employer for an employee's health coverage are tax deductible to the employer under Code Section 162, and benefits are not taxable to the employee under Code Section 105 (Beam, Burton T. and McFadden, John J. 391). Employee contributions are tax deductible when participating in an employer's group plan whereas an individual purchasing health insurance on his or her own cannot deduct the contributions.

Traditional Health Insurance

A traditional medical expense plan is a plan that provides protection against financial losses due to medical expenses resulting from an accident or an illness. In a traditional medical expense plan patients choose a doctor, pay for the service, and file a claim to be reimbursed. The most important aspect of traditional coverage is that an employee may choose his or her health care provider.

The three primary suppliers of traditional coverage include Blue Cross and Blue Shield, insurance companies, and employers who choose to self insure. According to the Blue Cross and Blue Shield Association (2009), the "Blues" is a national federation of thirty-nine Blue Cross and Blue Shield companies that provide millions with top quality, affordable health care. Starting out as two separate companies, Blue Cross for hospital insurance and Blue Shield for physicians' insurance, the Blues have combined operations to form a healthcare system that provides health insurance for one out of every three Americans (BlueCross BlueShield Association). Although in the past the Blues were the most common health insurer, today insurance companies write the majority of group medical expense policies. A smaller amount of large employers choose to self insure. Self-insurance is a method by which an employer can finance the cost of its employee health insurance benefit. The employer chooses to pay for benefits from current revenue, administer the plan, and bear the risk that benefit payments will exceed expected payments (Beam, Burton T. and McFadden, John J. 763).

Basic Medical Expense

Basic medical expense coverage consists of benefits for hospital expenses, surgical expenses, and physicians' visits expenses. Hospital expense coverage provides benefits for employees and their covered dependents for inpatient and limited outpatient charges incurred in a hospital. Inpatient benefits consist of room and board coverage which includes the cost of the hospital room, meals, and services. Other charges include services and supplies ordered by a physician such as drugs, laboratory services, and x-rays.

Surgical expense coverage provides benefits for physicians' charges associated with surgical procedures. It provides coverage for the surgeons' fee as well as the assistant surgeons' and anesthesiologists' fees. Coverage is available for surgery performed in a hospital as well as outpatient surgery performed in an ambulatory surgical center or physician's office. Most surgical expense plans provide benefits on a reasonable and customary basis meaning it pays within a range of fees charged for a procedure by physicians of similar training within a geographic area (Beam, Burton T. and McFadden, John J. 265).

Physicians' visits expense coverage provides benefits for charges of physicians other than surgeons (because surgeon's fees are covered under surgical expense). Benefits cover physician's visits while in an intensive care unit, coverage for consultation services, coverage for care in medical care facilities, coverage for care in a physician's office or in an insured's home, and some coverage for baby-well care.

Basic medical expense plans provide limited coverage for an insured. They must be combined in order to provide adequate benefits for a major accident or illness. However, even when used together they may not cover all basic expenses associated with a hospital stay or physician visit. Basic medical expense plans also tend to have a substantially lower maximum benefit than other types of medical plans provide. For these reasons, basic medical expense coverages are mostly used to supplement a major medical plan instead of used as a primary coverage.

Major Medical

Most employers today provide major medical coverage to their employees. Major medical plans provide substantial protection against catastrophic medical expenses arising from a devastating illness or accident. Unlike basic medical expense plans, major medical plans offer a broader range of coverage and higher overall maximum benefits (usually $1-2 million). Because major medical plans are more expensive to administer, employees are usually required to pay part of the cost through deductibles and coinsurance provisions. These are four characteristics that distinguish major medical coverage from other types of health insurance.

Major medical offers extensive coverage for expenses incurred for medical visits, services, and supplies. Major medical encompasses hospital expense coverage by insuring hospital room and board as well as other necessary hospital charges such as drugs, x-rays, and laboratory services. It encompasses surgical expense coverage by insuring services of surgeons and anesthesiologists. It also encompasses physicians' visit expenses by insuring services of registered nurses and other service providers including audiologists, therapists, dieticians, physical therapists, and in some plans chiropractors and optometrists. Other covered expenses include but are not limited to outpatient surgical centers, anesthetics, prescription drugs, physical and speech therapy, radiation therapy, blood, artificial limbs, pacemakers, casts, braces, crutches, wheelchairs, and ambulance services (Financial Web).

Although major medical is broad, it contains specific exclusions and limitations. Most importantly, major medical plans exclude pre-existing conditions. A pre-existing condition is an illness or injury for which an insured received medical care during the three month period prior to the individual's effective date of coverage (Beam, Burton T. and McFadden, John J. 272). The condition is not considered pre-existing if the individual does not receive care for the condition for a period of three months or after twelve months of treatment under the major medical plan. This exclusion is in place in order to protect the insurer from adverse selection. Other key exclusions include cosmetic surgery, benefits provided under worker's compensation, dental care, and Medicare.

An employee must satisfy a deductible before receiving benefits under major medical. A deductible is the initial amount of covered medical expenses an employee must pay before he or she receives benefits. Most plans follow a calendar year deductible where an employee must only satisfy the deductible once per year. A few plans, however, use a per-cause deductible where a small deductible is paid for each accident or illness. In order to minimize the cost of deductibles for employees, most plans offer a family deductible. Because a deductible must be satisfied for each individual (this includes the employee and his or her dependents), a family deductible allows a smaller amount to be paid. For example, if an employee has three dependents and the deductible for each person is $200, the family deductible may be $500 instead of $800 (4 insureds times $200 each). Another condition to allow for lower deductibles is the common accident provision. The common accident provision states that if two or more insureds are injured in the same accident, only one deductible must be paid.

Employees contribute to the cost of major medical by the use of the coinsurance provision. Coinsurance is the percentage of the covered expenses that are paid by the major medical plan. Most plans have a coinsurance percentage of 80%. This means that the plan pays for 80% of the covered expenses while the insured employee pays the remaining 20%. For example, if an insured has a $500 deductible, an 80/20 coinsurance provision, and a $2,000 loss, the individual will pay the $500 deductible and 20% of the remaining $1500 for a total of $800. In addition, a stop-loss limit may be used to reduce the amount paid out of pocket by an insured.

Managed Care

Because of the rise in the cost of health insurance, managed care has become a popular choice for many employers. According to the American Journal of Managed Care (2009), a goal of managed care is to take effective steps to address long-term healthcare spending growth by promoting prevention and wellness and reducing inefficiency. It has grown in recent years in response to demands by employers and government for cost containment, enhanced access to providers, and improved quality (Franks, JT 703).

Managed care is a term used for any system that manages healthcare delivery with the aim of controlling costs without sacrificing quality. Managed care systems typically rely on a primary care physician who acts as a gatekeeper through whom the patient has to go to obtain other health services such as specialty medical care, surgery, or physical therapy. Managed care works by limiting an insured's choice of health care provider. The contracted providers are then paid at reduced rates of reimbursement. Decisions made by these providers are influenced by the managed care organization through utilization management and quality assurance. Because of this, financial risk is shifted from insureds and insurance companies to health care providers to influence further clinical decision-making (Franks, JT 703).

Managed care programs often include six basic characteristics (Beam, Burton T. and McFadden, John J. 294). The first characteristic is the concept of controlled access to providers. By limiting an insured's choice of health care provider, managed care can control costs through negotiated reduced fees with contracted providers. A second characteristic is comprehensive utilization management. This includes examining cases, monitoring care, and reviewing the appropriateness and success of treatment to make sure resources were used efficiently and effectively. A third characteristic is preventive care. Managed care promotes overall well-being and the prevention of future health care problems through yearly physicals and other regular check-ups. A fourth characteristic is risk sharing where risk is shifted from payers and insurance companies to the contracted providers. High quality care is a fifth characteristic of managed care. Although one of the main goals of managed care is cost containment, health care cannot reduce costs by reducing quality. Lastly, managed care uses referral management where a primary care physician acts as a gatekeeper before an insured can see a specialty physician such as a cardiologist or urologist.

There are three primary types of managed care organizations: health maintenance organizations (HMOs), preferred provider organizations (PPOs), and point-of-service plans (POSs).

Health Maintenance Organizations (HMOs)

Health maintenance organizations are by far the most common type of managed care. An HMO is an organized system of health care that provides a comprehensive selection of medical services on a prepaid basis to insured persons living within a specific region (Beam, Burton T. and McFadden, John J. 309). HMOs focus on wellness by providing annual physical examinations and other regular check-ups. Employers make a contract with an HMO so that insured employees pay an annual premium in return for health care access that is limited to the HMO's network of physicians and hospitals (Wilson, Jeffrey 873-881). The HMO requires the employee to choose a physician from the HMO as a primary care provider who must first be consulted for a medical problem. The primary care provider then decides whether or not the patient should consult a specialist or get a second opinion. This is known as the "gatekeeper function."

Three characteristics distinguish HMOs from types of traditional health care (Beam, Burton T. and McFadden, John J. 310). The first is the concept of comprehensive care. For a small copayment, HMOs offer its members a comprehensive package of health care services. Copayments are usually in the range of $10-$20 per visit, and employees generally do not require a deductible or coinsurance provision. Within this package of services, HMO's promote preventive care by the use of routine physicals and immunizations that in some cases do not require a copayment. A second characteristic is the delivery of medical services. Traditional health care reimburses an individual for health care expenses while HMO's not only pay for expenses but also deliver the medical care. In the staff model, the purest form of HMO, care is provided by salaried physicians and other employees of the HMO. The third characteristic is cost control which is found in all managed care programs. HMOs control costs by the use of preventive care, utilization management, and controlling payments for physician services.

There are many types of HMOs, each of which offer access to a range of providers (Health Maintenance Organization, Gale). In a staff model HMO, the HMO owns its facilities and hires salaried physicians. The facilities may include hospitals, laboratories, and pharmacies. Few staff model HMOs exist, however, because of the great start up cost. A group model is an

HMO that contracts with a physician group who are employed by a separate legal entity. The physicians are paid on a capitation basis, which means a provider gets a predetermined fee for each member cared for. The network model contracts with two or more independent groups of physicians. The staff model, group model, and network model are closed-panel HMOs because the members must only use physicians employed by the HMO. An individual practice association is a model where physicians practice individually or in small groups in their own offices. This is a form of an open-panel HMO because the plan allows members to choose physicians within the plan.

Below is a comparison between a major medical plan and an HMO. One major difference between an HMO and major medical is that major medical allows an insured to choose a health care provider while HMOs restrict that choice. A deductible and coinsurance must be exercised with major medical while an HMO requires only a small copayment. Maximum benefits are limited with major medical while HMOs have no maximum limits. Finally, HMOs cover 100% of preventive care while major medical still requires a deductible and possibly coinsurance.

Figure 1: Comparison of Major Medical and HMO

	Major Medical	HMO
Choice of provider	Choice of provider	Choose from participating physicians and hospitals
Deductible	Yes	No
Maximum limits	$1 million lifetime maximum	No overall maximum limits
Preventive care	Not 100% covered	100% covered
Coinsurance	Usually 80/20	100% coinsurance
Copayments	No	Yes, usually $10-20 per visit

Preferred Provider Organization (PPOs)

A PPO is a benefit plan that contracts with preferred providers in order to obtain lower-cost care for plan members (Beam, Burton T. and McFadden, John J. 326). The plan sponsor negotiates discounts with participating doctors and hospitals and pays them on a fee-for-service basis. Health care providers accept fees that are lower than the market rate in return for an increased volume of patients.

As with HMOs, most individuals who enroll in a PPO plan do so through their employer who usually pays part of the cost (Preferred Provider Organization, Gale). The employee is required to satisfy an annual premium (which may be deducted from a paycheck) and an annual deductible (that varies depending on whether the employee uses in-network or out-of-network health care providers). Most PPOs have a coinsurance provision such as 80/20 where the insurer pays 80% of the expenses while the employee pays the remaining 20%. Some PPOs also use small copayments at the point health care is received. If employees use in-network providers, PPOs usually do not have a lifetime maximum limit. However, like major medical, PPOs offer lifetime maximums if the employee uses out-of-network providers with the most common limit being one million dollars (Beam, Burton T. and McFadden, John J. 328). If an employee uses an

in-network provider, he or she does not need to file a claim. However, if an out-of-network provider is used, the employee must file the appropriate claim forms to receive benefits.

A major difference between a PPO and an HMO is that PPO members have the option of obtaining health care from outside the PPO network. However, the employees are offered an incentive to use the PPO's practitioners and hospitals. An employee will receive a higher level of benefits for care received from network providers than they would for care received from non-network providers. Also, unlike an HMO, a PPO does not use a primary care physician to act as a gatekeeper.

Below is a comparison between PPOs, HMOs, and traditional major medical. PPOs offer less choice of health care provider than major medical but more choice then an HMO. Because of this, PPO plans are, on average, more expensive than HMOs but less expensive than major medical plans.

Figure 2: Comparison of PPO, HMO, and Major Medical

	PPO	HMO	Major Medical
Choice of provider	Choice of in-network or out-of-network providers	Choose from participating physicians and hospitals	Choice of provider
Deductible	Yes	No	Yes
Maximum limits	Unlimited for in-network and $1 million for out-of-network	No overall maximum limits	$1 million lifetime maximum
Preventive care	Usually 100% covered	100% covered	Not 100% covered
Coinsurance	Usually 80/20	100% coinsurance	Usually 80/20
Copayments	May have small copayments or no copayments	Yes, usually $10-20 per visit	No

Point-of-Service Plans (POS)

A point-of-service plan is a hybrid between a PPO and an HMO plan. It may be referred to as a PPO plan with great flexibility. At the time that health care is needed, the employee may choose whether to receive treatment within the plan's network of physicians and hospitals or obtain treatment outside the plan's network. There is an incentive for using in-network providers, but the employee has the ultimate choice. If an in-network provider is chosen, the employee will pay a lower copayment. Likewise, if an out-of-network provider is chosen, the copayment is increased (Employee Benefits, 229-233). As in all managed care plans, the health care providers accept a discount for their services in exchanged for greater patient volume and referrals.

There are two types of POS plans. The first is an open-ended HMO which consists of HMO coverage with an endorsement for non-network coverage (Beam, Burton T. and McFadden, John J. 329). In essence, an employee may see a health care provider within the

HMO network or outside the network. The second type is a gatekeeper PPO which requires the employee to select a primary care physician to act as a gatekeeper. The gatekeeper must give the employee approval before he or she can see a specialist which ultimately controls health care costs to the POS plan.

Below is a comparison of a POS, a PPO, an HMO, and a major medical plan. A POS plan incorporates elements from an HMO and a PPO. It allows an employee to use in-network or out-of-network providers. A deductible and coinsurance applies only for out-of-network providers and usually does not apply to in-network providers. However, a copayment is used for each health care visit. Because it allows an employee more choice than an HMO, it is more expensive than an HMO but less than a major medical plan.

Figure 3: Comparison of POS, PPO, HMO, and Major Medical

	POS	PPO	HMO	Major Medical
Choice of provider	Choice of in-network or out-of-network providers	Choice of in-network or out-of-network providers	Choice of participating physicians and hospitals only	Choice of provider
Deductible	Only for non-network providers	Yes	No	Yes
Maximum limits	Unlimited for in-network and $1 million for out-of-network	Unlimited for in-network and $1 million for out-of-network	No overall maximum limits	$1 million lifetime maximum
Preventive care	100% covered	Usually 100% covered	100% covered	Not 100% covered
Coinsurance	Only for out-of-network	Usually 80/20	100% coinsurance	Usually 80/20
Copayments	Yes	May have small copayments or no copayments	Yes, usually $10-20 per visit	No

Consumer Directed Medical Expense Plans

Consumer directed medical expense plans give the employee increased choices and responsibilities with the selection of his or her own medical expense coverage (Beam, Burton T. and McFadden, John J. 343). Consumer directed medical expense plans use a savings account in addition to a health plan. For example, an employer may provide employees with a high deductible health plan as well as a contribution into a savings account. The money in the savings account can be used by the employee to pay medical expenses that are not covered by the health plan because the deductible has not yet been satisfied. The use of a high deductible medical expense plan and a savings account can lead to considerable costs savings (Beam, Burton T. and McFadden, John J. 345). It eliminates the cost of administering and paying small claims and also gives employees an incentive to seek cost-effective health care.

There are two forms of consumer directed medical expense plans. The first is a health reimbursement arrangement (HRA) and the second is a health savings account (HSA). The largest distinction between the two is that only employers can establish HRAs for employees while HSAs can be set up by an employer or an individual.

Health Reimbursement Arrangement (HRA)

An HRA is a type of personal savings account that is set up for an employee by an employer and used to pay unreimbursed medical expenses. It is most commonly established with a high deductible health plan but is not required. HRAs can be established by any employer for its employees except when an individual is self-employed. Only the employer can make contributions into an employee's HRA (Health Savings Accounts 361-362). However, the employee may be required to pay part of the premium for the high deductible health plan. HRA contributions can be carried over to subsequent years. However, when an employee terminates employment, the HRA account reverts back to the employer.

Health Savings Account (HSA)

Health savings accounts were established by the Medicare Prescription Drug, Improvement, and Modernization Act (Beam, Burton T. and McFadden, John J. 348). An HSA is an investment vehicle from which individuals can withdraw funds to pay qualified medical expenses including deductibles, coinsurance, and copayments (Health Savings Accounts 361-362). The HSA must be set up in the form of a trust or custodial account established with a high deductible health plan. According to the IRS, for 2009, a high deductible health plan is one with at least a $1,100 deductible for an individual or a $2,200 deductible for a family (Health Savings Accounts 361-362). The account can be set up by an employer for the benefit of its employees, or it can be set up by an individual through insurance companies and banks. Contributions to an individually set up HSA are made directly by that individual and are deductible for federal income tax purposes. For an employed person, contributions can be made by the employer and the employee. Employer contributions are tax deductible to the employer. The employee must pay a premium for the high deductible health plan and may choose whether or not to contribute to the HSA. For 2009, the maximum annual HSA contribution for an individual is $3,000 and for a family is $5,950 (Health Savings Accounts 361-362).

Money placed in an HSA account may be invested in a variety of investments including stocks, bonds, and mutual funds. The gains are non-taxable as long as the money is used for unreimbursed qualified medical expenses. Accumulated funds in the HSA can be carried over from year to year and, unlike the HRA, remains with the employee after termination of employment. A comparison of a health reimbursement arrangement and a health savings account is shown on the following page.

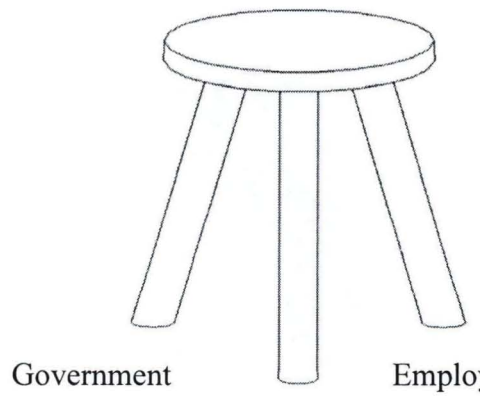
Figure 4: Comparison of an HRA and HSA

	HRA	HSA
Eligibility	Employees only	Employees and individuals
Use of a high deductible health plan	Not required	Required
Contribution	By employer	By employer, employee, and individuals
Taxation of distributions	Tax free for qualified medical expenses	Tax free for qualified medical expenses
Portability	No	Yes

Retirement Plans

Sources of retirement funds can be viewed as a three legged stool. The first leg is savings from government programs such as Social Security. The second leg is private savings which consists of individual bank accounts and investments. The third leg is provided by the employer through employer sponsored retirement plans. Employer provided retirement planning will be discussed in detail in this section.

Figure 5: The Three Legged Stool

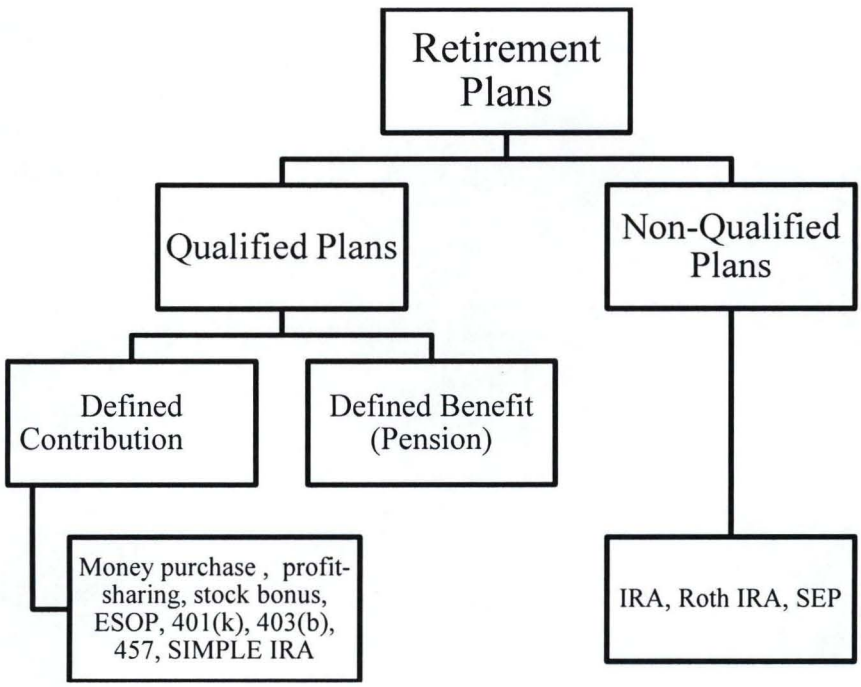


Retirement plans are set up by employers in order to improve employee productivity by attracting and retaining the best workers and providing incentives for exceptional performance. The basic objectives of retirement planning include the following:

- Help employees save for retirement
- Provide tax benefits to owners and employees
- Help attract, retain, and retire employees
- Encourage productivity

Retirement plans can be broken down into two forms: qualified and non-qualified plans. A qualified plan is one that receives special tax benefits in return for compliance with government rules. Qualified plans include defined benefit (or pension plans) and defined contribution plans. Money purchase plans, profit-sharing plans, stock bonus plans, ESOPs, 401(k) plans, 403(b) plans, 457 plans, and SIMPLE IRAs are all considered to be defined contribution plans. Although 403(b) plans, 457 plans, and SIMPLE IRAs are not true qualified plans, they receive the same tax benefits and are therefore grouped with the other defined contribution plans. Non-qualified plans consist of individual retirement accounts (IRAs), Roth IRAs, and SEP plans.

Figure 6: Breakdown of Retirement Plans



Qualified Plans

A qualified plan is a plan that receives special tax benefits in return for compliance with complex rules. The initial eligibility provision says that no minimum age over twenty-one can be required and no more than one year of service can be required for eligibility (Beam, Burton T. and McFadden, John J. 542). One year of service is defined as 1,000 hours in a 12-month period. This requirement excludes part-time workers and the cost of maintaining many small accounts. Additionally, a qualified plan cannot discriminate in favor of highly compensated employees who include those who own more than 5% of the employer or those who earn more than $110,000 per year in 2009 and 2010. This dollar figure is adjusted frequently (Beam, Burton T. and McFadden, John J. 542-543). Funding requirements demand a qualified plan to be fully funded before an employee's retirement. The plan must be under the control of a fiduciary who will manage the fund solely for the benefit of the plan participants (or the employees and beneficiaries). A vesting schedule is required to be in the plan, and an employee must be 100% vested at the normal retirement date specified in the plan. As a rule, all employee contributions

are 100% vested while employer contributions are vested according to the vesting schedule in the plan. Restrictions on benefit payouts penalize employees for withdrawing funds before retirement. There is a 10% penalty for withdrawing funds from a qualified plan before the age of 59½ with few exceptions such as disability. In addition, payouts must begin by April 1st of the year the employee turns 70½.

The most important tax advantage of a qualified retirement plan is tax deferral (Beam, Burton T. and McFadden, John J. 544). An employer who contributes to a qualified plan on behalf of an employee will receive a tax deduction for the year the contribution is made. An employee does not pay taxes on the employer contribution. An employee who contributes to his or her own qualified plan will receive tax deferral and therefore does not pay taxes on the contribution until it is withdrawn upon retirement. Thus, the earnings in the qualified plan accumulate tax free.

Within the scope of qualified plans lie the defined benefit (or pension) plan and the defined contribution plans. The differences between the two categories are shown in a table below and a discussion of each will follow.

Figure 7: Differences between Defined Benefit and Defined Contribution

	Defined Benefit	Defined Contribution
Who bears the investment risk?	Employer	Employee
Is the benefit guaranteed?	Yes, it is partially guaranteed by the PBGC	No, it is based on investment results
Is the contribution known?	No, it must be calculated by actuaries	Yes, the contribution is stated in the plan document
Who funds the plan?	Usually the employer	Employer, employee, or a combination of both
How are the accounts set up?	No individual accounts	Individual accounts

Defined Benefit (Pension) Plans

A defined benefit plan is a contract between an employee and an employer organized to provide income during retirement years (Wilson, Jeffrey 1269-1272). It is an investment program whereby employees receive benefits based on a formula using years of service, a percentage of salary, or both. This arrangement promises the employee a specified dollar amount upon retirement. The Employee Retirement Income Security Act of 1974 created the Pension Benefit Guarantee Corporation (PBGC) which insures vested pension benefits and guarantees payment upon employer insolvencies up to a limit (Wilson, Jeffrey 1269-1272).

Defined benefit plans have several important distinguishing characteristics. First of all as previously stated, the plan document specifies the benefit amount promised to the employee at retirement age based on a formula. A flat-benefit formula takes into account a flat amount (such as $200 per month at retirement) or a flat percentage (such as 50% of the prior year's compensation). A unit-benefit formula is based on the employee's length of service and compensation. For example, an employee could receive a benefit of 2% of compensation for each year of service (Beam, Burton T. and McFadden, John J. 635). Secondly, the plan uses an actuary to determine the annual contribution required so that the plan will be able to pay the

promised benefit upon retirement. As a result, the employer bears the investment risk of a defined benefit plan.

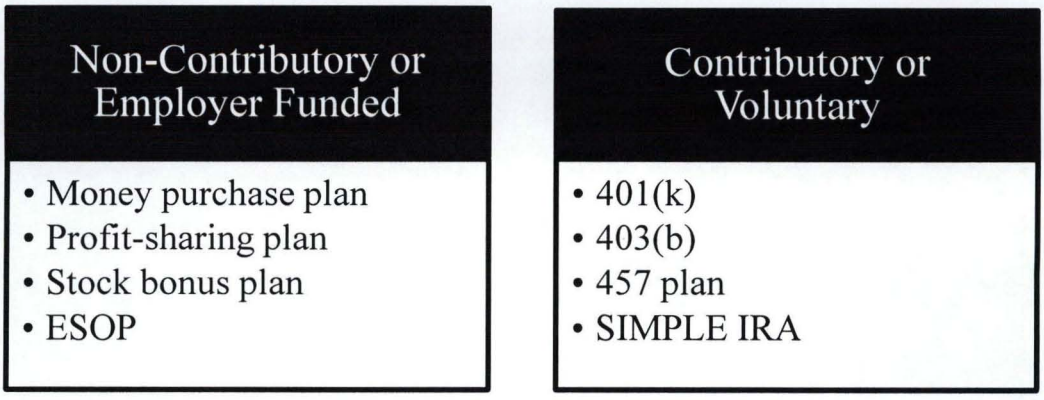
Defined benefit plans are usually funded 100% by the employer. The contributions into the plan are tax deductible to the employer, and fund earnings on the invested contributions are not taxed until they are paid out to the employees (Wilson, Jeffrey 1269-1272). This increases the popularity of pension plans as opposed to savings accounts and other investments which are taxed when the interest is earned. The plan must be handled by a fiduciary such as a trust company or insurance company who will diversify the contributions on behalf of the employee. Upon termination of employment, an employee may roll-over the vested portion of the pension fund into another account without a tax penalty; therefore, pension plans are portable.

Defined Contribution Plans

A defined contribution plan is a qualified plan that provides individual accounts for each participating employee (Beam, Burton T. and McFadden, John J. 546). The plan document describes the amount the employer will contribute to the plan. Additional contributions are supplied by the employee. The benefit from the plan is the employee's account balance at any given point in time. This is in contrast to the defined benefit plan where a specific benefit is promised by the employer upon an employee's retirement. Because the balance of the account depends on the investments chosen by the employee, the investment risk is borne by the employee, not the employer. Because the employee contributes to the plan and each employee has his or her own account, an employee is permitted to make withdrawals from the plan, subject to certain restrictions.

The types of defined contribution plans can be broken down into two groups: the first being non-contributory (or employer funded plans) and the second being contributory and voluntary plans. Contributory means that the employee, along with the employer, may contribute to the plan. Voluntary means that the employee chooses to enter and pay for 100% of the plan. Plans that are funded by the employer include the money-purchase plan, the profit-sharing plan, the stock bonus plan, and the employee stock ownership plan (ESOP). Contributory and voluntary plans include the 401(k), 403(b), 457 plan, and the SIMPLE IRA.

Figure 8: Breakdown of Defined Contribution Plans



Money Purchase Plans

A money purchase plan is a qualified defined contribution plan set up for each employee by the employer. Although the accounts are commingled for investment purposes, each

individual in the company has his or her own account. The plan is solely employer-funded and requires the employer to make an annual contribution to each employee's account. Most contributions are based on a percentage of compensation; for example, 10% of compensation. The amount of an employee's benefit at retirement depends on the account balance at retirement. Therefore, it can be stated that those employees with more years of service will have a larger benefit at retirement. The benefit may be given to the employee as a lump sum or set up as an annuity.

Profit-Sharing Plans

A profit-sharing plan is an incentive plan whereby the employer distributes a portion of the organization's profits to the employees in addition to wages (Profit Sharing 753-754). Profit-sharing can generate benefits to the company by fostering greater employee cooperation, raising productivity levels, and providing retirement security for employees. Profit-sharing plans give employees a direct stake in the profitability of the company in hopes that employees will want the company to succeed.

The contribution by the employer can be variable or a specified percentage of annual profits. For 2009, the most that could be contributed to a profit sharing plan was the lesser of 100% of compensation or $49,000. According to the IRS, employers are allowed to omit contributions in a given year. However, the employer contributions must be "substantial and recurring" meaning that the plan will be terminated if employers omit contributions too frequently (Beam, Burton T. and McFadden, John J. 596). Contributions also cannot discriminate in favor of highly compensated employees. The amount of future benefits depends on the performance of the account. The balance of the account will include the employer's contributions from profits, any interest earned, any capital gains or losses, and possibly any forfeiture from other plan participants (Profit Sharing 753-754).

Profit-sharing plans allow employees to make withdrawals from the plan. In most instances, if the withdrawal is made prior to 59½, there will be a 10% penalty tax in addition to the income taxes that are due. To be eligible for withdrawal, an employee is usually required to be in the plan for two years. When an employee terminates from the plan before being fully vested, the forfeitures are reallocated to the remaining employees in a nondiscriminatory manner.

Stock Bonus Plans

Stock bonus plans are built around the idea that it is beneficial to give employees ownership interest in the company in which they work. The stock bonus plan, in which employees receive shares of stock, acts as a performance incentive for workers. Other advantages of using employee stock in a benefits plan include creating a market for employer stock, obtaining a deduction for a noncash contribution to a benefits plan, and tax advantages from the fact that unrealized appreciation of stock is not taxed to the employee until it is sold (Beam, Burton T. and McFadden, John J. 606).

A stock bonus plan is a defined contribution plan in which the employer makes a contribution of stock to each employee's account. Unlike a profit-sharing plan where the contribution is based upon profits, the contributions to a stock bonus plan are based upon employee compensation. The value of an employee's account is stated in terms of a certain number of shares of employer stock (Beam, Burton T. and McFadden, John J. 606). Therefore, the value of the account varies with the success or failure of the company and the company's

share price. Dividends received from the shares can be used to increase the number of shares in the employee's account or can be taken as taxable income.

Before the benefit is received by the employee upon retirement, the employee may ask to receive cash of equal value instead of the share certificates. Also, if the stock is not traded on a securities market, the employee may require the employer to repurchase the securities. This is due to the fact that small employers may not have a large market for its stock which leaves the employee with illiquid or hard to sell shares of stock.

Because the stock bonus plan is a qualified plan, it receives tax advantages. An additional advantage to the stock bonus plan is the tax deferral of stock appreciation. This means that the employee is not taxed when given the shares of stock. The employee keeps the shares and enjoys appreciation of the shares for as long as they are held. Capital gains taxes are not due until the employee sells the shares in the marketplace.

Employee Stock Ownership Plans (ESOP)

An employee stock ownership plan is very similar to the stock bonus plan. It differs in that the plan is used by the company as a means of raising funds on a tax-favored basis (Beam, Burton T. and McFadden, John J. 607). The ESOP allows the company to borrow money from a bank and repay the loan with fully deductible repayments. The repayments are deductible because they are used for contributions into the ESOP.

In essence, this is how the ESOP works. The plan borrows money from a bank and is used to purchase the company's stock from the employer. The shares are distributed to the employee accounts as employer contributions into the plan. As contributions are made, the employer receives a tax deduction which enables the plan to repay the loan. The result is that the employer receives the bank loan and pays off the loan through tax-deductible contributions to the ESOP plan (Beam, Burton T. and McFadden, John J. 608).

401(k)

A 401(k) plan is a qualified, defined-contribution retirement plan that incorporates an option for employees to put money into the plan or receive it has taxable income (Beam, Burton T. and McFadden, John J. 615). The name comes from a section of the Internal Revenue Code that allows an employer to generate a retirement plan to which employees may voluntarily contribute a percentage of their compensations on a before-tax basis (Laurie Collier Hillstrom and Kevin Hillstrom 526-529). It also allows the employer to match an employee's contribution with tax-deductible contributions up to a certain limit ($16,500 in 2009). The balance in an employee's account is invested as the employee sees fit. The earnings in the account accumulate on a tax-deferred basis meaning that the employee does not pay taxes on the earnings until the funds are withdrawn upon retirement. Funds may also be borrowed from the account prior to retirement at low interest rates for medical expenses, higher-education tuition, home purchases, and other reasons. 401(k) plans are portable and can be rolled over into another qualified plan if an employee changes jobs.

There a several advantages to a 401(k) plan over other qualified retirement plans. First of all, 401(k) plans allow employees to save money on a tax deferred basis. Secondly, it allows the employee to choose how much to contribute into the plan each year. This permits an employee to manage his or her own tax situation because the contributions made into the plan lowers an employee's taxable income for the year the contribution is made. Thirdly, 401(k) plans are advantageous to the employer because it can be funded solely on employee salary reductions and

does not require additional costs to the employer. However, most employers match an employee's contribution up to a certain amount or percentage of compensation. Lastly, employee contributions and earnings are 100% vested immediately while employer contributions follow the vesting schedule in the plan.

An employee's account balance upon retirement is a function of the employee's contributions, the employer matches, and the investment results. Therefore, the employer does not promise a specific benefit and the investment risk is borne by the employee. Upon retirement, employees may take a lump sum distribution or roll the 401(k) into another qualified plan. Withdrawals prior to age 59½, like all qualified plans, are subject to a 10% penalty tax in addition to income tax.

403(b) Tax Deferred Annuity

A 403(b) plan allows employees of tax-exempt organizations to set money aside for retirement by salary reductions or direct employer contributions into a tax-deferred plan (Beam, Burton T. and McFadden, John J. 623). The name comes from the section in the Internal Revenue Code dealing with retirement planning for tax-exempt organizations. Employers of tax-exempt organizations, but not government employers, may choose between a 401(k) or 403(b) plan. 403(b) plans are also called tax-deferred annuities or tax-sheltered annuities.

Two types of organizations are eligible for 403(b) plans. The first is a 501(c)(3) organization which is an employer "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, or to foster national or international amateur sport competition…or for the prevention of cruelty to children or animals" (Beam, Burton T. and McFadden, John J. 624). This requires that the organization benefit the public instead of private shareholders. The second type of organization is an educational organization such as a public school or university. Thus, those eligible for 403(b) plans include churches, school and universities, hospitals, and charitable organizations.

Section 415 of the Internal Revenue Code sets the limit on annual contributions into a 403(b) plan. For 2010, the limit is the lesser of 100% of an employee's compensation or $49,000 (IRS.gov). The limit may be reached through employee and employer contributions into the account. Contributions and investment earnings are not taxable to the employee until withdrawn. The contributions into the plan must be invested in either an annuity contract or mutual fund shares held in a custodial account. This gives an employee a broad range of annuity and mutual fund choices in which to invest account balances.

Distributions from a 403(b) account are restricted except for retirement after age 59½, death, disability, termination of service, or financial hardship. As in all qualified plans, distributions must be taken before April 1st of the year the employee turns 70½. The distributions, with the exception of the cost basis, are fully taxable as ordinary income to the employee when withdrawn.

457 Plans

A 457 plan is a defined contribution plan used primarily by government employers. It applies to government employers and those employers that are exempt from federal income tax (Beam, Burton T. and McFadden, John J. 628). The annual employee contribution is the same as a 401(k) plan and is limited to $16,500 in 2010. Employees make monthly elections to defer compensation into the plan. Each employee's contributions are placed into a trust fund or custodial account. Like qualified plans, distributions cannot be taken before age 59½ but must

be taken before age 70½. Contributions are not taxed until distributions are made from the plan which will be taxable in full when received by the employee.

SIMPLE IRA

A SIMPLE IRA stands for "savings incentive match plan for employees." SIMPLEs are employer-sponsored plans under which plan contributions are made to the participating employees' IRAs (Beam, Burton T. and McFadden, John J. 621). Each employee elects a salary reduction to contribute to an IRA. Likewise, an employer contribution is made directly to the employee's IRA. Although a SIMPLE IRA is not a qualified plan, it provides employers and employees with some of the same benefits as qualified plans.

SIMPLE IRAs are available to businesses with less than 100 employees that do not maintain a qualified plan. The plan provides an easy, low-cost way for small business and their employees to contribute jointly to tax-deferred retirement accounts (Laurie Collier Hillstrom and Kevin Hillstrom 973-976). An IRA set up as a SIMPLE account requires the employer to match up to 3% of an employee's contribution or 2% of compensation for all employees regardless of what they contribute to the plan (Beam, Burton T. and McFadden, John J. 622).

As in an IRA, benefits in a SIMPLE IRA are portable because employees are always 100% vested. Each employee owns and controls his or her own account and makes investment decisions based on risk tolerance. Therefore, the investment risk is borne solely by the employee. The balance in the account depends on the amount of contributions and investment results.

Non-Qualified Plans

There are three retirement plans that are not technically qualified plans but that offer employees the same tax deferral advantages as qualified plans. These include the individual retirement account (IRA), the Roth IRA, and the simplified employee pension (SEP). Non-qualified plans can be used to supplement or as an alternative to a qualified plan.

IRA

An individual retirement account (IRA) is a tax-deferred retirement program in which any employed person can participate (Laurie Collier Hillstrom and Kevin Hillstrom 589-591). To be eligible, the employee or self-employed person must have an earned income. Earned income does not include investment income, money from a pension or annuity, or any type of deferred compensation. IRAs have additional eligibility restrictions. Individuals who participate in an employer sponsored qualified plan and those individuals who have an adjusted gross income above the annual limit are restricted from participation in an IRA. The 2010 limit for a single individual is more than $56,000 but less than $66,000. The 2010 limit for a married couple filing a joint return is more than $89,000 but less than $109,000 (IRS.gov). If these adjusted gross incomes are exceeded, the deduction for contributions to an IRA is reduced or phased out. The contributions may be established up to the individual's tax filing deadline on April 15th which allows for flexibility and tax management.

When an employee makes a contribution into the IRA, the first $5,000 is deductible. The money placed into the IRA is deducted from the employee's income before taxes and is allowed to grow tax-deferred until the worker reaches retirement. IRAs can be invested in stocks, bonds, money market accounts, treasury bills, mutual funds, and certificates of deposit (Laurie Collier

Hillstrom and Kevin Hillstrom 589-591). Funds cannot be invested in insurance contracts, option contracts, or derivative contracts.

Because an IRA is set up to fund retirement, early distributions are subject to a 10% penalty tax except in a few situations. Distributions can be made after the employee reaches age 59½, if the employee dies or is disabled, and if the employee uses the funds for health insurance premiums, medical expenses, higher education, or a first time home purchase ($10,000 limit). Distributions must begin by age 70½ and a minimum distribution requirement must be met. When distributions are received by a retired individual, the full amount is taxable as ordinary income in the year it is received.

IRAs are usually thought of as a vehicle for individual retirement savings. However, some employers choose to sponsor an IRA for its employees. The contributions made to an employee may be made as additional compensation or a salary reduction. The employer's contribution to an employee's IRA is taxable to the employee as compensation (Beam, Burton T. and McFadden, John J. 716).

Roth IRA

The Roth IRA was created as part of the Taxpayer Relief Act of 1997 (Laurie Collier Hillstrom and Kevin Hillstrom 589-591). The Roth IRA is a form of nondeductible IRA. Therefore, contributions made into a Roth IRA are not deductible from gross income. Instead, Roth IRAs allow all earnings from the contributions to be tax-free when withdrawn. Like the traditional IRA, the annual limit allowed to be contributed into a Roth IRA is $5,000.

Roth IRAs are not restricted from individuals who participate in an employer-sponsored qualified plan. Roth IRA contribution limits are reduced for individuals that exceed an adjusted gross income. The 2010 limit for a single individual is no more than $105,000 but less than $120,000. The 2010 limit for a married couple filing separately is no more than $167,000 but less than $177,000. Therefore the adjusted gross income limits for a Roth IRA are higher than for a traditional IRA.

Whether it is more advantageous to use a traditional or Roth IRA depends on the individual's tax situation and future assumptions. If an individual is in a low tax bracket now but expects to be in a higher tax bracket later, he or she is better off in a Roth IRA. On the other hand, if an individual is in a high tax bracket but expects to be in a lower tax bracket later, he or she is better off in a traditional IRA.

The figure below highlights the main differences between a traditional and Roth IRA. In a traditional IRA, the contributions are tax deductible but the distributions are taxable. In a Roth IRA, the contributions are taxable but the distributions are tax free.

Figure 9: Differences between a Traditional and Roth IRA

	Traditional IRA	Roth IRA
Contributions are tax deductible	yes	no
Contributions are taxable	no	yes
Distributions are tax free	no	yes
Distributions are taxable	yes	no

Simplified Employee Pension Plan (SEP)

A simplified employee pension plan or SEP is a pension plan specifically for self-employed individuals and small businesses. It is designed to give small business owners and employees the ability to save money for retirement (Laurie Collier Hillstrom and Kevin Hillstrom 1048-1049). SEP plans look similar to an employer-sponsored IRA but with higher deduction limits. The limit on deductible contributions for each employee is the lesser of $45,000 or 25% of the employee's compensation (Beam, Burton T. and McFadden, John J. 721). This number is indexed for inflation on a yearly basis.

An SEP plan is easy to set up and administer because the employer simply makes contributions to IRAs that are established by employees. The employee is responsible for making investment decisions and therefore bears the investment risk. If an employer sets up an SEP plan, it must cover all employees who are at least 21 years old and who have worked for the employer three out of the last five years (Laurie Collier Hillstrom and Kevin Hillstrom 1048-1049). Also, SEP plans allow employers to have flexibility in making contributions because the employer is not required to contribute any particular amount to the SEP in a given year. During good financial years, employers may make larger contributions than during poor financial years. The benefit to using a SEP is that it provides a tax deduction to both the employer and to the employee for amounts contributed into the plan.

Disability Income

Disability income insurance provides a measure of financial security to people who cannot work because of an accident or illness. The purpose of the disability benefit is to partially offset the income of disabled employees who cannot make a living. Group disability income is a benefit that may be overlooked by employers; however, it is a significant part of an employee benefits package. It has been estimated that one out of every three employees will have a disability that lasts at least ninety days during his or her work years and one of every ten employees can expect to be permanently disabled prior to age 65 (Beam, Burton T. and McFadden, John J. 199).

Disability income insurance can be divided into two categories: the first being short-term disability income plans and the other being long-term disability income plans. Short-term disability income plans provide benefits for a limited time period, usually up to six months. These benefits may be insured or uninsured plans. Long-term disability income plans provide extended benefits after an employee has been disabled for a period of time. Most employers who offer both long-term and short-term plans will coordinate them so that when short-term benefits are exhausted, long-term benefits begin immediately.

Benefits for disability income insurance may be expressed as flat-dollar amounts, varying dollar amounts based on covered classifications, or a percentage of earnings. Most disability income plans are designed to replace a percentage of earnings, usually between 50 and 70 percent of an employee's annual income (Disability Insurance, Gale). Short-term and long-term policies contain several important exclusions. Both exclude any period during which the employee is not under the care of a physician, intentionally self-inflicted injuries, or benefits payable under workers compensation. Others include war, participation in a crime, or pre-existing conditions. It is now illegal for employers to exclude benefits for pregnancies.

Tax treatment for disability income insurance is based on whether the plan is non-contributory or contributory. Employer contributions for group disability income insurance are fully deductible to the employer as a business expense. However, contributions made by

individual employees are considered payments for personal disability income insurance are therefore not tax deductible (Beam, Burton T. and McFadden, John J. 217).

Short-Term Disability Income

A short-term disability income insurance plan provides benefits that replace a portion of the employee's lost income and requires a period of time before benefits start (Beam, Burton T. and McFadden, John J. 200). Most employers provide short-term benefits to a wide range of employees. This is in contrast to long-term plans which restrict benefits to certain classifications of employees. Short-term disability income insurance contracts define disability as "the total and continuous inability of the employee to perform each and every duty of his or her regular occupation" (Beam, Burton T. and McFadden, John J. 204). Most contracts limit coverage to non-occupational disabilities because occupational disabilities are covered under worker's compensation. A waiting period is the length of time for which an employee covered under a contract must be disabled before benefits begin. For accidents, there is usually no waiting period to satisfy but for illnesses, a week must usually be satisfied before benefits are received. Once benefits begin, they are received for the duration of the benefit period, usually 13 or 26 weeks.

Long-Term Disability Income

Long-term disability income plans often limit benefits to specific covered classifications with full-time salaried employees being the most common. In order to receive benefits, a probationary period must be satisfied by the employee and can range from three months to one year. Long-term disability income insurance contracts use a wider range of definitions for disability. One definition of disability is "the total and continuous inability of the employee to engage in any and every gainful occupation for which he or she is qualified or shall reasonably become qualified by reason of training, education, or experience" (Beam, Burton T. and McFadden, John J. 204). Most policies use this definition combined with the short-term disability definition. Under the dual definition of disability, benefits are paid for a specified period of time as long as the employee is unable to perform his or her regular occupation. After that time, benefits are paid only if the employee is unable to engage in any occupation for which he or she is qualified by reason of training, education, or experience. The purpose of this definition is to require and encourage a disabled employee to adjust his or her lifestyle in order to make a living. After a waiting period has been satisfied, benefits may be paid for as short as two years to as long as the employee is disabled.

Group Life Insurance

Group life insurance is one of the most widespread forms of employee benefit plans. Group life insurance accounts for 40-45% of all life insurance policies in force today (Black, Kenneth and Skipper, Harold D 456). The most common type of group life is term insurance which covers an insured's life for a limited period of time. In most cases, the term insurance is in force during an employee's working years and expires upon retirement. Employers use yearly renewable term insurance so that coverage can be renewed annually with each successive policy period being for one year (Beam, Burton T. and McFadden, John J. 152). In group life insurance, the premium is a function of the age distribution among employees. Therefore, the flow of young employees and the retirement of older employees leave the premium fairly constant throughout time.

In order to be eligible for group life insurance, an employee must be a regular, active, full-time employee in a covered classification. A full-time employee is defined as an employee who works at least the number of hours in the normal workweek established by the employer, most commonly 40 hours per week. To fulfill eligibility requirements, an employee must satisfy a probationary (or waiting) period upon hiring. This period, usually lasting one to six months, minimizes the administrative expenses involved in insuring employees who work for the employer for a short period of time.

In order to minimize adverse selection, a benefits schedule is used to predetermine the amount of group life insurance for which an employee is eligible. The benefits schedule classifies the employees who are eligible for coverage and the amount of insurance available for each class. Five benefit schedules are most commonly used and include a fixed amount, an amount based on compensation, an amount based on position, and an amount based on years of service, or a combination of benefit schedules (Black, Kenneth and Skipper, Harold D 458). The fixed amount benefit plan is the simplest and places all employees in one category. The amount of compensation benefit plan utilizes a benefit formula that takes into account a multiple of earnings such as a benefit of two times an employee's yearly salary. The position benefit plan gives an amount of life insurance based on an employee's position within the company. For example, it may give officers and managers a benefit of $100,000 and all other employees a benefit of $50,000. In the service plan, the amount of insurance is increased in accordance with the length of time the employee has worked for the employer.

There are numerous contract provisions that an employee must recognize in order to understand his or her group life insurance policy. First of all, the employee has the right to name the beneficiary to his or her group life insurance contract. A beneficiary is the person who will receive the death benefit when the insured employee dies. The beneficiary may be a spouse, children, parents, siblings, or the employee's estate. Secondly, the employee must understand that in order for the beneficiary to receive a death benefit, a written proof of death must be submitted to the insurance company. Thirdly, an insured employee must choose a settlement option. A settlement option is a method by which a beneficiary receives the life insurance proceeds. While the lump sum settlement option is the most common, others include the interest option, a fixed period option, a fixed amount option, and a life income option (Beam, Burton T. and McFadden, John J. 158).

Group life insurance plans may be noncontributory (meaning paid solely by the employer) or contributory (meaning paid for in part or in full by the employee). Group life contracts stipulate that it is the policyowner's responsibility to pay all premiums to the insurance company. In the case of contributory plans, the employee's portion of the premium is paid by payroll deductions. Premiums can be deducted monthly, quarterly, semi-annually, or in few cases annually.

Upon termination, an insured employee has the right to convert his or her policy into an individual life insurance policy. The employee may choose to convert within 31 days after termination of employment to one of the insurer's regular cash value life insurance policies at standard rates for his or her attained age (Black, Kenneth and Skipper, Harold D 459). The face amount of the individual policy cannot exceed the amount of life insurance that was terminated under the group life contract. This conversion privilege is an advantage to the employee because no evidence of insurability is required to convert.

An employer may allow its employees to choose additional life insurance coverages by adding a rider (or endorsement) to employees' individual coverages. One such coverage is

supplemental life insurance. Supplemental life insurance allows an employee to purchase additional amounts of life insurance in addition to the group life insurance benefits. Supplemental life is contributory and usually requires evidence of insurability in order to reduce adverse selection. A second coverage is accidental death and dismemberment insurance (AD&D). AD&D gives an additional benefit if an employee dies accidentally or suffers certain types of injuries (Beam, Burton T. and McFadden, John J. 166). A third coverage is dependent life insurance which provides life insurance coverage to the lives of the employee's dependents. A dependent includes a spouse and unmarried dependent children including stepchildren and adopted children.

Employer contributions for an employee's group life insurance are fully deductible under Code Section 162 to the employer as a business expense (Beam, Burton T. and McFadden, John J. 171). Contributions by an employee are considered payments for personal life insurance and are not deductible for income tax purposes by the employee. Code Section 101 states that death proceeds do not result in taxable income to the beneficiary of a group life insurance contract if paid in a lump sum distribution (Beam, Burton T. and McFadden, John J. 177).

Dental Insurance

Dental insurance is a specialized form of health insurance that is designed to pay for normal dental care as well as dental care needed as a result of an accident (Beam, Burton T. and McFadden, John J 399). Most dental plans are voluntary and require the employee to pay the full contribution without any assistance from the employer. Group dental plans usually provide benefits on a traditional fee-for-service basis and also are likely to incorporate managed care into the plan. For example, most dental plans pay high levels of benefits for preventive care such as regular teeth cleaning and fluoride treatment.

Group dental care is offered by Dental Service Plans (also called Delta Dental Plans), Blue Cross and Blue Shield, insurance companies, managed care plans, and self-funded plans. Dental Service Plans are nonprofit organizations that are sponsored by state dental associations (Beam, Burton T. and McFadden, John J 401). In this type of plan, dentists provide services on a contractual basis. The Blue Cross and Blue Shield plans as well as plans provided by insurance companies are often paid on an indemnity basis. Managed care plans focus on preventive care. Coverage can be obtained through the use of PPOs or dental health maintenance organizations (DHMOs). DHMOs function like a health maintenance organization but only offer dental care instead of other medical benefits (Beam, Burton T. and McFadden, John J 403). Lastly, dental plans can be self-funded meaning that the employer funds the dental plan through its current revenues.

To become eligible for dental benefits, an employee must satisfy certain requirements. A probationary period is imposed by employers. The probationary period is important because those individuals who do not have dental insurance tend to postpone dental treatment until a time where dental insurance is provided by an employer. This postponement leads to adverse selection, a major problem with dental insurance. Because of this, insurers impose more stringent underwriting requirements on group dental plans than most other group medical plans.

Group dental plans pay for most types of dental expenses, although each employer's plan may have different coverage limits and exclusions. Most plans do cover benefits for routine diagnostic procedures such as oral examinations and x-rays and preventive dental treatment such as teeth cleaning and fluoride treatment (Beam, Burton T. and McFadden, John J 403). In addition, benefits may be provided for other types of dental treatment including the following:

- *Restoration* including fillings, crowns, and other procedures used to restore the use of natural teeth
- *Oral surgery* including the extraction of teeth and other surgical treatment of diseases, injuries, and defects of the jaw
- *Endodontics* including root canals and other treatments for diseases of the dental pulp within teeth
- *Periodontics* or the treatment of diseases of the surrounding and supporting tissues of the teeth
- *Orthodontics* or the prevention and correction of dental and oral abnormalities through the use of corrective devices such as braces and retainers

Dental plans categorize treatments into four categories. Below is a breakdown of the four service levels. In most dental plans, benefits are provided for the first three service levels. The fourth service level may or may not be covered by group dental plans. Plans tend to provide the most benefit for service level 1, less for service levels 2 and 3, and even less or no benefit for service level 4.

Figure 10: Categories of Dental Treatment

Service Level	
1	Preventive care and diagnostic services
2	Basic services including minor restorative procedures and endodontic, periodontic, and oral surgery services
3	Major services including major restorations and prosthetic procedures
4	Orthodontic services

Most group dental plans have annual deductibles that must be satisfied. Coinsurance is common and varies depending on the service level of the treatment (Beam, Burton T. and McFadden, John J. 404). For example, service level 1 may have 80-100% coinsurance, service level 2 may have 70-85% coinsurance, and service levels 3 and 4 may have 50-60% coinsurance.

Exclusions and limitations are found in all group dental plans. However, they vary according to each plan. Major exclusions found in most group dental plans include cosmetic dental services, replacement of lost prosthetic devices, occupational injuries covered by worker's compensation, and pre-existing conditions. Limitations are found in dental plans and the function is to limit and control claim costs for dental care. Most plans have benefit maximums, especially for orthodontics. Other plans limit the frequency with which benefits are paid. For example, most plans will only pay for teeth cleanings every six months.

Miscellaneous Payments and Services

Holidays

Employers pay employees for certain holidays not worked including the following:

- New Year's Day
- Memorial Day

- The Fourth of July
- Labor Day
- Thanksgiving
- Christmas

Other holidays in which employees may or may not receive pay include the following:

- Martin Luther King Day
- President's Day
- Good Friday
- Columbus Day
- The Friday after Thanksgiving
- Veteran's Day
- Christmas Eve
- New Years Eve
- The employee's birthday

Holiday pay received by employees is treated the same as compensation for time worked and is taxed accordingly.

Vacations

Vacations are an important aspect of an employee benefit package. Most plans are based on the employee's length of service and the number of vacation days given to an employee increases as years of service increase. Sometimes there is a waiting period of 3-6 months before an employee can use any vacation time. However, this is not imposed in all plans.

The treatment of unused vacation days will vary by plan. Some employers let employees roll unused vacation days onto the next year while others do not. Most of the time, supervisory approval must be given before vacation time is granted. This provision is in place to prevent too many employees taking vacations during busy work times.

Personal Time Off with Pay

Some employers account for situations that require employees to miss work by providing a certain number of days for paid time off with pay. Reasons for paid time off include serving in the United States reserve, jury duty, funeral or bereavement leave, sabbatical leave, and observation of religious holidays. An employee's wedding day may also be included in paid time off with pay.

Personal Time Off without Pay (Family Leave)

The Family and Medical Leave Act of 1993 allows an employee to take up to twelve weeks of unpaid leave in any 12-month period for certain circumstances. These include the birth or adoption of a child; to care for a child, spouse, or parent with a serious health condition; or for the worker's own serious health condition (Beam, Burton T. and McFadden, John J 485). The act specifies that the employee must seek approval from his or her employer before the leave can be taken. The employee should give thirty days notice to the employer for planned pregnancies and planned medical treatment (Beam, Burton T. and McFadden, John J 486). During the leave, an employer does not continue an employee's pay or most benefits except medical and dental benefits. Upon returning from leave, an employee must be given his or her former job or one that is equivalent.

Bonuses

Employers, particularly for Christmas or the employee's birthday, may give gifts or bonuses to employees. A gift does not result in taxation for an employee as long as the value of the gift is small.

Financial Planning Programs

Financial planning programs are beginning to become a prevalent employee benefit. Most financial planning programs in the past were directed towards top management; however, now it is being offered to employees throughout the organization. Group meetings can be used, but the most common financial planning program offers individual counseling. Financial planning is composed of separate but interrelated segments (Beam, Burton T. and McFadden, John J 501). These include:

- Compensation planning including an explanation and analysis of employee benefits and compensation options
- Preparation of tax returns
- Estate planning including the preparation of wills and minimizing taxes
- Investment planning including investment advice and management
- Insurance planning

Most employers use the services of outside specialists such as lawyers, accountants, and insurance agents or the services of investment companies that provide comprehensive financial planning. Fees paid for financial planning are tax deductible by the employer while fees paid on behalf of an individual employee become taxable income to the employee (Beam, Burton T. and McFadden, John J 502).

Part Two

Analysis of Thrivent Financial

Thrivent Financial for Lutherans is a faith-based, not-for-profit financial services organization with nearly 2.6 million members. It is a Fortune 500 company that manages approximately $67 billion in assets (Thrivent Financial for Lutherans: About Us). The mission of Thrivent Financial is to "improve the quality of life of its members, their families, and their communities by providing unparalleled solutions that focus on financial security, wellness and caring for others" (Thrivent Financial for Lutherans: About Us). Thrivent Financial accomplishes its mission by providing financial solutions, supporting member activities, and providing resources to the Lutheran community and nonprofit organizations. What makes Thrivent Financial unique from other financial services companies is its designation as a fraternal benefit society. This is a not-for-profit organization that provides insurance to its members and operates for religious purposes for the benefit of its members and the public (Thrivent Financial for Lutherans: About Us).

Thrivent Financial employs roughly 2,500 financial representatives throughout the United States. As a financial representative, one is given an employee benefit package that includes health insurance, a pension plan, a 401(k) plan, disability income insurance, life insurance, dental insurance, and a variety of bonuses and incentives. Each plan within the benefit package will be examined and explained in detail.

Health Insurance

Thrivent Financial utilizes a traditional health insurance plan for its employees. However, the plan functions similar to a PPO because it contains aspects of managed care. The supplier of this plan is Blue Cross Blue Shield (BCBS). Under this plan, the employee will receive the greatest benefit when a participating provider is used for health care. The participating providers file the claim on behalf of all Thrivent employees. If out-of-network providers are used, the employee is responsible for filing a claim. All full-time employees are eligible for coverage along with the employee's spouse and children. The employee must enroll in the plan within 30 days of the hire date. Premiums are based upon specific underwriting criteria and are paid bi-weekly by each employee.

Plan details depend on whether the employee chooses an in-network or out-of-network service provider. The plan pays 80% of in-network eligible charges and 70% of out-of-network eligible charges for most covered expenses including office visits, hospital stays, and surgeries. The out-of-pocket maximum and lifetime maximum are the same regardless of the service provider chosen. The table below outlines the key features of this health insurance plan.

Figure 11: BCBS Health Plan

Plan Feature	In-Network	Out-of-Network
Deductible	Individual: $250 Family: $750	Individual: $500 Family: $1,500
Out-of-Pocket Maximum	Individual: $2,750 Family: $7,250	Individual: $2,750 Family: $7,250
Office Visits	Pays 80% after the deductible	Pays 70% after the deductible
Hospital Stays	Pays 80% after the deductible	Pays 70% after the deductible
Surgery	Pays 80% after the deductible	Pays 70% after the deductible
Prescription Drugs	Generic: Covered Brand-name: Plan pays $15 or 20% whichever is greater to a max of $100	Generic: Not covered Brand-name: Not covered
Lifetime Maximum	$2 million (per individual)	$2 million (per individual)

Pension

Thrivent Financial offers each financial representative a pension plan to help save for retirement. All full-time employees who were active participants in the plan before the end of 2002 are eligible for the pension plan. This plan is no longer offered to newly hired employees. The pension is paid for solely by Thrivent Financial and therefore, employees do not contribute to their pension. Loans and withdrawals by employees are prohibited from this plan.

Pension benefits depend on an employee's years of service at Thrivent Financial. To start a pension benefit, election forms must be completed and submitted to Corporate Benefits. Employees must be fully vested before pension payments may be received. If vested, an employee is eligible for the first pension payment on the first day of the calendar month following the employee's retirement date. The pension payments are made on the first Tuesday of each calendar month.

401(k)

All employees including newly hired employees participate in Thrivent's 401(k) retirement plan. Full-time, part-time, and regular part-time Thrivent employees are eligible for this plan. An employee may enroll in the plan when he or she is hired or anytime after if the employee chooses not to enroll when hired. New hires will receive a letter from M&I trust, the administrator of the retirement plan, within three weeks of the hire date. Once enrolled, contribution deductions will begin on the next available pay period. An employee may select one of several contribution options including:

- 1% to 75% of eligible compensation as pretax contributions
- 1% to 75% of eligible compensation as after-tax contributions
- Up to 75% maximum total compensation
- At a different contribution rate if you are a highly compensated employee
- Rollover contributions

Thrivent Financial will make matching contributions in pre-tax dollars which will be taxable to the employee when distributed.

Withdrawals from the 401(k) are allowed for certain circumstances. Withdrawals may be made for qualifying hardships as described in Part One. Also, once an employee reaches the age of 59½, contributions may be withdrawn for any reason. Loans from the plan are allowed for any reason without penalty and are limited to three outstanding loans at a time. When an employee leaves Thrivent Financial, the vested account balance will be given to the employee upon termination.

Account balances may be invested based on the employee's choice of investment funds. Each fund differs with varying degrees of risk and expected return. Because employees choose how their accounts are invested, Thrivent Financial does not bear the investment risk and is not responsible for declining balances. Thrivent offers seventeen investment funds managed by The Vanguard Group, Inc., M&I Investment Management Corp., or Thrivent Asset Management, LLC. Funds include aggressive, moderate, and conservative allocation funds as well as large cap, mid cap, and small cap stock portfolios.

Disability Income

The disability income plan provides Thrivent employees with income in the event that a disability renders an employee disabled due to an injury or an illness. To become eligible for coverage, an employee must be deemed full-time and satisfy a six month waiting period. Although coverage does not start for six months after the hire date, an employee must enroll within thirty days of the hire date. Because this plan is optional, the employee must pay the full cost of the plan. If an employee becomes disabled, he or she must file a claim with the Hartford Insurance Company. The employee will then receive 60% of their pay.

To be considered disabled, the employee must satisfy certain requirements. First of all, the employee must satisfy a 120 day elimination period which means the employee must be totally disabled for 120 days before the long term disability payments commence. Benefits will be paid until the employee is no longer disabled, reaches age 65, or according to a schedule if the employee's disability started after a certain age.

This plan contains specific restrictions and exclusions. If a mental health problem or a drug or alcohol problem prevents an employee from performing his or her job, the employee is

covered under this plan. However, payments will end after twenty-four months or on the date the employee refuses to participate in available treatment. No benefits will be paid for pre-existing conditions, attempted suicide, attempt to commit a felony, or acts of war.

Life Insurance

Group life insurance is provided for Thrivent employees in case of premature death. For financial representatives, the death benefit is adjusted each year based on the employee's income for the previous year. The plan is noncontributory, and therefore, is paid for entirely by Thrivent Financial. Each employee may designate the beneficiary who will receive the death benefit.

Thrivent also offers its employees a business travel accident plan. This plan provides a benefit if the employee dies or suffers dismemberment while traveling for company business. Thrivent Financial pays the full cost of this plan. All full-time employees are covered under this plan, and there is no waiting period to satisfy. Enrollment is automatic; therefore, employees do not need to enroll in the plan. The plan will pay a $400,000 benefit if an employee is killed while traveling for business. Dismemberment benefits are paid at a percentage of the death benefit. If more than one employee is killed in the same accident, the plan will pay up to $10,000,000 per accident for all employees involved in the accident.

Dental Insurance

Thrivent Financial offers its employees a dental plan called the Humana Comprehensive Dental Plan. Full-time employees are eligible for coverage and do not have to satisfy a waiting period. An employee's spouse and children will also be covered under the plan. An employee must enroll in the plan within thirty days after becoming eligible. The premium will be paid biweekly based on underwriting requirements. Most services are subject to a deductible. The individual deductible is $25 per calendar year, and the family deductible is $75 per calendar year. The deductible does not apply for certain services including:

- Cleanings (limited to 2 per year)
- Emergency treatment
- Fluoride treatment
- Routine exams (limited to 2 per year)
- Sealants
- Space maintenance
- X-rays

The plan payment varies by the type of service performed. Preventive care is covered for 100% of the usual and customary charges. Basic care is covered for 80% of the usual and customary charges. Major care is covered for 50% of the usual and customary charges. The annual maximum is $1,500 per calendar year per person while there is no lifetime maximum.

Bonuses and Incentives

Thrivent's financial representatives are paid based off of commissions. However, to encourage productivity, Thrivent offers its employees various bonuses. Career bonuses are given to employees who meet production goals and increase their productivity from one year to the next. Sales bonuses are given to employees who increase the number of sales during pay periods and from year to year.

Incentives are given to employees as well, including yearly field conferences. Eligibility for field conferences is based on an employee's production level. Only the highest producers are asked to attend field conferences each year. Each year, three field conferences take place. The highest level is the Pinnacle Council Conference, the mid level is the Summit Circle Conference, and the third level is the Sierra Conference. The field conference locations for 2010 and 2011 are given below.

Figure 12: 2010 and 2011 Field Conferences

Pinnacle: St John, U.S Virgin Islands	**Pinnacle**: Alaskan Cruise
Summit Circle: White Sulfur Springs, WV	**Summit Circle**: British Columbia, Canada
Sierra: San Fransico, CA	**Sierra**: Grapevine, TX

The field conferences promote company-wide rivalry to produce the best results on an annual basis. To encourage increased output, each year the goal is raised for all employees. To become eligible for a conference is a major feat and one that is recognized generously by Thrivent Financial. Because field conferences are paid for by Thrivent Financial, it is a free vacation for the financial representative, his or her spouse, and children under age 21. The employee is only required to pay for the taxes and extra food and spending outside what Thrivent Financial offers.

Conclusion

In response to the growing competitiveness in today's workforce, employee benefits have become a greater part of employee compensation and recruiting practices. Employee benefits discussed in Part One include health insurance, retirement plans, disability income insurance, life insurance, dental insurance, and other forms of payments and services such as bonuses and personal time off. Because of the growing importance of employee benefits, it is important for employees to understand what benefits they are offered, how the benefits work, and where their money is going. The description and analysis of Thrivent Financial's employee benefits program builds on Part One of the thesis. It allows one to not only comprehend what each benefit provides to an employee, but it also gives a real life example needed to apply the knowledge learned in Part One. While a description may suffice for some, I find that validating new information with a relevant illustration reinforces learning and helps one retain the essential facts.

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