BENEFIT

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Economic Pressures Have Employees Mulling CDHPs

Economic pressures and public policy trends will have an increasing number of employers considering the use of **consumer-driven health plans (CDHP)**, according to a white paper published this summer by the University of Pennsylvania's Wharton School.

The report, "Consumers Take Charge: Defined Contribution Health Plans," notes that such plans will never completely replace health maintenance and preferred provider organizations, "but they are another option that could have as significant an impact on the operating principles and direction of the health-care sector as HMOs and PPOs did when employers began to embrace them in the 1980s and 1990s."

CDHPs are employer-sponsored programs that educate employees about the true cost of medical services, and place increased responsibility upon them for their medical purchase decisions. The programs are generally referred to by the CDHP designation, but are also known as **defined-contribution**, **consumer-directed**, or **self-directed plans**.

In a typical plan, an employer would place a defined contribution each year into an employee account (on a pre-tax basis) that would be used for medical expenses. Employees would be responsible for medical expenses they incur beyond the defined contribution made by the employer. Then, once a high deductible amount is reached, a catastrophic insurance feature would take effect.

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With health care costs climbing by double-digits each year, a survey by Deloitte and Touche (2003) suggests that CDHPs may become increasingly popular. The survey found that nearly half of 300 senior financial and human resource executives contacted believe that CDHPs will be part of most employer health plans by 2005.

The Wharton School paper, however, noted that there are concerns among some employers that CDHPs will attract only healthy employees, leaving more chronically ill individuals to shoulder higher premiums under

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managed care programs. Additionally, the report notes that some employers are concerned that employees would be unable or unwilling to take charge of their own health care spending.

Meanwhile, the Deloitte and Touche survey found that some employers are questioning the defined contribution portion of CDHPs since it would mean providing first-dollar coverage if the funds are not depleted in any given year. As a result, the survey found that these companies were studying the possibility of creating a plan with a pre-defined contribution deductible. In turn, the challenge of how to communicate these types of plans to employees has become an issue.

‘Exempt’ Status May Receive New Definition

New regulations as to who qualifies for overtime pay have been proposed by the U.S. Department of Labor (DOL) with the backing of the Bush administration. The changes are aimed at redefining what constitutes exempt status, as currently outlined by the 1938 **Fair Labor Standards Act (FLSA)**.

It’s expected that the final regulations, which do not require congressional action, would take effect later this year or early in 2004.

Under the current regulations, employees are exempt from overtime pay if they earn more than $155 each week, or $8,060 annually. The new proposal would raise that amount to $425 each week, or $22,100 annually. Any employee earning less than that amount would automatically be required to receive overtime pay.

The DOL is proposing the use of a single “standard test” to determine single exempt status.

The proposed DOL regulations would also eliminate the existing system that allows an employer to apply a long or short test for determining exempt status. These tests have different salary levels and job requirements. Instead, the DOL is proposing the use of a single “standard test” to determine exempt status. Under this single test, the employee must be paid a minimum of $425 per week or $22,100 per year and meet the primary job requirements of the applicable **executive, administrative**, and **professional (EAP) exemption**.

In selecting the minimum weekly earning amount of $425, the DOL noted that a 2002 U.S. Bureau of Labor statistic report showed that was the amount earned by 80% of the salaried employees in the U.S. The weekly salary increase could make 1.3 million lower-wage employees eligible for overtime pay, according to the DOL.

In general, the proposal exempts employees from overtime if they manage more than two employees and have the authority to hire and fire, or if they have earned an advanced degree and work in a specialized field.

The DOL said it created the new proposal to simplify the rules and make them easier to apply and enforce. The existing regulations are 31,000 words; the new proposal, 13,000 words. In addition, the DOL said it hoped the new regulations would reduce the number of overtime pay lawsuits. In 2000, for example, employees filed 79 federal collective-action lawsuits. Union officials, however, have expressed opposition to the new proposal arguing that overtime pay is the only deterrent stopping some employers from creating longer workweeks.

When Distributions For Medical Bills Are Taxable

Beneficiaries who take funds from a qualified retirement plan to pay for health insurance premiums under a **Section 125 cafeteria plan** must pay income tax on the distributions, according to the Internal Revenue Service (IRS). Furthermore, any similar distributions used to reimburse plan participants for medical expenses are also taxable.

Under Revenue Ruling 2003-62, the IRS explained that under Code Section 402(a) those types of distributions are generally taxable. The IRS noted that there are two exceptions to this general rule that can be found in Section 402, but neither is related to Section 125 cafeteria plans. (One exception refers to distributions that are properly ***rolled over*** to another eligible retirement plan or Individual Retirement Account; the other applies to the net unrealized appreciation of employer securities.)

"Neither of the exceptions in Section 402 to the general rule of Section 402(a) allows a participant to exclude from gross income amounts distributed from a qualified retirement plan and applied to the purchase of benefits under the cafeteria plan," the IRS stated in its ruling. "Accordingly, the general rule of Section 402(a) applies and the distribution is includible in the distributee's gross income. The same conclusion applies if distributions from the qualified plan were applied directly to reimburse medical care expenses incurred by a plan participant."

Insurer Correct In Halting LTD Benefits

The **Employee Retirement Income Security Act of 1974 (ERISA)** was not violated when a company terminated a beneficiary's **long-term disability (LTD)** benefits after receiving medical evidence the beneficiary was capable of administrative or sedentary work.

In its ruling concerning *Lopes v. Metropolitan Life Insurance Company*, the First Circuit U.S. Court of Appeals affirmed one previously issued by a district court.

The suit was brought by George Lopes who began working for Fischbach Corporation in 1969 and was a participant in the MetLife-sponsored group insurance plan. The plan provided long-term disability benefits for the first 24 months of disability if a physical impairment prevented an employee from working in his regular occupation. To qualify after that initial period, the employee must have been "completely and continuously unable to perform the duties of any gainful work or service for which [he is] reasonably qualified, taking into consideration [his] training, education, and experience and past earnings," or have suffered a 50% (or more) loss of earnings.

In early 1996, Lopes was diagnosed with stage IV pulmonary sarcoidosis, a chronic inflammation of the lungs. He stopped working on Feb. 20, 1996 and applied for LTD benefits. On May 28, 1996, Lopes had a right lung transplant. His physician filed a statement with MetLife stating Lopes had a "Class 5" impairment, or was totally disabled. The doctor also stated Lopes was a "suitable candidate for future rehabilitation."

A "Class 4" classification meant the individual was capable of sedentary activity.

Over the next two years, Lopes received disability payments and followed a rehabilitation program. However, his health remained precarious. He was twice hospitalized for possible pneumonia or infection and required ongoing medical supervision and several medications. Two new treating physicians continued to rate Lopes as having a "Class 5" impairment.

After paying LTD benefits for 24 months, MetLife reevaluated Lopes' eligibility for continued benefits, noting that he would only continue to receive them if his illness prevented him from performing any job that matched his skill set. On Oct. 3, 2000, one of the treating physicians characterized Lopes' impairment as "Class 4." The less severe ranking implied Lopes was capable of sedentary activity. Despite the change in ranking, the attending physician stated he felt Lopes remained "totally disabled."

On Feb. 7, 2001, MetLife sent Lopes a letter stating it had terminated his disability benefits as of Jan. 31, 2001 because he was no longer totally disabled, based on the most recent medical information, as well as his training and education.

Lopes filed suit in U.S. district court alleging the loss of LTD benefits violated ERISA. The court, however, concluded MetLife had acted reasonably. Lopes appealed the decision. In turn, the First Circuit court noted, that although the final treating physician's report stated Lopes was totally disabled, the defendant had been given a "Class 4" impairment classification. This, the court said, implied Lopes was capable of sedentary activity.

Retiree Benefits May Be Exempted From ADEA

Employers who change or eliminate retiree health benefits when retirees become eligible for Medicare or a state-sponsored program, could soon be exempt from a federal age discrimination law.

The exemption is included in a proposed regulation issued by the **Equal Employment Opportunity Commission (EEOC)** and applies to the **Age Discrimination in Employment Act (ADEA)**. The EEOC's proposal, expected to be adopted following the close of a public comment period on September 12th, stems from its belief that employers could be discouraged from offering retiree health benefits out of concern about the potential use of the ADEA.

The proposed EEOC exemption would nullify a ruling issued by the 3rd Circuit Court of Appeals in 2000. In *Erie County Retirees v. County of Erie*, the court found that the county violated ADEA by offering Medicare-eligible retirees benefits that were inferior to those offered to those younger than 65.

In issuing the proposal, the EEOC said it was pursuing a course of action that would encourage employers to offer retiree benefits to the greatest extent possible. The commission noted that many companies are already curtailing or eliminating retiree health coverage, and the possible application of the ADEA was only aggravating circumstances. Furthermore, the EEOC noted that employers are not legally obligated to provide retiree health coverage.

The EEOC was attempting to encourage employers to offer retiree benefits.