BENEFITS INSIDER
A Member Exclusive Publication

Volume 21, August 24, 2006

WEB's ***Benefits Insider*** is a member exclusive publication providing the latest developments from the Nation's Capital on matters of interest to benefits professionals. The content of this newsletter is being provided as a result of a partnership with the American Benefits Council, a premier benefits advocacy organization, which provides much of its core content.

Articles in this Edition

Health Action Council
Benefits Insider
2006 Sponsor

RECENT LEGISLATIVE ACTIVITY

Coalition Urges Action on HSA Improvement Legislation

On July 27, members of the HSA Working Group, a broad-based coalition of organizations representing employers, health plans, and the financial services institutions in support of legislation to improve HSAs as they are being introduced into the marketplace and make them more responsive to marketplace needs, sent a letter urging House Ways and Means Committee Chairman Bill Thomas (R-CA) to act on two proposals recently introduced by Representatives Eric Cantor (R-VA), H.R. 5262 (the "Cantor measure"), and Paul Ryan (R-WI), H.R. 5743 (the "Ryan bill"), legislation which would improve health savings accounts (HSAs). Both bills include several provisions based on policy recommendations from the HSA Working Group, and both are discussed in more detail later in this Issue.

Cantor and Ryan both serve on the House Ways and Means Committee and have been seeking action by the Committee on their proposals so that HSA reform legislation can be considered by the House of Representatives before the 109th Congress adjourns later this year. House Majority Leader John Boehner (R-OH) also reportedly favors action later this year on HSA reform legislation. The Cantor measure is considered the leading HSA reform proposal in the House because it includes the President's agenda of recommendations to improve HSAs, such as provisions to establish new tax incentives for those who purchase HSA-qualified high deductible health coverage in the individual insurance market.

The HSA Working Group letter stated that "over the past two years, the marketplace response to HSAs has been significant, but could be even greater" and called for action before Congress adjourns in August "to improve HSAs and accelerate the momentum toward consumer-oriented health plan choices."

In response to recent activity in the Senate regarding HSAs, on August 4, the HSA Working Group also sent a letter to Senate Finance Committee Chairman Charles Grassley (R-IA) urging him to act on the HSA Improvement and Expansion Act (S. 3585), a bill introduced by Senator Orrin Hatch (R-UT) (the "Hatch bill"). The Hatch bill includes several provisions based on policy recommendations from the HSA Working Group and is almost identical to the Ryan bill.

Hatch is the chairman of the Senate Finance Committee's Health Subcommittee and has indicated that he would like the Committee and the Senate to act on HSA legislation before the 109th Congress adjourns at the end of this year. On June 20, a group of twelve Republican Senators also sent a letter to Chairman Grassley and Senate Majority Leader Bill Frist (R-TN) urging action on HSA reform legislation this year by the Finance Committee and the full Senate.

The Hatch bill includes numerous improvements to HSAs, including provisions to increase contributions to HSAs, permit funds in HSAs to be used on a tax-free basis by early retirees for high-deductible health plan coverage, and allow early adopters of Health

Reimbursement Arrangements (HRAs) a one-time opportunity to convert the balances in these plans as employer contributions to HSAs.

House Approves Health IT Bill

On July 27, the House of Representatives voted 270-148 to approve legislation that encourages greater use of health care information technology (Health IT). The House vote was on an amended version of the Senate Health IT bill (S. 1418), which had been approved in November 2005, but only after House leaders inserted the text of the leading House Health IT bill (H.R. 4157) as a substitute for the Senate measure. The legislation now heads to a House and Senate conference, where differences between the two bills will need to be resolved, following the congressional August recess.

The House-approved bill codifies the Office of the National Coordinator for Health Information Technology in the Department of Health and Human Services and calls on its director to establish a panel to propose national standards for the storage of health data and data transmission interoperability requirements. The billing codes for health care services would increase from approximately 24,000 to over 200,000 separate codes by October 2010. Another significant provision would provide relief from federal anti-kickback laws to permit hospitals to provide physicians with health IT hardware and software. The Senate measure does not contain the expansion of the billing codes for health care services or the relaxation of the federal anti-kickback statute, so these issues will undoubtedly be among the major ones which lawmakers will need to resolve this fall during conference committee negotiations. The adequacy of current safeguards to protect the privacy of medical information was also a contentious issue for many opponents of the House bill and is another issue that is almost certain to be debated further by the conferees.

The primary sponsors of the House bill are Representatives Nancy Johnson (R-CT) and Nathan Deal (R-GA), the respective health subcommittee co-chairs of the Committee on Ways and Means and the Committee on Energy and Commerce. The two House committees share jurisdiction on the Health IT measure and will represent the House in the conference negotiations. The lead sponsors for the comparable Senate bill are Senate Health, Education, Labor and Pensions (HELP) Committee Chairman Mike Enzi (R-WY), the Committee's ranking Democratic member Ted Kennedy (D-MA), Senate Majority Leader Bill Frist (R-TN) and Senator Hillary Clinton (D-NY).

Ryan (R-WI) Introduces New HSA Bill, Includes Several Council Priorities

On June 29, Representative Paul Ryan (R-WI) introduced the HSA Improvement and Expansion Act (H.R. 5743) along with co-sponsors Eric Cantor (R-VA) and Melissa Hart (R-PA). All three are members of the House of Representatives Ways and Means Committee, which has jurisdiction over health savings account legislation. H.R. 5743 is the House companion to the Health Savings Accounts Improvement and Expansion Act (S. 3585) introduced earlier by Senator Orrin Hatch (R-UT), as discussed previously in this Issue, and, like the Hatch bill, Ryan's measure contains three major policy improvements for HSAs:

- Allowing a one-time rollover of funds from an HRA, FSA, or IRA to an HSA;

- Increasing the HSA contribution limit up to the statutory contribution limit ($2,700 for individual and $5,450 for family coverage for 2006); and

- Allowing premiums for high deductible health plans (HDHP) to be paid on a pre-tax basis using funds from an HSA, a provision which could be particularly helpful for early retirees in combination with the higher contribution limits to the accounts.

Both bills include several policy recommendations that were recommended by the American Benefits Council's (Council) health policy committee and approved by the Council's Board of Directors. For example, additional provisions of the legislation would require earlier announcement by the Treasury Department of the annual indexing of HSA and HDHP adjustments, allow employees over age 65 to continue to contribute to HSAs, permit individuals who enroll mid-year to make a full-year contribution to their HSA, and allow individuals to participate in an HSA even if their spouse has established a flexible spending arrangement (FSA) through another employer.

Senate Finance Subcommittee Holds Hearing on Small Business Pension Plans

On June 29, the Senate Finance Committee's Subcommittee on Long-Term Growth and Debt Reduction held a hearing to discuss pension coverage for employees of small businesses. The Subcommittee received testimony from a range of academic experts and service providers on this topic; the witnesses' written statements are available on the hearing Web page.

The hearing serves as a backdrop to emerging issues that look beyond the current legislation, including the need for greater financial literacy, increasing the share of workers in workplace retirement plans and raising retirement savings rates.

The witnesses generally discussed the pension coverage rate of workers employed by small businesses and innovative ways to increase coverage among these employees. Numerous witnesses urged resolution of the recently-enacted pension legislation conference and identified specific provisions in the bills that would encourage small business to provide retirement plans, such as the EGTRRA permanence provisions and automatic enrollment. Witnesses David C. John, senior research fellow at The Heritage Foundation, and J. Mark Iwry, senior advisor at the Retirement Security Project and non-resident senior fellow at The Brookings Institution, described their proposal for mandatory payroll deduction IRAs for small employers that do not sponsor qualified retirement plans.

RECENT REGULATORY ACTIVITY

Treasury Department Issues Final Regulations on Comparable Contributions to HSAs

Final U.S. Treasury Department regulations were published on July 31 clarifying requirements for employer comparable contributions to health savings accounts (HSAs). Although employers are not required to contribute to the HSAs of their employees, if an employer makes contributions to any employee's HSA, the employer must make comparable contributions to the HSAs of all "comparable contributing employees." An employer who fails to make comparable contributions to the HSAs of its employees is subject to a 35 percent excise tax.

The final regulations provide much of the flexibility sought by the Council in its November 2005 comments on the proposed regulations and testimony provided at public hearing earlier this year. For example, the final regulation allows for greater flexibility to vary contributions to correspond with levels of high deductible health plan coverage. The final regulations also clarify an exception to the comparability rule for employer contributions "made through a Section 125 cafeteria plan." Employer contributions that satisfy the exception are permitted greater flexibility in their structure; they may, for example, be made on a matching basis, which is not permitted under the comparability rule.

IRS Finalizes Supplemental Wage Withholding Regulation

On July 24, the Internal Revenue Service (IRS) issued final regulations regarding the supplemental wage withholding requirement enacted as part of the American Jobs Creation Act of 2004 (AJCA). AJCA requires that mandatory withholding at the maximum tax rate (currently 35 percent) be applied to supplemental wages in excess of $1 million. The final regulations provide clarification on what constitutes supplemental wages and address some concerns raised by the business community in comment letters and testimony. The Council filed a comment letter on April 11, 2005 and testified in the related hearing on June 9, 2005. Council member Miller & Chevalier has prepared an excellent summary of the final regulations.

Among the significant changes in the final regulations are:

- Payments of non-qualified deferred compensation (whether made by the employer or from a rabbi trust) will be supplemental wages regardless of whether the payments are made in addition to regular wage payments during that calendar year or during the entire career with the employer;

- Income from disqualifying dispositions of shares of stock acquired pursuant to the exercise of statutory stock options is not included in supplemental wages; and

- Final regulations permit the employer to treat the entire amount of the payment that results in the employee receiving total supplemental wages of more than $1 million as subject to mandatory flat rate withholding (which can be applied on an employee-by-employee basis).

The IRS requested additional comments on ways to mitigate the burden of distinguishing between regular wages and supplementary wages, including views on whether it should permit employers to withhold at the mandatory rate on any amount of total wages (both regular and supplemental) that exceed $1 million.

The final regulations are effective January 1, 2007, but the statutory withholding requirement applied effective January 1, 2005. The IRS failed to provide employers with specific relief from a failure to withhold or properly report withholding if the employer makes good faith efforts to comply with the new requirement.

SEC Approves New Executive Compensation Disclosures

On July 26, the Securities and Exchange Committee (SEC) voted unanimously to require companies to provide more details on executive compensation in proxy statements, annual reports and registration statements. The new disclosure rules, which will apply to the principal executive officer, principal financial officer, and the three other highest paid executive officers and directors (all "named executive officers"), will include disclosure of the actuarial present value of each named executive officer's accrued benefit under any pension plan, as well as any contributions (employer and employee) to, withdrawals from, earnings on, and year-end balances for nonqualified deferred compensation plans.

As reported in earlier Issues, the proposed rule that would have required disclosure for up to three employees who were not executive officers if their compensation exceeded any of the named executive officers was dropped but will be revised and re-proposed for public comment. The new proposal will only apply to large accelerated filers and would exclude employees having no responsibility for significant policy decisions within the company, a significant subsidiary, or a principal business unit, division or function.

EBSA Proposes Asset Allocation and Revenue Sharing Disclosure

The U.S. Department of Labor's Employee Benefits Security Administration (EBSA) has proposed dramatic changes to the Form 5500 reporting requirements for qualified retirement plans. This Benefits Insider issue provides additional information on the dramatic changes to the reporting rules for both defined benefit and defined contribution plans.

For defined benefit plans, the new rules would revise Schedule B of the Form 5500 to require defined benefit plans with 1,000 or more participants to provide the percentage of plan assets held in each of four categories: (1) stocks, (2) debt instruments (bonds), (3) real estate, and (4) other. The debt instrument data would be required to be further divided into three categories: (1) governmental debt, (2) investment-grade corporate debt, and (3) high-yield corporate debt. Finally, plans would be required to provide a measure of the duration of the aggregate debt instruments using the "Macaulay duration" involving a weighted average of the number of years until each interest payment and the principal are received. The weights are the amounts of the payments discounted by the yield-to-maturity of the bond. Corporate debt that has not been rated would be included in the high-yield corporate debt category.

For defined contribution plans, the new rules would revise Schedule C of the Form 5500 to require identification of each person who received, directly or indirectly, $5,000 or more in total compensation in connection with services rendered to the plan (thereby eliminating the 40 highest paid service providers limit). The filing must also indicate whether each service provider received compensation from a party other than the plan or plan sponsor attributable to the person's relationship with or services provided to the plan. If a fiduciary or any of an enumerated list of service providers received, directly or indirectly, $5,000 or more in total compensation and more than $1,000 in compensation from a person other than the plan or plan sponsor, the filing must include information identifying the payor of the compensation, the relationship or services provided to the plan by the payor, the amount paid, and the nature of the compensation. Enumerated service providers include contract administrator, securities brokerage (stock, bonds, commodities), insurance brokerage or agent, custodian, consultant, investment advisory (plan or participants), investment or money management, recordkeeping, trustee, appraisal, or investment evaluation. Compensation includes "float" or similar earnings on plan assets or plan deposits retained by a service provider as part of its compensation package, as well as brokerage commissions and fees.

When a plan acquires a unified package or bundle of services from a provider, direct compensation would only include the aggregate amount paid by the plan and it would not be necessary to break out or report amounts on a service-by-service basis. However, payments made by the provider of the bundled services to other providers would be reported if either (1) the plan is also paying the provider directly for services in addition to those included in the package or bundle, or (2) the recipient is a plan fiduciary or an "enumerated" service provider with compensation as described above (at least $5,000 total, $1,000 indirect).

EBSA attempted to alleviate the potential burden of allocating revenue sharing income and third-party payments to individual plans by providing that such "indirect" compensation can be reported as an actual amount or an estimate of compensation received during the reporting period. If an estimate is used, however, the formula used for calculating the estimate must be disclosed.

Additional revisions would require identification of defined contribution plans with automatic enrollment features and default investment provisions.

Update on Status of 403(b) Regulations

The Council has learned that publication of the final Section 403(b) regulations will likely be delayed at least until early fall, and therefore part (and potentially all) of the regulation will have a delayed effective date of January 1, 2008. The U.S. Treasury Department's (Treasury) original goal for publication was June 30, 2006. Treasury has not yet made the decision of which portions will be subject to the delay.

The proposed 403(b) regulations, issued November 15, 2004, with a proposed effective date of January 1, 2007, would update the guidance governing tax-deferred retirement savings for employees of public schools, tax-exempt organizations and churches.

Perhaps most noteworthy, the proposed regulations would require 403(b) plan sponsors to provide a written plan document requirement that may have adverse consequences for employers trying to avoid the application of Title I of ERISA (among other things, Title I covers disclosure requirements and fiduciary responsibilities). The Council prepared a brief summary of the proposed regulations.

Responding to a rumor, a Treasury source confirmed that Treasury and the Department of Labor have been discussing the application of Title I of ERISA to Section 403(b) retirement savings programs, but the Treasury source indicated this inter-agency discussion is not the sole reason for the delay (although it is one of the more complex issues). The Treasury source indicated Treasury does not intend to bring more 403(b) plans under Title I (but the Treasury source indicated some plans are now subject to Title I even though the plan sponsors think they are not). The Treasury source also indicated a number of issues need to be worked out and because numerous officials are working on the regulation, it is difficult to predict when it will be finalized.

Treasury Issues Guidance on Use of Debit, Credit and Stored Value Cards

On July 11, the Treasury issued Notice 2006-69, guidance that clarifies requirements and substantiation methods for the use of debit cards, credit cards, and stored value cards to reimburse participants in self-insured medical reimbursement arrangements (such as FSAs and HRAs) as well as dependent care assistance programs (DCAPs) (including dependent care FSAs). The Treasury Department had previously addressed the use of cards to reimburse participants in health FSAs and HRAs in Rev. Rul. 2003-43. Using examples, Notice 2006-69 clarifies additional methods an employer may adopt for substantiating medical claims. These include:

- Expansion of the current co-payment match substantiation method to include certain matches of multiple co-payments as automatic substantiations; and

- A method whereby when an employee uses the card, the merchant's system collects information about the items purchased using the inventory control information (e.g., SKUs) and the system approves the use of the card only for those items identified as qualified medical expenses.

Guidance as to certain substantiation methods and requirements that apply to all medical reimbursement plans whether or not a card is used is also provided, including direct third-party substantiation and clarification that self-certification by an employee-participant does not constitute required substantiation. The notice also clarifies that an employer may use a payment card program for its DCAP, but dependent care expenses may not be reimbursed before the expenses are incurred.

CMS Issues Notice of "HSA-Like" Medicare Demonstration Project

On July 13, the Centers for Medicare and Medicaid Services (CMS) issued a notice soliciting proposals for a Medical Savings Account (MSA) demonstration intended to make "HSA-like" plans available to Medicare beneficiaries in 2007. CMS had previously announced the demonstration in a press release stating its intent to provide "some needed flexibility to make the increasingly popular consumer-directed plans available to Medicare beneficiaries" and to provide support for beneficiaries to make informed health care spending decisions.

In an MSA, Medicare pays for the high-deductible health insurance plan for enrolled beneficiaries and also funds an account established for the beneficiary to pay qualified medical expenses. Although current law authorizes Medicare Advantage plans to offer MSAs to Medicare beneficiaries, the CMS notice explains that the required benefit structure is not perceived by insurance organizations as easily marketable. According to the CMS press release, the demonstration solicitation provides the flexibility to offer HSA-type products for individual Medicare beneficiaries and products to employers who are now offering HSA plans to their pre-Medicare employees and retirees. Although Medicare's total payment to the plans will follow current rules, CMS hopes that the improvements and alternative benefit design available under the demonstration will make MSAs more attractive to Medicare beneficiaries and, as a result, to the organizations who may offer them.

Department of Labor Seeks Volunteers for Database Project

The U.S. Department of Labor (DOL) is actively pursuing volunteers to assist with its Occupational Information Network (O*NET), an employment resource for employers, workers, educators and others. The Council has been asked by the DOL to let interested parties know about this effort.

O*Net and related links provide:

- Employers and individuals with updated occupational information, wage information, in-demand occupations and updated regulation; and
- Teachers and students with access to new skill sets, career path information, wage information for each occupation, PowerPoint presentations and educational assistance.

O*NET is updating its data on the current workforce and is seeking the input of professionals who are performing in a number of selected careers. Specifically, the program is seeking individuals with expertise as a "Compensation & Benefits Manager" or a "Compensation, Benefits, & Job Analysis Specialist." Volunteers will be asked to complete a series of questionnaires and return them by mail to O*NET representatives.

Tax Change to Affect Income Taxes for Individuals Working Abroad

The Tax Increase Prevention and Reconciliation Act (Public Law 109-222), the tax relief bill passed by Congress and signed by President Bush in May 2006, included a significant change in the housing exemption for U.S. citizens living and working abroad. Under prior law, Section 911 of the Internal Revenue Code excluded from U.S. income tax the amount of any housing allowance (above $12,447) to the extent that the combined wage exclusion ($82,400 annually, under the new law) and housing limit did not exceed the individual's foreign wages. Under the new law, the housing exemption is changed from a floor to a ceiling with the deduction limited to $11,536 in 2006. Many companies offset the increased tax expenses incurred by employees working outside the United States. The legislation is retroactive to January 2006. Due to the breadth of reach of this change and the spike in increased tax costs associated with the change, this issue should not be ignored.

On June 13, Senator Jim DeMint (R-SC) introduced the Working American Competitiveness Act (S. 3496) (the "DeMint bill"), which is intended to address this issue by eliminating the limitation on foreign earned income exclusion, including the housing exemption. The DeMint bill is unlikely to progress very far in the current Congress, though DeMint is hoping to build support for S. 3496 during the remainder of the congressional session.

Regulatory Update: American Benefits Council, Others Comment to IRS on 409A Regulations

The Council, HR Policy Association, and the American Council of Life Insurers have jointly submitted a comment letter to the IRS regarding regulations for Internal Revenue Code section 409A, which govern the taxation of non-qualified deferred compensation arrangements. The letter urges the agency not to finalize the proposed regulations, allowing additional time for employers to comment on the new rules and enter into compliance before the effective date.

The Council and the HR Policy Association submitted formal comments to the IRS and the Treasury in January 2006 and testified before the agency in a January 25 hearing.

In a related matter, on July 5, IRS issued Notice 2006-64, regarding accelerated payments of nonqualified deferred compensation made to satisfy federal conflict-of-interest requirements. Section 409A (a) (3) of the Internal Revenue Code provides that a plan may not permit acceleration of the time or schedule of payment for non-qualified deferred compensation except as provided in regulations by the Treasury Secretary. Notice 2006-64 establishes some of the guidelines under which acceleration is permitted.

PBGC Releases 2005 Annual Report

The Pension Benefit Guaranty Corporation (PBGC) has released its 2005 Annual Report, with updated figures on the agency's assets and liabilities and the number of participants in PBGC-insured plans. The agency's $22.8 million deficit – a decrease from the $23.3 million deficit reported in 2004 – was announced in November 2005, but the annual report does contain limited new data. The number of participants in trusteed plans has risen to over 1.2 million, while the number of insured participants has decreased from 44.4 million to 44.1 million.

The Council released a paper in fall 2005 titled Promises to Keep: The True Nature of the Risks to the Defined Benefit Pension System, in which an independent research firm examined the true dimensions of the PBGC's deficit.

American Benefits Council Members Meet with GAO on 401(k) Fees

On June 28, plan sponsor and service provider members of the Council and Council staff met with representatives of the U.S. Government Accountability Office (GAO) to discuss typical fee structures for 401(k) plans. The GAO is working on a report on 401(k) fees at the request of Representative George Miller (D-CA), ranking member of the House of Representatives Committee on Education and the Workforce. Miller's request for a GAO study on 401(k) plans was more comprehensive than only a fee study but the GAO has elected to break the study into smaller portions and start with an examination of fees.

Council staff had previously met with GAO representatives to discuss their project and the possibility of arranging the June 28 meeting so that GAO could have employer input. The Council is working with the GAO on this issue to try to ensure that the GAO takes a balanced approach.

At the June 28 meeting, Council members discussed a variety of fee practices and indicated fees can vary significantly depending on the types and levels of services (and investments) provided.

RECENT JUDICIAL ACTIVITY

Federal Court Invalidates Maryland "Fair-Share" Act

In a July 19 decision, the U.S. District Court of Maryland held that a Maryland law requiring employers with 10,000 or more employees to spend at least 8 percent of total payroll in the state on health care costs was preempted by ERISA. Under Maryland's "Fair Share Act," which was to take effect January 1, 2007, an employer who did not satisfy the 8 percent mandate would be required to pay the difference to the state. The Fair Share Act also imposed annual reporting requirements on employers regarding numbers of employees, as well as the amount and percentage of payroll spent on health insurance costs. Only one employer, Wal-Mart, was the direct target of the Fair Share Act's spending requirement; but it clearly had potential implications as a precedent for legislation that could be considered in other states and localities. The Retail Industry Leaders Association challenged the Fair Share Act arguing that it was preempted by ERISA and violated the Equal Protection Clause of the U.S. Constitution.

The court rejected the Constitutional challenge, but held that the Fair Share Act contravened the main objective of ERISA's preemption clause, permitting uniform administration of employee benefit plans by creating spending requirements that are not applicable in most other jurisdictions. (The decision specifically mentioned similar legislation in New York City and Suffolk County, NY.) The court further concluded that unless such legislation is deemed to be preempted, employers potentially will face not only 50 different state requirements, but also a "virtually limitless number of requirements that local subdivisions in each state may enact."

In a statement to the media upon the initial passage of this legislation, Council president James Klein said, "these legislative proposals constitute ill-advised public policy and ignore the real problems with today's health care system: high costs and uneven quality that contribute to the rising number of uninsured Americans."