The Use of Self-Insured Plans as 'Bona Fide' Fringe Benefits
Under The Service Contract Act

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The Service Contract Act ("SCA") requires specified minimum monetary wages and fringe benefits be paid to service employees working on a covered contract. Contractors are permitted to meet the per hour fringe benefit obligation either by providing benefits costing the contractor at least that amount per hour, or by paying the employee a "cash-in-lieu" of fringe benefits payment equal to the hourly amount, or a combination of the two.

SCA regulations limit the types of fringe benefits that qualify for purposes of meeting the contractor's obligations. In doing so, they use the term "bona fide" fringe benefits. To be considered "bona fide" the benefit plan must meet the following conditions:

- It must be in writing;
- It must be communicated to affected employees in writing;
- If jointly funded through employer and employee contributions, employee contributions must be voluntary. Employee contributions may not be used to satisfy the contractor's obligation;
- The primary purpose must be to provide systematically for the payment of benefits to employees on account of death, disability, advanced age, retirement, illness, medical expenses, hospitalization, supplemental unemployment benefits, "and the like";
- It must contain a definite formula for determining contractor contributions and for determining the benefits each employee is entitled to under the plan;
- Finally, and most importantly for our discussion here, except as otherwise permitted by the regulations and approved by the Department of Labor (DoL), contractor contributions must be made "irrevocably to a trustee or third person pursuant to an insurance agreement, trust or other funded arrangement".[1]

It is this irrevocable remittance requirement that causes uncertainty when using self-insured plans for SCA benefit compliance. The regulations further state:

> Unfunded self-insured fringe benefit plans… under which contractors allegedly make "out of pocket" payments to provide benefits as expenses may arise, rather than making irrevocable contributions to a trust or other funded arrangement …, are not normally considered "bona fide" plans … for purposes of the Act.[2]

Despite this disallowance of "unfunded" self-insured plans for purposes of SCA compliance, the regulations say that the "contractor may request approval by the [DoL] of an unfunded self-insured plan in order to allow credit for payments under the plan to meet the fringe benefit requirements of the Act."[3]

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Funded vs. Unfunded Self-Insured Plans

When considering whether a self-insured benefit plan must seek approval from the DoL to be considered a "bona fide" fringe benefit, it's important to understand the distinction between funded and unfunded plans.

Under an unfunded plan, the plan sponsor makes periodic payments, generally through a third party claims administrator, as claims are presented for payment. Such payments are made out of the plan sponsor's general assets and may vary greatly from month to month.

Under a funded plan, the plan sponsor establishes some type of scheduled funding that is intended to pay the plan's expenses - including fees, stop loss premium and expected claims. This funding will take the form of an amount that is a fixed monthly contribution per employee that is then deposited into the "fund". In effect, the plan sponsor is establishing a monthly per employee "premium equivalent" contribution that acts much the same as an insurance premium. These amounts are contributed to the fund, which can be in the form of a health and welfare trust, including a 501(c)(9) VEBA trust, or other fund arrangement, such as a third party custodial account. In this way, the contributions per employee are consistent month to month, although claims paid will vary based on actual plan experience.

Assuming these monthly contributions are made irrevocably to the trust or fund arrangement, then the "funded" plan meets the requirements of a "bona fide" fringe benefit and no DoL approval is needed, assuming of course that it meets the other requirements listed above. It is only the use of an unfunded arrangement that

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[1] 29 CFR 1.171(a)(4)
[2] 29 CFR 4.171(b)(1)
[3] 29 CFR 4.171(b)(2)

is considered to not be a "bona fide" fringe benefit unless DoL approval of the plan is obtained.

Seeking Approval of an Unfunded Self-Insured Plan

Among the primary purposes of the Service Contract Act are the desires to put competitors on a level playing field in terms of labor costs and to make sure service employees actually receive the hourly fringe benefit contributions set forth in the Wage Determination. To meet these goals, the DoL looks at a number of factors in determining whether an unfunded self-insured plan should be considered "bona fide" for SCA compliance purposes. The primary factors it considers are:

- Can the plan be reasonably anticipated to provide the prescribed benefits?
- Is it a legally enforceable commitment on the part of the employer?
- Is it carried out under a financially responsible program?
- Has it been communicated to the employees in writing?

To meet these requirements, the employer should make sure the plan meets the requirements under ERISA, including a written plan document and summary provided to eligible employees. There should also be a written, enforceable contract with a Third Party Administrator (TPA) that is responsible for adjudicating and paying claims as they are submitted by providers for coverage under the terms of the plan.

If the unfunded plan meets these requirements, it should satisfy the primary purpose test to be a "bona fide" fringe benefit under the SCA. It should also satisfy the legally enforceable and financially responsible requirements and therefore be approved by the DoL.

Ongoing Operational Issues

Once the plan has received approval, the employer needs to have a satisfactory method for accounting for actual cash payments via the plan and crediting those payments towards its hourly fringe benefit obligation. While claim payments will vary from week to week, there should be a method of crediting a consistent amount towards the fringe and then comparing that credited amount with the actual cash expenditures of the plan.

Similar to the "premium equivalent" contribution used in a funded self-insured plan, the employer, in conjunction with the plan actuary or other advisor, should establish an estimated "premium equivalent" amount that is used for hourly fringe accounting purposes. For example, the plan's actuary may determine that the reasonable amount needed to pay claims and other allowable plan expenses is $500 per employee per month.

While the employer would not be contributing this specific amount each month, it could use this amount as its estimated per-employee credit towards its SCA fringe benefit obligation. However, on an aggregate plan basis, the DoL would expect the amount of fringe credit taken to be based on the actual plan expenses. Therefore, the employer must do a periodic accounting to determine if actual employer paid expenses are at least equal to the amount of credit taken towards the fringe obligation. In keeping with SCA regulations, that accounting should be done at least quarterly.

Other Considerations

In addition to the concerns raised by the Service Contract Act regulations with respect to self-insured plans, additional requirements may be imposed under the Federal Acquisition Regulation, particularly with respect to Contract Officer approval of such plans in certain circumstances. A discussion of these requirements is beyond the scope of this article. However, contractors should, at a minimum, be aware and take into account the following:

- FAR Part 31.205-19, Insurance and Indemnification
- FAR Part 28.308, Self-insurance
- Cost Accounting Standards 416, Accounting for Insurance

Failure to take these requirements into account can result in the disallowance of costs, or the imposition of penalties for improperly charging the government for self-insured costs.

Conclusion

The use of a self-insured benefit plan for SCA fringe benefit compliance can often result in cost savings and greater plan design flexibility for the sponsoring employer. However, for government contractors using such a plan comes with additional legal, accounting and administrative requirements. The contractor considering using a self-insured plan should be fully apprised of these requirements and weigh them against the anticipated cost savings before fully committing to using a self-insured plan for its SCA-covered employees. ■

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