Our Updated Survey on Group Life Insurance & Other Survivor Benefits

Almost all employees at large and medium size companies have access to affordable life insurance. And while over half of the U.S. population has some life insurance coverage, figuring out the right amount and type of coverage can be a challenge. September was Life Insurance Awareness Month and, according to the Life Insurance and Market Research Association (LIMRA), the average worker should maintain coverage equal to 5 to 6 times their income. Comparing life insurance needs by generations, Generation X (those born between 1965 and 1981) showed the widest gap between adequacy of coverage and amount currently in place, according to a New York Life study. Among well-known fictional characters, a recent survey by Life Happens (intended to educate the public about general life insurance needs) reveals that James Bond was voted the most in need of more life insurance compared to Homer Simpson and Phil Dunphy (from “Modern Family”). The reason most have not acquired more life insurance is due to the perceived cost, having other financial priorities, and not having trustworthy resources to help identify the right amount and type of insurance.

Of course, there is no magic number of insurance that is right for everyone - family situation, age, health, employment status, other assets and liabilities are just some of the factors likely to influence how much insurance an individual should consider maintaining. Furthermore, saving for retirement is a greater priority for a large majority of workers. Often, a major life event (marriage, birth of child) will trigger a review of the adequacy of coverage – although, most should review their needs periodically – and this includes reviewing beneficiary designations under all policies.

We recently updated our periodic informal survey of the life insurance coverage provided to employees and family members at 350 companies where Ayco provides financial counseling or financial education services. We also reviewed those companies which still provide a company-paid death benefit or executive-only insurance. The following types of survivor coverage are now being offered by our survey group compared to what was offered 15 years ago in our 2000 survey (total will exceed 100% due to multiple offerings):

- **Group Term Life**: 97% (2000) - 98% (2015)
- **Group Universal Life**: 40% (2000) - 40% (2015)
- **Executive-Only Life**: 8% (2000) - 34% (2015)
- **Company-Paid Death Benefit**: 9% (2000) - 9% (2015)
Group Term Life

Almost all of the companies in our survey group offer group term life insurance to their employees, as well as eligible dependents. Those that do not have replaced term life coverage with voluntary universal or variable life insurance. Nearly all companies provide, at no cost, a certain amount of basic non-contributory coverage, with about one-half of our survey group placing a dollar limit on the amount of this basic term coverage. At nearly one-third of the companies surveyed, group term life insurance is part of a §125 cafeteria plan.

A significant advantage of group term coverage offered by almost all employers is the ability to enroll and possibly later increase coverage (usually in small increments) without underwriting or proving good health. In addition, most employers provide a certain amount of basic coverage for their full-time employees and offer additional coverage that employees can purchase at group rates paid through convenient payroll deduction. But because group term coverage typically is a multiple of salary only and disregards other elements of compensation, it may not provide sufficient coverage for higher-paid executives.

Basic Term Coverage - Of those companies with basic term coverage, the amount provided to active employees at no cost is as follows:

Supplemental Term Life Coverage – Just over 90% of the surveyed group offer supplemental term life coverage in addition to basic life. This coverage is elective and fully paid for by an employee with after-tax dollars. An employer can elect to treat supplemental group term life paid entirely by employees as not “carried” by the employer. Thus, employees should have no imputed income for supplemental coverage. (However, the benefit remains governed by ERISA, as confirmed by a recent federal case.)

For those employers that offer elective supplemental term coverage, the maximum coverage amounts are as follows:

Group Term Life Maximum Dollar Amount

A large majority of companies in our survey group have a dollar maximum for the basic and any supplemental term coverage. We did see about 5% of our survey group that increased the coverage maximum within the past two years. Here is the aggregate maximum for group term coverage for those with a maximum

*Employee may elect multiple of salary or $50,000
Group Universal (GUL) or Variable (GVL) Life Insurance

Forty percent of our survey group offers GUL or GVL insurance on a voluntary basis in addition to group term coverage or in place of elective supplemental term life. An employee may elect to insure a spouse and/or children if the employee elects coverage. Premiums are almost always paid entirely by the employee with after-tax dollars. Several policies now offer long-term care (LTC) “riders”. These are not a substitute for LTC insurance (and are not approved in all states), but do provide a potential valuable benefit for those willing to pay the additional cost. At some companies, variable life insurance with equity investment vehicles is available. The maximum amount of coverage for those companies offering this type of insurance, subject to a dollar maximum, is as follows:

Maximum Amount of GUL or GVL Coverage

From an employer’s perspective, an advantage of a GUL program is that administration is outsourced. The employer may only have to deduct policy premiums and transmit them to the insurer. A significant advantage for employees is that this insurance coverage is portable, so that an employee may elect to continue coverage following termination of employment for any reason. However, recent historically low interest rates have impacted universal life policies, especially for those with contracts in force for more than 10 years.

Executive-Only or Heritage Split-Dollar Life Insurance

Prior to the enactment of the Sarbanes-Oxley Act (SOX) of 2002, one-third of our survey group offered split-dollar life insurance to select key executives. But a company’s payment of premiums under a collateral assignment contract would be treated as an impermissible loan under SOX; as a result, virtually all public companies have eliminated such programs or gone to a bonus arrangement where the executive pays the entire premium with the company making a special bonus payment to reimburse a portion of the cost. Currently, only about 8% of our survey group retain vestiges of executive-only life insurance. Typically, these contracts are for a grandfathered group of executives, although, there are a handful of companies that do still offer whole life or variable life coverage for key executives.

Dependent Life Insurance

In addition to providing life insurance coverage for the employee, an overwhelming majority of companies offer coverage for a spouse/domestic partner and children. Generally, this is term insurance, unless the company offers group universal life with coverage available for dependents. The employee almost always pays for any such coverage and is the automatic beneficiary of death benefits payable. An employer may provide or pay for up to $2,000 of coverage for a spouse (including legally married same-sex spouse) or child without imputed income. This amount is considered a de minimis fringe benefit.

Here are the maximum coverage amounts available for dependents; these are generally expressed as dollar amounts and a spouse’s coverage cannot exceed that of the employee:

<table>
<thead>
<tr>
<th>Spouse/Partner</th>
<th>% of Companies</th>
<th>Child</th>
<th>% of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $100K</td>
<td>15%</td>
<td>Under $10K</td>
<td>9%</td>
</tr>
<tr>
<td>$100K</td>
<td>25%</td>
<td>$10K</td>
<td>51%</td>
</tr>
<tr>
<td>$150-$200K</td>
<td>20%</td>
<td>$15K</td>
<td>6%</td>
</tr>
<tr>
<td>$250K</td>
<td>25%</td>
<td>$20K</td>
<td>14%</td>
</tr>
<tr>
<td>$300K or More</td>
<td>15%</td>
<td>$25K or More</td>
<td>20%</td>
</tr>
</tbody>
</table>

Accidental Death & Dismemberment (AD&D) Insurance

Almost all of the survey group provides AD&D coverage to employees, usually in an amount equal to the basic life coverage paid for by the company. There is no imputed income to an employee for any AD&D coverage paid for by an employer. In addition to this basic AD&D coverage, just over 70% of the survey group offer employees the choice of purchasing additional AD&D coverage for themselves and eligible family members.
Retiree Life Insurance
While most companies continue to provide a limited amount of term life insurance to eligible retirees—often with staggered reductions in coverage amounts beginning at age 65—there is no requirement that such coverage be offered or made available. In fact, within the past several years, we have seen several companies—approximately 8% of our survey group—reduce or eliminate altogether term life insurance coverage for retirees. This is one reason that some companies utilize universal life coverage; those employees who want to continue coverage after retirement or termination of employment can do so with the cost paid entirely by the retiree. When group life coverage is reduced or ends (for any employee, not just a retiree), the individual generally can convert coverage to an individual policy—although, due to cost, this makes little economic sense for anyone who is healthy. Similar imputed income rules apply for retirees where the employer pays the premium with an exception for those who retired prior to 1984 or retired after 1984, were employed in 1983 and were at least age 55 on 1/1/84. In those limited circumstances, there is no imputed income for non-discriminatory term life coverage.

Survivor Income Benefit
These are programs intended to provide a surviving spouse or dependent children with an ongoing stream of income for a stated period of time following the death of an employee. Typically, the periodic payment is a percentage of the employee's final salary. Payments may continue until the spouse's remarriage, reaching a stated age (e.g., 65) or for a stated number of years. It can be argued that these programs are representative of a past paternalistic era of employer-employee relations. But, because they are ERISA benefits, it can be difficult for employers to eliminate them. Fewer than 2% of our survey group have such grandfathered coverage.

Company-Paid Death Benefit
We continue to see a relatively small number of companies maintain a company-paid death benefit. This is not an insured benefit; hence the proceeds are income taxable to the beneficiary and deductible by the company. Prior to 1996, there was a $5,000 death benefit income tax exclusion; however, this tax benefit was eliminated for decedents dying after 8/20/06. Almost always, these programs only provide benefits upon the death of an active employee. One advantage of these programs is that there is no imputed income during the lifetime of the employee.

Pension Plan Death Benefits
More than a generation ago, when defined benefit pension plans were the primary, and sometimes only, retirement plan offered to employees, a handful of pension plans provided a lump sum death benefit which was in addition to any joint and survivor benefits. Typically, the amount of this special death benefit was one times pay. These pension death benefits were not funded by insurance and are now rare in either qualified or nonqualified plans. ERISA's anticutback rule generally prevents qualified pension plans from reducing or eliminating certain accrued vested benefits earned by plan participants. However, a federal court ruled several years ago that a company could eliminate its pension death benefit for future retirees.

Divorce and Life Insurance Benefits
In the event of a legal separation or divorce, the parties may agree to change beneficiaries for any group or other life insurance. This can be included in any domestic relations order approved by a state court. What hasn’t always been clear is whether such a provision can be included in a QDRO. This has been the matter of litigation, with some federal courts indicating that it is effective and others concluding that life insurance plans are excluded from QDRO requirements. The DOL has indicated that a QDRO may impact company-paid survivor benefits (ERISA Op. Letter 2000-09A).

Income Tax Treatment
While life insurance death benefits received by a beneficiary are not income taxable (per IRC §101), the cost of life insurance paid for by an employer or paid by an employee with pre-tax dollars through a cafeteria plan can result in imputed income. Any non-discriminatory group term life, up to $50,000, under a policy carried directly or indirectly by an employer can be provided without imputed income, while coverage in excess of $50,000 results in imputed income using the IRC §79 tables. This income is included in wages reported in boxes 1, 3, 5 of the Form W-2 and also is to be reported in box 12 with Code C. An employer need not withhold federal income taxes on this income, but should withhold Social Security and Medicare taxes for active employees. There is similar tax reporting for coverage provided to former or retired employees, but there is no requirement for the employer to withhold income or Social Security taxes—although, the amount of any uncollected Social Security tax is to be reported on the Form W-2 with a code M in Box 12 and code N for uncollected Medicare Tax. There is no reporting required for the 0.9% Additional Medicare tax.
Generally, all term life insurance offered by an employee is to be treated as a single policy for purposes of calculating imputed income – with a reduction for any coverage paid for by an employee.

But in a recent private ruling (PLR 201542003), the IRS confirmed that if an employer offers supplemental term life insurance which employees pay for with after-tax dollars, an employer can treat the basic non-contributory coverage and the optional coverage as separate. This would mean that employer would not need to combine the total coverage elected under both plans to calculate any imputed income to the employee. This can be particularly beneficial where the premium cost for the supplemental life is less than the Table 1 rates under IRC §79.

Any premiums paid for by an employer for whole or universal life insurance should be reported as taxable income, but based on the amount paid rather than using the §79 tables. The taxation rules for split-dollar life were modified by the IRS in 2003.

ISS and Glass Lewis Release 2016 Shareholder Voting Policy Changes
The two major shareholder voting/corporate governance organizations, Institutional Shareholder Services (“ISS”) and Glass Lewis, each issued their 2016 policy updates late last month. These are currently being studied by those responsible for executive compensation design and the impact on the “Say-on-Pay” voting by shareholders. As an example, Glass Lewis now states that if it identifies egregious compensation practices, it may recommend a “no” vote for Say-on-Pay and also a vote against compensation committee members based on actions taken by the committee during the year. Possible egregious practices include large one-off payments to select executives, the inappropriate or unjustified use of discretion relating to executive pay, and sustained poor pay-for-performance practices.

In its 2016 guidance, ISS issued a number of updates to their policy guidelines, although these do not significantly modify most existing executive compensation related recommendations. Here is a brief summary of a few of the changes in ISS policies for next year’s proxy season:

- **Company Size** - Under their 2016 U.S. Equity Plan Scorecard (EPSC), ISS will score each company’s key policies to five different models related to a company’s size and status (S&P 500, Russell 3000, Non-Russell 3000, and two special cases groups). ISS will accept suggestions as to each company’s self-selected benchmarking peers, which it will use for its peer group selection process to assess the company’s relative executive compensation.

  - **Three Pillars** - ISS will now consider a range of positive and negative factors to evaluate equity incentive plan proposals, rather than a series of “pass/fail” tests. Factors will be grouped under three “pillars”: plan cost, plan features, and grant practices.

  One plan provision to be reviewed is any acceleration in vesting upon a change in control. Other grant practices reviewed will be a company’s three-year average “burn rate” relative to its industry and peers, the vesting schedule of the CEO’s equity grants, the proportion of the CEO’s most recent equity awards subject to performance conditions, and any clawback policy.

  ISS will evaluate share retention features for senior executives on a case-by-case basis, taking into account the percentage of net shares to be retained, the required retention period, the robustness of share ownership and retention requirements, and the actual ownership levels of key executives.

  - **External Management** - ISS will generally recommend against a Say-on-Pay proposal at companies where there is an external management structure in place (aimed primarily at REITs) and there is insufficient detail in the company’s disclosures with regard to the pay for those executives to perform a comprehensive pay-for-performance analysis.

  - **Overboarding of Directors** - ISS has modified its policy with respect to the number of boards any director sits on. After a one-year transition period, ISS will issue a negative vote recommendation for directors (who are not CEOs) and who sit on more than five public company boards. CEOs will be considered to be “overboarded” if they sit on more than three public company boards, including their own board.

Compensation consultants will be reviewing existing corporate pay practices which could lead to some equity award design changes to help avoid negative voting recommendations by either of these organizations. A target for most U.S. public companies will be to achieve a 90% or greater Say-on-Pay shareholder vote.
Reimbursing Employee For Health Coverage Through Spouse’s Employer

When married couples are both working for employers that offer medical coverage, each has to decide whether to elect coverage for themselves and any family members with their own employer or with their spouse’s. Usually, it will be the cost for coverage or the opportunity to elect a high deductible health plan with an associated health savings account (HSA) that could be the driver of decision making. We are also seeing more employers impose a spousal surcharge if an employee seeks to cover a spouse in their employer’s medical plan when the spouse has access to coverage through his/her own employer. In our most recent survey of 2016 open enrollment described in last month’s Digest, we indicated that over 25% of our survey group will impose a spousal surcharge in 2016. An employer could provide that it will reimburse an employee for the cost of coverage if the employee elects to be covered by the spouse’s employer’s plan. The IRS was asked to opine on the tax consequences of any such reimbursement made to an employee. Recently, the Office of Chief Counsel did provide an answer to this question in Chief Counsel Advice 201547006. Although this type of response may not be used or cited as precedent, it does indicate the IRS current position on such an arrangement.

The memorandum concludes that any payments or reimbursements made by an employer can only be excluded from the employee’s income if the spouse pays for health care coverage on an after-tax basis and does not utilize pre-tax salary reductions under a §125 cafeteria plan. The CCA illustrates seven different situations. In the first two, the spouse does pay on an after-tax basis to cover the employee. If the employee’s employer reimburses only a portion of the cost for the employee’s share or reimburses the entire payment for the family, the reimbursement will be excludible from the employee’s income and is not subject to FICA taxation. In contrast, if the spouse pays for coverage on a pre-tax basis, any reimbursement made by the employee’s employer will be treated as taxable income.

The memo also describes the consequences if the employee’s employer maintains a health reimbursement arrangement (HRA) that reimburses for health insurance premiums. Here, the results would be the same as described above – the payment would be treated as tax-free only if the spouse paid his/her share of the cost of coverage on an after-tax basis. The final situation described is where the HRA reimburses the employee only for medical expenses incurred other than the payment of insurance premiums. This type of reimbursement would be excludible from the employee’s gross income.

This guidance from the IRS could be of interest to those employers seeking to incentivize employees that have access to attractive medical coverage through a spouse’s employer and may also help employers avoid any potential Cadillac excise tax.

The Importance of Completing Pension Forms Correctly

While the number of companies maintaining defined benefit pension plans for active employees is rapidly decreasing, there remain millions of Americans entitled to receive a pension benefit, including those entitled to benefits under a frozen plan. A plan participant generally would elect the form and timing of payments prior to when payments are scheduled to commence. Depending on plan terms, this could be following retirement or termination of employment or at a later date to avoid a reduction associated with early payment. If an individual is married, the normal form of payment would be a joint and survivor annuity unless spousal consent for an alternate form of payment is obtained. Payment forms do have to be properly completed and executed. Otherwise, payments can be delayed and this can potentially have negative consequences. Here is a recent example.

Victor Fife retired from the Ford Motor Company in 1979 after 25 years of service. He then elected to receive his pension payable monthly with a 50% survivor annuity in favor of his wife, Julia. However, Julia passed away in 2011, a fact that Fife failed to report to the pension plan administrator. Under the plan, a participant wishing to cancel survivor benefits payable to a deceased spouse must submit evidence satisfactory to the committee administering the plan as to the death that includes providing a death certificate. This was not done.

Then in 2012, Ford made a pension de-risking offer that authorized retirees in pay status to elect to receive the present value of remaining payments in a lump sum. Fife elected to receive a lump sum by submitting the required election form. However, the plan administrator deemed the form submitted by Fife to be ineffective because it stated an inaccurate payment amount that included the survivorship benefit that would no longer be payable. They requested
that Fife execute a corrected form. But before he could do so, he passed away. When Ford refused to pay the lump sum to the family, the estate sued.

Recently, a federal District Court in Michigan upheld the company and plan administrator’s actions (Fife vs. Ford Motor Company). Under the terms of the plan, a participant who sought to request a lump sum payment had to submit a completed and properly executed form. The court held that since Fife had not disclosed his wife’s earlier death and therefore had an inaccurate lump sum payment amount in his election form, he had not properly submitted a request for a lump sum. Therefore, the company was within its rights in refusing to make the payment and this decision was not arbitrary and capricious.

Moral of this story is that both active employees and former employees may need assistance in making appropriate elections with regard to a variety of employee benefits.

**Did You Know...**

**Comparing Highest Pay Levels By Job Function**

Just for fun this holiday season, here are some publicly released annual compensation figures for several different positions:

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<thead>
<tr>
<th></th>
<th>1st</th>
<th>2nd</th>
<th>3rd</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO (U.S. public co.)</td>
<td>David Zaslav (Discovery Commun.) $156.1M</td>
<td>Michael Fries (Liberty Global) $111.9M</td>
<td>Mario Gabelli (GAMCO Investors) $88.5M</td>
</tr>
<tr>
<td>Private College Presidents</td>
<td>Lee Bollinger (Columbia Univ) $4.6M</td>
<td>Amy Gutmann (Univ. of Penn.) $3.0M</td>
<td>Nido Qubein (High Point Univ.) $2.9M</td>
</tr>
<tr>
<td>College Coaches</td>
<td>Nick Saban (Alabama-Football) $7.1M</td>
<td>Jim Harbaugh (Michigan-Football) $7M</td>
<td>John Calipari (Kentucky-Basketball) $6.4M</td>
</tr>
<tr>
<td>U.S. Professional Athletes (by sport)</td>
<td>Floyd Mayweather Jr. (Boxing) $300M</td>
<td>LeBron James (Basketball) $64.8M</td>
<td>Phil Mickelson (Golf) $50.8M</td>
</tr>
<tr>
<td>Movie Stars</td>
<td>Robert Downey Jr. $80M</td>
<td>Jennifer Lawrence $52M</td>
<td>Jackie Chan $50M</td>
</tr>
<tr>
<td>U.S. Gov’t Officials</td>
<td>President Obama $400,000 + $50,00 non-taxable allowance</td>
<td>Supreme Court Chief Justice Roberts $255,500</td>
<td>Vice President Joe Biden $230,700 + $10,000 non-taxable allowance</td>
</tr>
</tbody>
</table>

(1) Per Equilar rankings as reported in NY Times (Avg. CEO pay at S&P 500 Company: $12.2M)
(2) Per The Chronical of Higher Education as reported in NY Times (pay is for 2013)
Did You Know Cont’d....

- Under proposed legislation entitled the Seniors and Veterans Emergency (SAVE) Benefits Act, the performance-based compensation exception to IRC §162(m) would be eliminated. This would potentially mean that a public company could take a tax deduction and compensation paid for its top officers only up to $1 million. The expected additional revenue would help pay for a one-time payment of $580 to Social Security recipients in 2016 to make up for the fact that there will be no cost of living adjustment in Social Security benefits next year.

- It has been estimated by Edvisors that 70% of 2015 college graduates will have student loans outstanding with an average loan balance of $35,000. A recent Charles Schwab of 401(k) plan participants found that 37% said they can’t save more for retirement because of student loan payments.

- According to data released by America’s Health Insurance Plans (AHIP), the number of Americans enrolled in high deductible health plans eligible to fund an HSA increased by over 2.3 million in 2014 to a total of 19.7 million individuals. The Employee Benefit Research Institute (EBRI) estimated that there were 13.8 million HSA accounts holding $24.2 billion in assets as of December 31, 2014. Nearly 80% of HSAs have been opened since 2011. We would expect around a 10-15% increase in these numbers for 2015.

- The IRS recently issued an Audit Techniques Guide for its auditors of equity stock compensation plans. The Guide describes potential tax issues impacting both employees and the company. It instructs IRS auditors to review SEC filed documents, as well as internal corporate documents, including individual employment contracts.

About This Newsletter
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