McGraw Wentworth

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In This Issue

In this second issue of the McGraw Wentworth Benefit Advisor for 2008, we will discuss voluntary life plans. Most employers offer employees the ability to purchase life coverage, in addition to any coverage provided by the organization.

Voluntary life plans can have complicated administrative rules. Are you confident your organization is administering your voluntary life plan properly? If your organization is not administering the plan properly, it may be a significant liability. This Advisor discusses the nuts and bolts for administering voluntary life plans. It may be a good idea to review your practices to make sure you are properly administering this important coverage.

We welcome your comments and suggestions regarding this issue of our technical bulletin. For more information on this Benefit Advisor, please contact your Account Manager or visit the McGraw Wentworth web site at www.mcgrawwentworth.com.

"Nuts and Bolts of Voluntary Life Insurance"

Many organizations have just completed their open enrollment. Open enrollment can be a frantic time. During this time it is crucial to inform employees of the many plans available and the complicated rules governing those plans. Although voluntary life coverage is usually a part of the open enrollment process, it often does not get as much attention as medical or even dental coverage. In fact, many organizations may not be properly managing their voluntary life coverage because it is so difficult to comply with the complex rules regarding evidence of insurability, open enrollment elections, salary changes, and so on.

If a voluntary life plan is not administered properly, it can pose a significant liability. Consider a very common situation. Perhaps, an employee elects $300,000 in voluntary life coverage and the plan offers $50,000 in coverage without evidence of insurability. The employer takes deductions for the $300,000 in coverage without verifying the evidence of insurability process has been completed. If the evidence of insurability process is not completed, the carrier will show the employee with only $50,000 in coverage. If the employee dies, when the claim is submitted, there is a $250,000 difference between the coverage amount and the expected death benefit. The employer, not the life insurance carrier, might be liable for the additional $250,000 benefit.

This *Advisor* offers practical advice to help your organization audit the administrative process for your voluntary life plan. You may want to review the following parts of your process:

- Evidence of Insurability
- Payroll Deductions
- Spouse and Child Coverage
- Salary Changes
- Contract Provisions

Your organization may not even be aware your life coverage is not being administered properly. In many cases, the problem may be with the administrative process, especially if any of the following apply to your plan:

- Your administrative process is decentralized with several different people responsible for tracking paperwork.
- You inherited responsibility for a voluntary life plan from

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another administrator and you are unsure whether that administrator followed the rules.
- Your organization recently changed life carriers and the administrative rules may differ slightly.

Each carrier has slightly different rules when it comes to administering a plan. Although this Advisor offers general guidelines on areas to review, you will need to consult your voluntary life contract to determine how your carrier will handle various situations.

Evidence of Insurability

Most voluntary life plans contain evidence of insurability requirements. Evidence of insurability means the life plan requires your employees to answer questions regarding their health history. The life insurance carrier can then either approve the requested amount or decline coverage if the employee is not considered a good risk.

However, evidence of insurability is not always required. Typically, when a voluntary life plan is first launched, the life carrier allows employees to elect a certain amount of coverage without having to provide evidence of insurability. This amount is sometimes called the guaranteed issue amount. In many cases, that limit may be around $50,000 in coverage. The coverage amount allowed without evidence of insurability will also apply to employees when they are first eligible for coverage under the plan.

Employers need to be mindful of evidence of insurability in any of the following situations:

- Employees elect more than the guaranteed issue amount when they are initially eligible for coverage.
- Employees decline coverage when they are initially eligible and then choose to elect coverage under the plan at a later date. Open enrollment provisions do not typically mean an employee can elect life coverage without submitting evidence of insurability.
- Employees elect more coverage at open enrollment than the carrier allows. Some life insurance carriers allow employees, if they elected life coverage when they were initially eligible, to buy additional life insurance at open enrollment. For example, let's say a voluntary life plan allows employees to purchase once, twice, or three times their annual salary. If employees elect one times the annual salary initially, some carriers will allow them to step up one election at open enrollment without submitting evidence of insurability. These employees would then be able to elect coverage for twice their salary at open enrollment. This approach often has a threshold amount of coverage that would require evidence of insurability, such as a $100,000 threshold amount. In such cases the carrier requires evidence of insurability regardless of the one step buy-up provision when coverage exceeds the threshold.

Evidence of insurability is important to life insurance carriers because the carrier does not want to underwrite large amounts of life insurance without knowing if your employees are healthy.

Evidence of insurability causes problems for many employers because they do not always know whether evidence of insurability rules apply. In addition, many employers self-report their voluntary life totals. This means they simply report life volumes to the carrier in set age/rate brackets. It is easy to overlook the need to verify approval for coverage before reporting the life coverage amount.

How can you tighten your administrative procedures to minimize problems with evidence of insurability?

Step 1: Clarify all situations where evidence of insurability may apply. Your administrative contract or your voluntary life summary plan descriptions should state when evidence of insurability is required. Then check your administrative process to make sure you are requiring evidence of insurability when necessary. If you find your process has not adequately checked for evidence of insurability in the past, it is a good idea to compare your records with your life carrier's records to identify any discrepancies. It is better to find these po-

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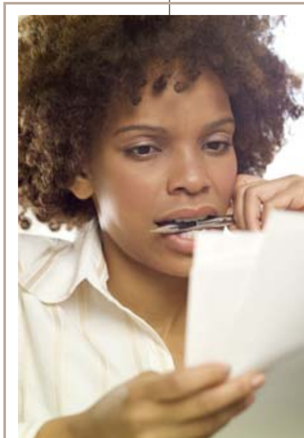
tential discrepancies up front before there is a possible claim situation.

Step 2: Set up a procedure to check for evidence of insurability. Different organizations may have slightly different administrative steps. Ideas to help improve the process are listed below.

- First, review your employee communication materials for both open enrollment and new hires to make sure the evidence of insurability requirements are explained clearly.
- Next, create a system to flag any life coverage election that may require evidence of insurability. You'll need to flag coverage elections that are above the evidence of insurability limits, any coverage election changes made at open enrollment, and any coverage elections or changes made mid-year.
- Then inform your employees of your requirements when you send them the evidence of insurability form. Clearly state that any coverage subject to evidence of insurability will not be effective until the carrier approves the evidence of insurability. Because some employers want to limit the amount of medical information they have on employees, they instruct employees to send the completed evidence of insurability form directly to the life insurance carrier. In other cases, however, the employee sends the form back to the employer to submit to the life insurance carrier.



Step 3: Create a method for tracking the evidence of insurability process. Typically it takes three or four weeks for a carrier to process an evidence of insurability request. Your organization should create a follow-up system to monitor the carrier's decision on evidence of insurability. Many carriers post the status on their administrative websites to allow employers easy access. If an employee is approved for coverage, the insurance carrier will usually notify you and your employee. If the employee is declined, the carrier will inform the employee and explain the reason why. In this case, the carrier will also inform you the coverage has been declined, but will not inform you of the reason for denying coverage.

If evidence of insurability is approved, your organization should verify the effective date for coverage. Since the employee pays for this coverage through payroll deductions, your organization may not want coverage to be effective retroactively because it affects payroll deductions. Your organization may be able to negotiate with your carrier. The carrier may allow a current effective date for approved life insurance coverage but allow a premium to be charged as of the first of the month following approval. This gives your organization time to process the needed change in payroll deductions. The approval for life insurance should be kept in the employee's benefit file so you have proof to verify coverage has been approved.

Special Steps when Electronic Enrollment is Used

If your organization manages enrollment electronically, the system needs to be reviewed and tested to make sure the evidence of insurability process is managed properly. Your electronic enrollment system should flag any election that exceeds evidence of insurability limits or when an individual enrolls after initial eligibility. The flag may be that these elections are pended until an HR representative approves them. However the election is flagged, HR needs to be aware there is a life amount that is pended subject to approval of evidence of insurability.

It is likely your software vendor will tell you life elections will be tracked for evidence of insurability. However, you should actually test the entire process to make sure the system handles the following correctly:

- Test all types of elections. Test new hire, mid-year, and open enrollment changes to make sure all possible situations, where evidence of insurability applies, are flagged.
- Review all screens to make sure it is clear to your employees that any amounts subject to evidence of insurability are pended until the life insurance carrier approves the additional amounts. The system should also communicate the steps the employee must take to submit evidence of insurability. Look at the confirmation screen when an employee completes enrollment to make sure any life insurance amount subject to evidence of insurability is clearly pended.

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- Look at the reports sent to the payroll vendor to make sure the only amounts being payroll deducted are guaranteed issue amounts. You need to communicate to your payroll department when deductions need to be increased as evidence of insurability is approved.

Keeping track of evidence of insurability requires attention to detail. You also need to make sure you are keeping your employees informed during this process.

Payroll Deductions

The employee typically pays for voluntary life coverage through payroll deductions. Payroll deductions seem like a simple topic, but there are complexities to these. In fact, you may need to review your payroll deduction process as well. Make sure to check the following:

Pre-Tax or Post-Tax Deductions: Most organizations take voluntary life insurance premiums on a post-tax basis. The IRS rules allow employees $50,000 in life coverage on a tax-favored basis. Any amounts that exceed the $50,000 in coverage require the employer to assess imputed income on the employee's W-2. Imputed income is addressed in detail in our *Benefit Advisor* at http://www.mcgrawwentworth.com/Benefit_Advisor/2007/BA_Issue_11.pdf.

Employee life insurance coverage paid for with post-tax dollars is not considered employer-provided as long as the IRS does not deem the plan "carried." A plan is deemed "carried" if the rates for the voluntary life plan straddle Table I rates in any age bracket. The straddling issue will definitely apply if the carrier charges a composite rate for voluntary life coverage. This situation is discussed in detail in the *Benefit Advisor* addressing imputed income. Most employers prefer employees to pay with post-tax dollars to avoid the additional administrative work required to calculate imputed income.

The new Section 125 regulations do confirm employers can offer life insurance coverage in a cafeteria plan and voluntary life insurance coverage can be paid for with pre-tax dollars. The new regulations also provide guidance on calculating imputed income when employees pay for voluntary life coverage with pre-tax dollars.

Employers that allow pre-tax deductions will need to calculate the imputed income implications for any employee that elects voluntary life coverage. In addition, changes to voluntary life coverage are subject to Section 125 rules for mid-year plan changes. Different organizations have different rules that apply to mid-year status changes under their Section 125 plans. When employees pay for life coverage with pre-tax dollars, employers must also follow Section 125 rules.

Employers may want to keep their voluntary life deductions on a post-tax basis. Post-tax deductions allow employees more flexibility to change deductions throughout the year. Employers will have less administration work when deductions are taken post-tax.

Effective Date of Payroll Deductions: Typically, payroll deductions are effective as of the pay just before or the pay just after the effective date of coverage. It depends on the payroll deduction process your organization follows.

Voluntary life insurance can have a two-phase rate structure. Most voluntary life plans have a guaranteed issue amount. Even if an employee is not approved for a coverage amount over the guaranteed issue amount, the employee can still purchase the guaranteed issued amount. The guaranteed issue amount is typically available only if an employee enrolls for coverage when initially eligible. Sometimes, however, if you change voluntary life carriers, the new carrier may offer a guaranteed issue amount of coverage for the first enrollment period.

This creates a bit of payroll deduction havoc. In many cases, the guaranteed issue amount is known at the time of the first payroll deduction, but the amounts subject to evidence of insurability may not be approved. The employer can push the carrier to decide on the amount subject to evidence of insurability, but in many cases, the carrier will need time to review the request. Employers do not want to take the full deduction if the additional life coverage has not been approved.

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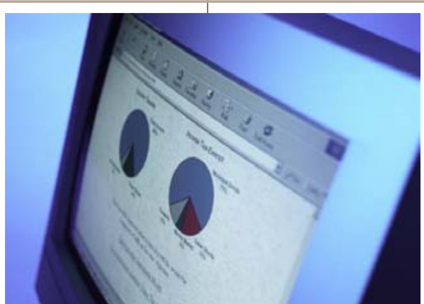
You may want to review your process for informing your payroll vendor or your payroll department about these payroll deductions. Your process should:

- Identify when guaranteed issued amounts apply.
- Identify the amount of life coverage subject to evidence of insurability.
- Open a clear communication channel between HR and payroll to make sure the deduction is correct.
- Create a follow up system to track any outstanding life insurance amounts subject to evidence of insurability.

If your organization is concerned the payroll deductions have not been managed properly, it may be a good idea to audit the voluntary life insurance plan. The audit may not be as cumbersome as you might think; only a percentage of your employees elect voluntary life coverage. You need to audit three sources: payroll deductions, HRIS records (or whatever records you use to keep track voluntary life insurance coverage elections) and the voluntary life carrier records.



Coverage Termination: When does coverage end? This question is important. Because voluntary life coverage is completely employee paid, most employers do not track voluntary life contributions or when coverage ends. This habit can cost employers money.

First, your organization needs to know how the voluntary life carrier processes termination requests. The key questions are:

- What is the effective date coverage will end? Is it the last day of active work? Is it the last day of the month employment ends?
- If coverage ends mid-month, how are premiums calculated for part of a month?

Once you have the answers to these key questions, you need to review your payroll deduction process. For example, if the life carrier ends coverage as of the last day of the month, the employer needs to collect enough from the last check to pay premium through the end of the month.

Many carriers also offer conversion or continuation rights on their voluntary life plans. Although it is not necessary, it is a good practice to send the terminated employee a notice verifying coverage has ended along with information the employee will need to investigate options to either convert the policy or continue coverage. The process to convert or continue coverage is between your former employee and the life insurance carrier. It is a good practice to make sure you can document life coverage has ended and you communicated the information your employee will need to investigate continuation rights.

Bill Payment: Bill payment is another area that should be reviewed. It is not just enough to clean up your internal records, your organization needs to make sure you are paying correctly. It is fairly common for your life insurance bills to be self-reported, meaning you report volumes and rates.

Key areas to address in reviewing your bill payments include:

- ***Check the rates you're using***: It seems pretty basic but it is not uncommon for organizations to discover they have not been paying based on the correct rates. For example, if your life rate is expressed as 0.204 cents per thousand in coverage, do not round up to 0.21 cents per thousand when calculating your premium. Calculate the premium based on the 0.204 cents and round once the total premium has been calculated.
- ***Check the voluntary rate table***: Make sure your voluntary rates are correct.
- ***Check benefit rounding***: If benefit is rounded to next $1,000, make sure volume reflects the next higher $1,000.
- ***Check effect of age bracket on rates***: The rates for voluntary life coverage are typically expressed in a rate per $1,000 of coverage based on the employee's age. The rates are typically expressed in five year age brackets. When an employee has a birthday and moves up a bracket, how is the rate change being handled? Your organization needs to make sure to change the payroll deduction as well as the bill.

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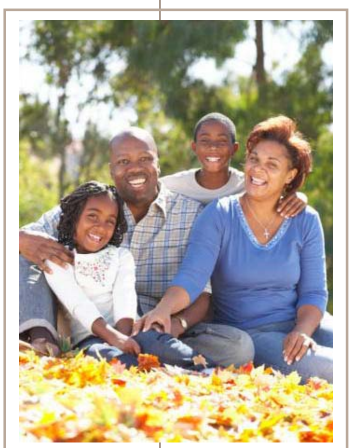
Since this area requires a great deal of oversight, some employers discuss alternative administrative procedures with their voluntary life carrier. For example, employers may negotiate with the carrier to make age adjustments annually at open enrollment and base life rate calculations on the employee's age as of a certain date. For example, organizations with a calendar year plan may base voluntary life rates on the employee's age as of January 1 each year. This simplifies the process and requires employers to update age records only once a year during open enrollment.



By auditing your bill, you can verify your organization is paying properly.

Spouse and Child Coverage

Most organizations do not limit voluntary life insurance coverage to "employee-only" options. Most carriers allow employees to elect coverage for legal spouses and children as well. It seems simple enough, but again, there are areas your organization should check in auditing your voluntary life plan:

- ***Requirements for seeking coverage***: Often voluntary life carriers have rules dictating when an employee can elect coverage for a spouse or a child. It is very common for the carrier to require employees to elect coverage for themselves before they can elect coverage for their spouses and children. Sometimes the carrier will also limit coverage on the spouse to 50% of the employee's election. Your organization should check your carrier's rules on covering a spouse or a child. As part of an audit you should check your employee's dependent life elections and make sure they meet the carrier's constraints.
- ***Evidence of Insurability:*** It is also fairly common for voluntary life plans to have separate guaranteed issue limits for spouse and sometimes even child coverage. Typically the guaranteed issue amount for spouse coverage is less than the employee coverage. Your plan might also have guaranteed issue amounts for child coverage but that only happens when higher amounts of life coverage are available for children. All the requirements discussed in the evidence of insurability section will also apply to spouse and child coverage.
- ***Rate Determination:*** Rates for spouse and child coverage can be tricky. First check the rates on your spouse coverage. It is common for the spouse to have age-banded rates similar to the employee. However, many carriers calculate the rates for spouse coverage using the employee's age. Your carrier can tell you whether the spouse coverage is based on the employee's age.

  The child coverage rate calculation can also be tricky. Many carriers charge a flat rate for covering a child. It is the same rate whether you have one child or ten children and each child receives full coverage. For example if the child coverage has a $10,000 life benefit, the employee would pay one rate regardless of the number of children covered and each child would be insured for a $10,000 life benefit. On the other hand, some carriers actually charge a separate rate for each child. For that reason, you need to be familiar with your carrier's approach.
- ***Qualifying spouse or child:*** Life carriers may not have the same definition of a qualifying spouse and child as your medical plan. Be sure to review the definition of spouse and child under your life plan as part of your audit process. Once you know who qualifies as a dependent, you should verify your plan covers only eligible spouses and children. Make sure your materials and plan documents define a spouse and a child correctly.

When you audit your voluntary life plan, remember to review spouse and dependent child coverage.

Salary Changes

On occasion, voluntary life plans base coverage on the employee's salary. This type of plan design would allow your employees to purchase an additional one, two or three times their salary in additional life insurance coverage.

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If your voluntary life benefit is based on the employee's salary, you need to consider the following:

- ***Definition of salary is important:*** How does your voluntary life plan define salary? Are bonuses and overtime considered part of salary? What other elements are included in salary? You need to use amounts included in the carrier's definition of salary when you calculate the life benefit and voluntary life rates.
- ***Changes in salary:*** These changes can affect premiums. How does your voluntary life plan handle salary changes? Salary is adjusted at least once a year for most employees. In some cases, however, salary may change more than once a year. If an employee is promoted mid-year and receives a significant salary increase, the life insurance benefit and premium would change significantly. You need to understand your process for identifying salary changes and how those changes affect a life plan that bases coverage amounts on salary. It may make sense to negotiate with your carrier to establish a favorable administrative process. In some cases, carriers will agree to allow you to adjust salary just once a year, typically as part of open enrollment. Your organization may be able to negotiate with the carrier to base the benefit on the current salary if an employee dies, but simply allow the premium adjustments to occur once a year.

If your organization's voluntary life plan design is based on the employee's salary, you need to review the salary component of the plan.

Contract Provisions

Your voluntary life plan should have a Summary Plan Description that outlines all the rules related to the voluntary life plan regarding evidence of insurability, eligibility, conversion rights and so on. The problem with summary plan descriptions is they are only effective if they are distributed to employees. In some cases, employers work on finalizing the documents, but don't distribute the documents in a timely fashion. Also many employees don't have their SPDs handy if they have questions when signing up for voluntary life coverage. It is important your communication materials for your employees detail the rules so there are no misunderstandings about how voluntary life coverage is administered.

The other area of voluntary life coverage that gets tricky is disability situations. How does your organization handle voluntary life insurance when an employee is off on a disability leave? Your organization needs to review your life insurance contract to see how the carrier handles leaves of absence. You also need to review your organization's leave of absence policy to make sure it matches the Summary Plan Description.

When an employee becomes disabled, organizations typically create a package of information to communicate to the employee requirements to apply for disability benefits and the information needed to communicate FMLA leave rights. It makes sense to clarify at this time how your organization handles life insurance when an individual is on a leave of absence. Some employers continue life insurance during the FMLA period and others will continue coverage during the waiver of premium waiting period.

Waiver of premium is a provision that is typically included in life plans that allows the life insurance to be continued without premium in the event a covered individual becomes disabled. Most carriers require the individual to be disabled anywhere from 6 months to 12 months before waiver of premium can be applied for.

It is important to understand how to handle disabled employees on the life insurance plan. Once your continuation period is exhausted, you should communicate an employee's right to conversion and the process for applying for waiver of premium.

Properly handling disabled employees is important. It is especially important at the point your organization decides to change life insurance carriers. It is fairly typical for life insurance carriers to have an actively at work requirement. If an individual is not actively at work, life insurance coverage with the new carrier will not go into effect. It is critical when transferring life insur-

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ance to account for any individuals who are not actively at work. Your organization should identify all employees who are not actively at work and determine their status.

If any have been approved for waiver of premium, the in force carrier maintains the risk for their life insurance coverage. For any individuals out of work but not able to apply for waiver of premium yet; your organization will need to negotiate continuity of coverage with the new carrier. Your organization discloses to the incumbent carrier and the new carrier any employees who are not actively at work. Your organization should arrange for these individuals to apply for waiver of premium with the incumbent carrier. The new carrier needs to agree to take the risk for any individual not actively at work that the incumbent carrier does not accept.

It takes exceptional attention to detail to make sure your life coverage is terminated properly. In some cases, waiver of premium will not apply. It is standard that waiver of premium does not apply past the age of 60. If waiver of premium does not apply, your organization will need to negotiate coverage with the new carrier for any disabled individuals where waiver of premium does not apply.

It is important to manage these complex administrative requirements properly.

Concluding Thoughts

A voluntary life plan must be managed properly. Although at first glance this may not seem to be a difficult task, it can be challenging. Anyone who has ever had a life claim where the carrier's records did not match the employer's records can understand the critical importance of monitoring the voluntary life coverage benefit.

If you are not confident your plan has been managed properly, it makes sense to audit your plan records and your procedures. If you identify discrepancies between your records and your carrier's, work with your carrier to resolve them. Updating your procedures now will minimize problems with your voluntary life insurance plan in the future.

If you have any questions regarding your voluntary life coverage, please contact your McGraw Wentworth Account Director. MW

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