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The information contained in this publication is intended for the general information of our clients. It should not be construed as legal advice or legal opinion regarding any specific or factual situation.

## Dependent Audits Beat Honor System

Most employers place dependents on their benefit plans based on “the honor system.” That is, they take an employee’s word that the dependent is eligible. And, to compound the situation, many employers also wait for an employee to tell them when a dependent is no longer eligible. Most employees are not sufficiently aware of the rules and definitions for their plans to understand when a dependent loses coverage.

Enter the dependent audit. Employers are stepping up their efforts to verify that dependents on their plans qualify to be there. Clearly, savings is motivating these efforts. Some studies have found that between two percent and eight percent of dependents are not eligible for the plan. The savings can be significant. A company with 5,000 employees and 9,000 dependents may see savings of as much as one half million dollars.

Dependents may be ineligible for a variety of reasons. Some include:

- They have exceeded the age limit for coverage under the plan
- They are no longer full-time students and that is a requirement of the plan
- There has been a change in marital status
- The person is not a legal dependent as defined by the IRS.

In many cases, fraud is not the driving force for ineligible depend-

ents. Employees may not understand the definitions of the plan or may have neglected to take the steps to terminate coverage. Employers are being prompted to act to maintain ERISA fiduciary obligations to protect a plan’s assets and, if applicable, to meet Sarbanes-Oxley requirements to protect the use of company assets.

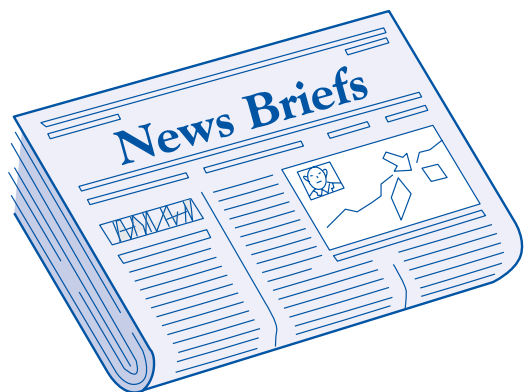
Some employers – and employees – argue that a dependent audit is a draconian measure that will only alienate employees. They also argue that these audits are not mainstream. However, recent surveys find that more than one half of large employers plan to conduct these audits. Even federal agencies are pursuing this strategy. The Federal Reserve conducted an “eligibility audit” during this past spring.

There are several steps that are common to dependent or eligibility audits. These include:

1. Using an outside vendor to conduct the audit. Employees are reluctant to own up to their errors for fear of adverse employment action. Using an outside vendor allows employees to ask questions and clarify situations anonymously.

2. An amnesty period as a first step. A 30 – 60 day amnesty period is common. To begin the process, employers should send a letter to employees with the details of the audit, the definitions of eligible dependents and dependents that are currently covered under the plan. The

*continued on back page*



### Out-of-State Same-Sex Marriages Require Review of Plan Definitions

California's Supreme Court ruling in favor of same-sex marriages may cause a ripple effect for employers of every state. California does not have a residency requirement for marriage, so people wishing to get married can easily do so.

Once the employees return to their home states, they may expect employers – and more importantly – their employer-sponsored health plan to recognize the marriage. As a first step, employers should review their plans to gain an understanding of the definition of “spouse” and “eligible dependent.” **Many plans use the federal definition of spouse, meaning that same-sex spouses need not be covered. Federal law explicitly defines marriage as between a man and a woman.**

Some employers have determined that they wish to offer coverage to same-sex spouses. If an employer has an insured plan, it is important to discuss this with the insurance carrier to have the benefit included under the plan. It is also important to understand the tax status of same sex benefits.

### Back to School Means Medical Exams

The list of requirements for medical exams when starting school or when reaching certain grades is long and growing. **For the 2008-2009 school year, a vision examination must be included as part of the health examination required within 1 year prior to entry to kindergarten or upon first entry into an Illinois school.**

**As of July 1, 2005, Illinois law required that all students in Kindergarten, second and sixth grades have a dental exam performed by a licensed dentist.**

**Illinois law also requires physical examinations for students entering Preschool, Kindergarten, 6th grade, 9th grade, and/or when transferring from an out-of-state school. Required physical exams and**

**immunizations must be completed by the first day of school.**

**Employers may want to review which, if any, of these back-to-school exams are eligible for coverage under the health plan. Alternatively, employers with flexible spending accounts or Section 125 plans should review their plan document to see if these services are contemplated as “eligible expenses.”**

### Medicare Part D Notices

**Medicare Part D Creditable Coverage Disclosure Notices must be provided to Medicare Part-D eligible individuals no later than November 15, 2008.** The notice must indicate whether an employer's plan satisfies the requirement that it is “creditable coverage.” Many insurers provide helpful information to help make this assessment.

Also, an electronic coverage disclosure must be submitted to CMS, the federal agency responsible for Medicare, within 60 days after the beginning of a group's plan year.

### 401(k) Safe Harbor Notice

The 401(k) Plan Safe Harbor Notice must be provided between October 3 and December 1.

Open enrollment is just around the corner for many firms. End-of-year communications and plans for January renewals need to be defined and set in motion.

The enrollment period to participate in a SIMPLE plan for 2009 is November 2, 2008 through December 31, 2008. Employers must notify eligible employees by November 2 to meet IRS requirements.

### AIG Financial Woes Frighten Policyholders

**The recent news about insurance giant AIG has many people worrying that their insurance plans are at risk. In the specific AIG situation, the financial woes were confined to the corporate holding company – not the more traditional insurance subsidiaries of the company.** Unfortunately, media coverage of the financial crisis did not make this distinction, needlessly worrying people with life insurance, annuities and the like.

In fact, the bailout did not apply to the insurance subsidiaries. They were – and still are – financially solvent according to the National Association of Insurance Commissioners.

**In the event that an insurer cannot meet obligations to policyholders, state guaranty funds step in. Every state has a guaranty fund. There are state guarantee associations for all lines of insurance: health, life, auto and homeowners.**

This AIG situation underscores the importance of state regulation of insurance. As soon as the AIG holding company asked its insurance subsidiaries for funds to meet their liquidity needs, state regulators stepped in. The subsidiary insurers are governed by state law, giving state regulators this authority.

It's important to note that state guaranty funds, if they must step in to a situation, may not provide the same level of coverage as that originally purchased by the insured. While laws governing maximum limits and types of policies covered vary from state to state, most states set basic limits of:

- \$300,000 in life insurance death benefits
- \$100,000 in cash surrender or withdrawal value for life insurance
- \$100,000 in withdrawal and cash values for annuities
- \$100,000 in health insurance policy benefits.

The overall benefit "cap" in most states for an individual life is \$300,000, though some states have maximums that are higher. However, the fact that a policyholder exceeds a state's cap still doesn't mean that the policyholder will be financially harmed. The value in excess of guaranty association benefit limits is eligible for submission as a general creditor claim against the estate of the failed insurance company. It is possible that the policyholder may receive distributions as the company's assets are liquidated by the receiver.

However, even in the event that state regulators step-in, their first effort is directed at rehabilitating the insurer or finding another insurance company to assume the policies for the failing insurer.

Policyholders that remain fearful can take steps to calm their concerns:

1. Find out what the state guaranty fund covers and whether policies are within guaranty fund limits – relax.
2. If policies exceed the limits – find out what options are available. It's important to determine whether there are surrender charges or penalties to consider.
3. Whenever purchasing or renewing an insurance policy, ask about the financial rating of the insurance company.

## **ERISA Form 5500 Often Overlooked**

**A study by Corporate Synergies has found that a large percentage of employers have not filed the ERISA 5500 form that is required by federal law. Noncompliance fees can be as much as \$1,100 per day.**

Companies with 100 or more workers are required to file a 5500 form for each of their employee benefit programs.

## **Economic Woes May Affect Plan Participation**

**With growing concerns over the economy, employees may turn to their benefit plans to make ends meet. Employers may find an increase in hardship withdrawals and waivers of medical coverage. Some employees will cease making retirement plan contributions.**

Employers should consider ramping up communication programs emphasizing the impact of these types of decisions. At a minimum, employers should be very direct concerning what steps, if any, an employee must take to reverse course. For example, waiving medical coverage would mean that an employee could not enroll in the health plan until the next open enrollment.

## **Section 125 Flex Plans Require Corporate Action**

A critical - and often overlooked - plan requirement for Section 125 plans is a formal action by the officers of a corporation to adopt the plan. The IRS will rule that a cafeteria plan was never started if a corporate resolution authorizing the plan has not been voted on by the corporation's officers.

Employers are advised to conduct a regular review of their various plans to ascertain that all required plan documents have been executed and communicated, if necessary. Furthermore, it is a good idea to have a set of documents for a plan easily retrieved in case there is a formal inquiry.

## **Medical Cost Trend in 2008 Lowers**

While the average increase in health plan costs for 2008 is estimated at 10.6%, this represents the lowest percentage increase in costs since 2001, according to Aon.

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**Mid American Group received the 2008 *Business Insurance Magazine* Readers Choice Award for Best Overall Retail Agent/Broker.**

## **Dependent Audits Beat Honor System – *continued from page 1***

notice should also outline what documentation will be required to prove that dependents are eligible for the plan. Typical documents are: birth certificates; adoption papers and marriage licenses. The amnesty period should allow employees to remove ineligible dependents without repercussions of any kind.

3. **Following the amnesty period is the actual dependent audit. Dependents remaining on the plan must provide documentation to prove their status. It's important to spell-out what actions will occur if ineligible dependents are discovered. At a minimum, the dependents will be deleted from the plan. Some employers require that employees pay back any benefits that should not have been paid. Other employers will take adverse employment action, up to and including termination.**

4. **Dependent audits should be followed with changes in practice. Proof of dependent status should**

**be required whenever dependents are added to the plan. This will stop the practice that some employers have seen where employees attempt to add the ineligible dependents back on the plan at the next open enrollment.**

5. **Employers may want to inquire whether their insurers or administrators can flag dependents who meet age limits and then follow up to see if they should be removed.**

It's important that employers look at verifying dependent eligibility as an ongoing process. Random audits or other measures such as ongoing proof requirements will ensure that plans are well managed.

**Also, before conducting a dependent audit, employers should review their plan documents. Most documents have to be amended to allow for the amnesty period.**