benefit basics | lifestyle spending accounts

Employers looking for a creative and flexible solution to meet their employees' well-being needs may want to consider offering lifestyle spending accounts (LSAs). Tom Kelly, principal and voluntary benefits leader for Buck, explains that LSAs can give employers the flexibility to meet employees' needs in the moment while also serving as a recruitment and retention tool.

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LSA Fundamentals

Preliminary data from the International Foundation of Employee Benefit Plans 2022 *Employee Benefits Survey* shows that 3.7% of employers offer LSAs. These reimbursement-based accounts are funded by an employer. Employees can use them to meet an array of covered needs, and these accounts can be adapted to multiple workforce segments. The employer has complete control over the design, eligibility, funding and services covered.

Employers should focus on covering expenses that resonate with employees or that help solve a specific issue. For example, during the pandemic when employees shifted to working from home, employers included expenses like home internet service, food delivery service, tutoring for children, summer camp, etc.

The bottom line is that employers can be as creative as they want. A key benefit of an LSA is that it can help address the needs of multiple audiences down to the individual because it allows employees to choose how they use their subsidy across a range of programs.

Design

LSAs are typically designed as an after-tax benefit, meaning that any reimbursements received by participants are taxed as ordinary income and included on the participant's W-2. While an employer can choose to roll over any unused balance from one year to the next, most do not want the ongoing financial obligation on the books. Instead, they adopt a "use it or lose it" approach.

Since the account is taxable and is not an Employee Retirement Income Security Act (ERISA) plan, there are no annual Form 5500 filings, cafeteria plan rules or discrimination testing requirements to comply with. One caveat: If the account reimburses for a Section 213(d) health expense, it becomes a group health plan and would then trigger ERISA and group health plan laws.

In rare circumstances, an employer may decide to include a combination of pretax and after-tax benefits under the plan. In this case, the regulatory and compliance requirements become more complex. Employers should consult with an ERISA attorney in the design phase.

Covered Services

Assuming the LSA is taxable, employers have total discretion to determine what is a covered expense.

In most cases, employers tie the LSA to a larger human resources (HR) or benefits issue. For example, if employees are using their 401(k) plan as an emergency savings vehicle rather than for retirement savings, the plan can be designed to cover unexpected short-term emergencies like car repairs, buying a new washing machine, etc.

Other organizations choose to link the LSA to a broader well-being strategy and include services that fall within the various dimensions of well-being. Some examples include:

- **Physical—**Gym membership, fitness equipment, race entry fee, massage
- **Social—**Club membership, cooking classes

- **Financial—**Student loan repayment, college savings, tax preparation fee, emergency savings, financial coaching
- **Emotional—**Stress management class, yoga, sleep app, back-up child care/adult care.

Rather than assuming that they know what employees value, employers should consider conducting employee focus groups and surveys to help determine what the LSA should cover.

Eligibility

In most cases, employers offer the LSA to all benefits-eligible employees; of course, budgetary constraints may impact the initial rollout strategy. In some instances, employers offer an LSA to only a segment of the employee population. For example, if an employer wants to address an attraction and retention issue, it might offer the LSA to only new hires or employees with a stated number of years of service.

Funding

One of the key design issues is the amount of the annual subsidy. Since this represents an additional expense to the employer, finding the budget to offer a reasonable amount can be a challenge. One approach is to redirect spending from underused benefits or to fold wellness incentives into the LSA design.

Some organizations have started with a subsidy as low as $150, although the rule of thumb is that anything less than $300 is not meaningful enough. Any amount above $500 tends to have the greatest impact. Most important, employees need to view the amount of the subsidy as relevant to their needs.

Administration

There are essentially two different LSA delivery alternatives—transaction or debit card.

Under the transaction model, participants are required to submit receipts to get reimbursed. The debit card model, on the other hand, allows participants to receive immediate reimbursement once money is loaded on the card.

Many employers prefer the transaction model since it gives them more control over how the plan is used and is more advantageous from a cash flow standpoint since funds are only required when requests are submitted for reimbursement.

Nevertheless, the setup and ongoing administration of the plan is challenging, requiring specializations that a thin benefits/HR staff may not be able to take on, so employers may need to outsource administration to a third-party account vendor.

Communications

While an LSA is not typically an ERISA plan, employers should provide participants with a simplified document that spells out the plan provisions, eligibility rules, covered services and reimbursement requirements.

Measurement

Employers may be able to measure the return on investment (ROI) by looking at factors such as the relative change in employee satisfaction or engagement levels. Other options include using typical HR metrics like turnover rates and "time to fill" for open positions to measure the financial impact of adding the plan. Establishing baseline metrics and targeted improvements is a good way to build the business case for implementing an LSA.

A Creative and Attractive Solution

Of course, there are some challenges attached to LSAs. Most LSAs are not tax-advantaged, and there are compliance issues like the need to exclude medical expenses from the LSA to avoid triggering group health plan laws. The accounts are exclusively employer-funded, which means they add cost to the employer's budget. And an LSA is a difficult benefit to unwind since it will be perceived as takeaway from employees once it is established.

A 2022 Buck survey found that when employees have a positive perception of both their benefits package and their employer's commitment to well-being they were more likely to stay with the employer. The challenge is to find ways to increase the value—and relevance—of these benefits for employees. LSAs may be one such strategy, allowing employers to get creative in supporting anything that promotes wellness.

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