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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

RECENT LEGISLATIVE ACTIVITY

Tax Technical Corrections Bills Introduced

Legislation containing technical corrections to the tax code was introduced in both the House of Representatives and the Senate on September 29. H.R. 6264 and S. 4026 do not contain any technical corrections to the Pension Protection Act of 2006, though they do contain two corrections relating to Roth 401(k) contributions:

- Clarification that FICA applies to elective deferrals that are designated as Roth 401(k) contributions, and
- Clarification of the interaction between special catch-up rules for certain tax-exempt organizations and the applicable $5,000 cumulative limit.

Lawmakers Introduce Automatic IRA Bill

On September 27, lawmakers introduced legislation that would require employers with ten or more employees that do not sponsor a qualified retirement plan to provide automatic IRA options. Under the Automatic IRA Act, no employer contributions are required and there is a tax credit of $25 per participant up to $250 for the first two years.

The Automatic IRA Act is sponsored in the Senate (S. 3952) by Senators Jeff Bingaman (D-NM), John Kerry (D-MA) and Gordon Smith (R-OR) and in the House of Representatives (H.R. 6210) by Representative Phil English (R-PA). S.3952 will be referred to the Senate Finance Committee and H.R. 6210 will be referred to both the House Ways and Means Committee and the House Education and the Workforce Committee.

Action on the legislation is unlikely before the end of the congressional session but could be reintroduced for debate in 2007.

Women's Pension Bill Introduced

On September 27, Senators Gordon Smith (R-OR) and Kent Conrad (D-ND) introduced the Women's Retirement Security Act (S. 3951), intended to address "the unique challenges that women face in planning for retirement." The bill would:

- Require employers to allow part-time employees that meet age and service requirements over three consecutive 12-month periods to make elective deferrals to their 401(k) plans;
- Require employers that currently do not sponsor a retirement plan to allow employees to contribute a portion of their pay to an IRA;
- Permit the rollover of up to $500 in unused benefits under flexible spending arrangements to a qualified retirement plan or to an eligible deferred compensation plan as defined in Internal Revenue Code ("Code") Section 457(b);

- Establish that taxation under constructive receipt rules does not apply to qualified retirement planning services under Code Section 132(m) simply because the participant can choose between such services and additional compensation; and

- Provide tax incentives and simplification of plan requirements intended to encourage small employers to maintain retirement plans.

An official summary of the bill is available.

H.R. 3951 is expected to be reintroduced next year rather than move through the legislative process this year. It does, however, provide insight into the growing congressional interest in retirement plan coverage and longevity issues.

House Ways and Means Committee Acts on HSA Legislation

The House of Representatives Ways and Means Committee marked-up legislation to improve health savings accounts (HSAs). The Committee reviewed the Health Opportunity and Patient Empowerment Act (H.R. 6134), introduced by Representatives Eric Cantor (R-VA) and Paul Ryan (R-WI), two leading proponents of HSA reform measures and members of the Ways and Means Committee. A short official summary of the bill is available.

The bill includes several provisions intended to improve HSAs. The bill would, for example, permit a one-time rollover of funds to an HSA from either a health flexible spending arrangement (FSA) or health reimbursement arrangement (HRA) prior to January 1, 2012, and increase the contribution limits to HSAs by repealing the present law provision that generally limit contributions to the amount of the deductible for the high deductible health coverage offered in combination with an HSA. In its place, amounts contributed to these accounts could not exceed the annual indexed statutory contribution limits for HSAs, which is currently $2,700 for single coverage and $5,450 for family coverage plans. Additional provisions would direct the Secretary of the Department of Health and Human Services (HHS) to publish by June 1 each year the indexed adjustments to HSA contributions, minimum deductible amounts and other figures to help facilitate planning by employers and employees. The bill would also allow individuals who enroll in an HSA in mid-year to contribute up to the full annual limit, repealing the present law restriction pro-rating contributions that may be made by mid-year enrollees to these plans. Other provisions would permit employers to make higher contributions to the HSAs of non-highly compensated employees and allow individuals to make a one-time rollover of funds in an IRA to an HSA, subject to the annual HSA contribution limit.

The Committee's action on H.R. 6134 does not include the full agenda of HSA changes that organizations participating in the HSA Working Group are seeking for HSAs, nor does it include many of the tax incentives proposed earlier this year by the Administration intended to increase HSA enrollment. Committee Chairman Bill Thomas (R-CA) reportedly favors acting on a limited set of HSA improvements at this time that can fit within a five-year revenue scoring target of approximately $1 billion in an effort to

minimize the budget impact if the legislation is enacted later this year during a lame-duck session of Congress.

Gregg Introduces Medicare Quality Bill

On September 14, Senator Judd Gregg (R-NH) introduced the Medicare Quality Enhancement Act, a bill authorizing the release of Medicare data to qualified organizations known as Medicare Quality Reporting Organizations (MQROs). These MQROs would then develop reports on the cost and quality of health care while following the necessary safeguards to protect patient privacy. Any reports or results derived from this data would need to be released to the public within one year.

Privacy of Medicare information would be ensured by requiring that all MQROs protect individual beneficiary privacy under the Health Insurance Portability and Accountability Act (HIPAA) and the Privacy Act. The bill also requires a privacy review by the HHS of any analytical report prepared by an MQRO prior to its release.

This legislation coincides with an ongoing campaign by the Bush Administration to promote the quality and transparency of public and private health care providers. As previously reported in the Benefits Insider, President Bush recently issued an executive order directing federal agencies that administer or sponsor a federal health care program to take specific steps intended to make price and quality information available to federal beneficiaries and employees. HHS has also launched a dedicated Web site for health care transparency that will be used for posting information about the Administration's plans for implementing the executive order.

Amendment Regarding Contractor Retirement Plans Added to DOD Appropriations Bill

On September 7, The U.S. Senate passed a Department of Defense (DOD) appropriations bill (H.R. 5631) with an amendment that requires the department to exclude retirement costs from the cost comparison in a competitive bid.

The Kennedy-Hatch Retirement Equity Amendment (No. 4857), offered by Senators Edward Kennedy (D-MA) and Orrin Hatch (R-UT), essentially mandates that a DOD contractor cannot win a bid for government work if the only cost savings are generated by providing less generous employee retirement benefit plans than the federal employees' retirement plan. A winning contractor may still provide less generous retirement benefits, as long as that is not the sole source of cost savings. The Senate bill with these key amendments will now need to be reconciled in a congressional conference with the House of Representatives.

This amendment is reminiscent of, but unrelated to, the proposed but temporarily suspended Department of Energy procurement policy that would have denied its private sector contractors reimbursement for defined benefit pension plans and certain health benefits for newly hired employees.

Senate Finance Committee Hears Testimony on Executive Compensation

On September 6, the Senate Finance Committee held a hearing titled Executive Compensation: Backdating to the Future, covering oversight of current issues regarding executive compensation, particularly backdating of stock options, including accounting, corporate governance and other non-tax issues raised by recent backdating cases. The hearing included substantial discussion of the current law $1 million deduction limit for compensation under Code Section 162(m), particularly whether the deduction limit had been successful in limiting "excessive" executive compensation and whether the "pay-for-performance" exception to the deduction limit was appropriate. The discussion also touched on reported abuses with respect to executive fringe benefits and severance pay. The deferred compensation rules being implemented under Code Section 409A were referenced but were not a topic of discussion.

Testifying at the hearing on behalf of the U.S. government were Deputy Attorney General Paul J. McNulty, Internal Revenue Service (IRS) Commissioner Mark Everson and Securities and Exchange Commission Division of Enforcement Director Linda Thomsen. The committee also heard testimony from a number of academics and finance experts. Witness testimony is available on the committee's hearing page.

Virtually all of the witnesses agreed that Code Section 162(m) was ineffective and several suggested that the provision inappropriately skewed compensation programs away from cash payments to stock options, severance and other benefits that either meet the "performance pay" exception or are not subject to Code Section 162(m) because they are paid after retirement. The tone of the hearing suggested a bipartisan interest among Committee members to propose changes to Code Section 162(m) and perhaps consider changes to the tax treatment of certain fringe benefits.

Both Senator Charles Grassley (R-IA) and Senator Max Baucus (D-MT), Chairman and ranking member, respectively, of the Committee, indicated a desire to revisit Code Section 162(m). At one point, Baucus asked whether the provision should be repealed altogether (which is consistent with prior Joint Committee on Taxation staff recommendations published in connection with their examination of the Enron Corporation tax returns.) Baucus asked IRS Commissioner Everson to provide alternatives to the Committee on how to solve the Code Section 162(m) problem. Grassley stated that he had opposed the adoption of Code Section 162(m) when it was enacted in 1993 and expressed the view that "162(m) is broken." He further stated that the Committee should consider eliminating the performance-pay exception to Code Section 162(m), which would have the effect of broadening Code Section 162(m) by keeping the $1 million deduction limit in place but significantly narrowing the exceptions.

Grassley also raised concerns about "discriminatory" and "nontaxable" fringe benefits that create a disparity between the tax treatments of compensation paid to executives in comparison to other workers. The academic panelists were quick to agree and several cited the income tax treatment of an executive's personal use of corporate aircraft as a continuing "abuse." "Executive health plans" and tax gross-up payments were also mentioned as examples of benefits that should be further addressed. Grassley concluded

by indicating that the Committee would be launching its own inquiry into companies that may have backdated stock options and the advisors and lawyers who may have been the "enablers" of such actions.

RECENT REGULATORY ACTIVITY

IRS Releases Guidance on Indian Tribal Plan Provisions

On October 2, the IRS released Notice 2006-89 that provides guidance on the new Indian tribal plan provisions of the Pension Protection Act of 2006 (PPA). Section 906(a)(1) of the PPA modifies the definition of "governmental plan" under the Internal Revenue Code to provide that a tribal plan is governmental only if (i) the plan is maintained by an Indian tribal government, a subdivision thereof or any agency or instrumentality of either entity, and (ii) all of the plan participants are employees substantially all of whose services are in the performance of essential governmental functions and not in performance of commercial activities. The new tribal plan provisions are effective for plan years beginning after August 17, 2006. In recognition of the early effective date of the new provisions, Notice 2006-89 provides limited transition relief for tribal plans, including plans that currently cover both employees who perform essential governmental functions and employees who perform commercial activities. Notice 2006-89 also indicates that the IRS anticipates issuing guidance on "governmental plans," including the new tribal plan provisions of the PPA, and requests comments by January 22, 2007.

SEC Finalizes Amendments to Redemption Fee Rule

On September 28, the SEC approved proposed amendments to the final redemption fee rule originally adopted in March 2005. The final rule mandates that most funds execute shareholder information agreements with financial intermediaries, such as plan administrators, that hold shares on behalf of other investors.

The amendments relate to the information-sharing agreements that most open-end investment companies (funds) must enter into with financial intermediaries, such as plan administrators. Under these agreements, the intermediaries must agree to provide, at the fund's request, shareholder identity and transaction information and carry out fund instructions to restrict or prohibit further purchases or exchanges by a shareholder that has engaged in trading that violates the fund's market timing policies.

The final rule extends some of the deadlines on the redemption fee rule such as the compliance date for entering into shareholder information agreements, which was extended by six months, until April 16, 2007, and the date by which funds must be able to obtain information from intermediaries under those agreements, which was extended by a year, until October 16, 2007.

FASB Issues Accounting Standard Number 158 Regulating Employee Benefit Plan Disclosure

The Financial Accounting Standards Board (FASB) issued on September 29 Standard number 158 that requires employers to recognize on their balance sheets the funded status of their defined benefit pension plans and other post-employment benefits such as a retiree health plan. Current accounting standards allow employers to report the funded

status of the pension plan in the notes to the company's financial statements. The Standard amends previous FASB Standards 87, 88, 106, and 132 and applies to public and private plan sponsors and to nongovernmental not-for-profit organizations.

Standard 158 requires the projected benefit obligation for pension plans and the accumulated post-retirement benefit obligation for retiree health benefits as of the fiscal year-end to be reported. For public companies the new reporting requirement would be effective for fiscal years beginning after December 15, 2006, and for non-public companies it is effective for fiscal years after December 15, 2007.

Publication of this Standard completed the first phase in a process to reconsider existing accounting rules; FASB has indicated that the second phase will be more comprehensive and will be done in collaboration with the International Accounting Standards Board. This suggests that FASB will likely attempt to introduce more of a "mark-to-market" approach to pension accounting, potentially causing more volatility in the financial reporting of companies that sponsor defined benefit plans.

DOL Releases Proposed Default Investment Regulations

On September 26, the Department of Labor (DOL) released much-anticipated proposed regulations that identify types of investments – including life cycle or targeted retirement date funds, balanced funds and managed accounts – that may qualify as default investment alternatives under a new statutory section added under the PPA. The new section provides relief to fiduciaries who designate appropriate default investments under the terms of the regulation that are used for plan investments when the participant or beneficiary fails to make an investment election. Although the default investment guidance is often discussed in the context of automatic enrollment (where participants automatically participate in the plan unless they opt out), the guidance was not limited to automatic enrollment situations. In addition, the relief is not contingent on the plan being a plan under Section 404(c) of the Employee Retirement Income Security Act (ERISA) or otherwise meeting the requirements of Regulation Section 2550.404c-1 (which sets out the requirements for fiduciary relief for investments selected by the participant).

The guidance provides general descriptions of three different types of investments and then mentions the above types of investments by name as examples. The proposed regulations list additional requirements for the "qualified default investment alternative" that includes management by an investment manager as defined in ERISA Section 3(38), or a registered investment company. The fiduciary relief also depends on meeting the following six conditions:

1. The investment must be a "qualified default investment alternative."

2. The participant or beneficiary must have had an opportunity to direct the investments but did not do so.

3. Notice (required contents of which are spelled out in the regulation) to participants and beneficiaries must be provided a reasonable time period of at least 30 days prior to the first investment and before each subsequent plan year.

4. Any material provided by the default investment to the plan such as proxy materials and prospectus must be provided to the participant or beneficiary.

5. Participants and beneficiaries must be able to transfer out of the default investment without financial penalty with the same frequency as other investments in the plan (and at least quarterly) with no restrictions that do not apply to other investment alternatives.

6. Plan must have a broad range of investments as would be required under ERISA Section 404(c).

The guidance makes clear that although the fiduciary relief in the regulation is based on the use of certain investment alternatives, the use of other investment alternatives would not necessarily be imprudent and the use of money market, stable value and similar investment vehicles may be prudent for some participants and beneficiaries. The guidance also does not provide relief from general fiduciary rules applicable to the selection and monitoring of default investment alternatives.

A DOL fact sheet is also available. The proposed rule is intended to be effective 60 days after publication of the final rule and comments on the proposed rule are due within 45 days of publication of the proposal on November 13, 2006.

SEC Releases Staff Guidance on Stock Option Grants

The Office of the Chief Accountant at the SEC has released staff guidance in letter form regarding grants of stock options to employees. The guidance is a response to recent announcements by various companies that errors in accounting for stock option grants has forced them to reissue their financial statements. These errors primarily involve the "backdating" options so as to lower the exercise price or reduce accounting costs.

Specifically, the guidance refers to Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (Opinion 25) that sets forth guidelines for proper dating and valuation of stock options. It generally states that while backdating errors do have an accounting consequence under Opinion 25, short administrative and procedural delays resulting in valuing errors would not result in an accounting consequence if the company operated its awards program as if the terms of the awards were final prior to completing administrative actions. If the company operated its program as if the terms were not final prior to completion of administrative actions by, for example, changing some award dates to receive more favorable treatment, the measurement date would be delayed until all actions were final for all stock option grants. The details of this SEC analysis are explained more fully in the letter.

SAVER Summit and White House Conference on Aging Reports Published

On September 8, the DOL published the report Saving for Your Golden Years: Trends, Challenges and Opportunities, which highlights the work done at the final Savings Are Vital to Everyone's Retirement (SAVER) Summit held in Washington, D.C. in March 2006.

The summit report identifies barriers to retirement savings confronting low-income workers, small business employees, new entrants to the workforce and individuals nearing retirement. The report reflects action plans and new programs and ideas recommended by the delegates for the target populations to raise awareness about retirement planning and help them adequately save for retirement.

The White House Conference on Aging (WHCoA) report has also been finalized and copies have been sent to the President, Congress and conference delegates. The report is available in electronic format on the WHCoA website. The conference was held in Washington, D.C. in December 2005.

WHCoA delegates ranked potential resolutions through a voting process. The appointed delegates were predominantly providers of services to the elderly, mostly from nonprofit organizations or state and municipal agencies. Relatively few delegates were employers or benefit professionals and therefore it was more difficult for employer-backed resolutions to garner significant support. Included recommendations were increased retirement savings – provide financial and other economic incentives and policy changes to encourage and facilitate increased retirement savings and resolutions addressing older workers, long-term care and Social Security.

PBGC Issues Pension Protection Act Updates

In a related matter, on August 30, the Pension Benefit Guaranty Corporation (PBGC) issued Technical Update 06-4, Use of Corporate Bond Rate for Certain PBGC Purposes that explains how the provisions of the PPA relating to the PBGC's required interest rate for determining variable rate premiums applies to certain PBGC requirements, particularly reporting and disclosure requirements.

The PBGC also released Technical Update 06-3, 2006: Participant Notice that provides a model notice for plan administrators required to provide participant notices of the plan's funding status. Technical Update 06-3 includes a description of the rules governing the requirements to issue the notice and how they are affected by changes in the Pension Protection Act. It also includes a worksheet to help plan administrators figure out if they need to issue the 2006 notice.

HHS Launches Transparency Web Site

As part of the Bush Administration's ongoing campaign for health care transparency, HHS has launched a dedicated Web site for health care transparency. President Bush recently issued an executive order directing federal agencies that administer or sponsor a federal health care program to take specific steps intended to make price and quality information available to federal beneficiaries and employees. The order also requires the agencies and their health care contractors to promote the use of interoperable health information technology (Health IT) and encourage approaches, such as pay-for-performance models, that facilitate the provision of high quality and efficient health care. The new Web site will be used for posting information about the Administration's plans

for implementing the executive order, as well as more information about the steering committee and its activities.

Final Regulations Issued on ESOP Stock Dividend Deductions

On August 30, the IRS released final regulations on employee stock ownership plan (ESOP) Stock Dividend Deductions under Code Sections 162(k) and 404(k). The regulations address whether a payment in redemption of employer securities held by an ESOP is deductible and conclude that such payments are not deductible. In effect, the regulations repudiate the U.S. 9th Circuit Court's decision in *Boise Cascade Corporation v. United States*. The regulations do not identify which corporation is entitled to the ESOP dividend deduction when the corporation paying the dividend is different than the corporation sponsoring the ESOP. Rather, the preamble to the regulations defers this issue to future regulations.

EEOC Proposes Rule Amending Age Discrimination Regulations

On August 11, the Equal Employment Opportunity Commission (EEOC) issued a notice of proposed rulemaking revising and clarifying its regulations concerning the Age Discrimination in Employment Act (ADEA). ADEA prohibits employers from discriminating against individuals age 40 or older because of the individual's age. The EEOC's current regulations prohibit any age-based preference between persons age 40 or over, regardless of whether the treatment favors older or younger persons. The proposed rule amends current regulations to reflect a 2004 U.S. Supreme Court decision, *General Dynamics Land Systems, Inc. v. Cline*, which interpreted the ADEA as permitting employers to make age-based employment decisions that favor relatively older employees. In *Cline*, the Supreme Court concluded that the ADEA reflects congressional intent to protect the relatively older employee from discrimination favoring the relatively younger employee. The deadline for public comments on the proposed regulation is October 10, 2006.

A different issue, whether an employer may favor a relatively younger retiree by coordinating retiree health benefits with Medicare eligibility, has also been addressed by an EEOC rule. The implementation of an EEOC final regulation that provides a narrow exemption from the ADEA for the practice of coordinating retiree health benefits coverage with Medicare eligibility remains blocked pending the an appeal of a legal challenge in the U.S. Court of Appeals for the Third Circuit. The EEOC proposed the exemption in response to a 2000 decision by the U.S. Court of Appeals for the Third Circuit in the Erie County case, which held that ADEA applies to retirees and prohibits altering, reducing or eliminating health benefits for retirees when the participant becomes eligible for Medicare or comparable state health benefits.

IRS Announces Delay in Effective Date for Section 403(b) Regulations

On August 29, the IRS announced that the general effective date for the regulations regarding Code Section 403(b) arrangements will be extended until at least January 1, 2008. The extension was provided to give employers, employees, insurance carriers, and mutual funds involved in Code Section 403(b) arrangements a reasonable advance period

before the regulations go into effect. The announcement does not give any indication on when final regulations are likely to be issued.

The proposed 403(b) regulations, issued November 15, 2004, with an original 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 Code Section 403(b) plan sponsors to provide a written plan document that may have adverse consequences for employers trying to avoid the application of Title I of ERISA, which among other things covers disclosure requirements and fiduciary responsibilities.

President Directs Federal Agencies to Take Actions Promoting Health IT, Transparency of Health Care Cost and Quality Information

On August 22, President Bush issued an executive order directing federal agencies that administer or sponsor a federal health care program to take specific steps intended to make price and quality information available to federal beneficiaries and employees. The order also requires the agencies and their health care contractors to promote the use of interoperable health information technology (Health IT) and encourage approaches, such as pay-for-performance models, that facilitate the provision of high quality and efficient health care.

The President's action today has important implications for private sector employers and the transparency and quality initiatives in which they are engaged. By establishing requirements for federal agencies, the Executive Order provides a possible model for promoting quality and efficient delivery of health care services in both public and private sector health benefits systems. The order also builds on and accelerates the efforts already underway within the employer community to drive our health care system to achieve higher levels of performance and efficiency.

The President's order also underscores the Administration's commitment to working in collaboration with similar initiatives in the private sector. HHS Secretary Mike Leavitt outlined a strategy to harmonize the purchasing practices of the federal government, state governments and large employers in a speech to the National Governors Association (NGA) earlier this month.

Although, as noted above, these developments are potentially important for private sector purchasers of health care services, the Executive Order directly applies to the Federal Employees Health Benefit Program, the Medicare program, and health programs operated by the Department of Defense, the Department of Veterans Affairs and the Indian Health Service. States would need to take action in order to commit Medicaid programs to the goals of the Executive Order.

The agencies have until January 1, 2007, to implement the order's requirements, which include:

- Creation of programs for measuring the quality of health care services supplied by health care providers to beneficiaries or enrollees of federal health care programs;

- Making pricing information available to beneficiaries and enrollees (and possibly the public) and agency participation in a private-public collaboration to develop information regarding the overall costs of services for common episodes of care and treatment of common chronic diseases;

- Utilizing Health IT that meets recognized interoperability standards to facilitate the exchange of health information among agencies and with non-federal entities. (By using such standards, data can be communicated and exchanged among different information systems, software applications and network, thereby allowing computer systems to talk to each other); and

- Developing and identifying approaches that promote high quality and efficient health care – including pay-for-performance models and consumer-directed health care insurance products.

According to A White House Fact Sheet, the federal government intends to work collaboratively in this process, building on efforts by quality alliances that include a broad range of health care stakeholders to improve quality and cost information.

HHS Secretary Leavitt Calls on Governors, Large Employers to Join Forces in Health Care Purchasing Practices

On August 6, HHS Secretary Mike Leavitt addressed the National Governors Association (NGA) and outlined a strategy that involves harmonizing the purchasing practices of the federal government, state governments and large employers. Leavitt told the governors his aim is to have all three health purchasing sectors agree to the following three practices:

1. Adopt interoperable health information technology (HIT) standards currently being developed by the American Health Information Community (AHIC) so that health information and records can be shared much more easily within the health care system

2. Begin using common quality measures for health care providers being developed by the Hospital Quality Alliance (HQA) and the Ambulatory Care Quality Alliance (AQA), and

3. Start paying health care providers on the basis of their performance. The Secretary also announced to the NGA that President Bush will soon be signing an Executive Order making these three actions contracting requirements for federal health programs such as Medicare, the Federal Employees Health Benefits Program and TriCare.

Leavitt has already met with about 20 large employers and intends to reach out to the largest 100 employers in the country to secure their voluntary agreement to these three conditions in their own health purchasing practices. In a follow-up question-and-answer session with the governors, Leavitt said that large employers have expressed a "desperate desire for us collectively to move this forward right now" and called on the governors to encourage employers in their states to become involved in quality purchasing initiatives.

IRS Releases Corporate Bond Rates for Pension Plan Funding

The IRS released Notice 2006-75 on August 18, providing the corporate bond rates from December 2005 through July 2006, along with the corporate bond weighted averages for plan years beginning in January 2006 through August 2006. These rates are necessary for calculating defined benefit pension plan funding under the recently enacted PPA. Notice 2006-75 provides guidance for those sections of the bill effective before January 1, 2008.

Heinz /Utilization (Section 411(d)(6)) Regulation Finalized

On August 8, the Treasury and the IRS released final regulations concerning the interaction of permitted forfeiture rules under Code Section 411(a) with the anti-cutback rules under Code Section 411(d)(6) (to reflect the holding in *Central Laborers' Pension Fund v. Heinz*, 541 U.S. 739 (June 7, 2004)), and a utilization test method under which a plan amendment is permitted to eliminate an optional form of benefit that has not been utilized during a look-back period. The final rules generally adopted the proposed regulations with a few changes. Changes (or major clarifications) in the final regulations include:

- *Vesting.* Treasury continued its expansive reading of the *Central Laborers'* decision, including application to changes in vesting schedules with respect to benefits already earned (but not necessarily vested). An example provided for a merger of two plans, one of which used a graduated three- to seven-year vesting schedule and the other a five-year cliff vesting schedule. The regulations indicate that changing the vesting schedule to a five-year cliff vesting for the merged plan, even providing participants with more than three years of service with a choice to remain under the old vesting schedule, would violate the final regulation. This portion of the regulation is effective with respect to plan amendments adopted after August 9, 2006.

- *Retroactive Application*. The final regulations continue to retroactively apply the requirement that a plan cannot add or expand a suspension of benefits provision back to June 7, 2004. Plans that adopted such an amendment prior to June 7, 2004, must adopt a reforming plan amendment, comply operationally with the reforming amendment, and provide notice to affected participants of their right to elect to retroactively commence payment of benefit and complete all these actions by January 1, 2007.

- *Utilization test.* The final rules adopt the proposed utilization test, allowing elimination of under utilized options, with a slight modification to the look-back period and a reduction from 100 to 50 in the number of participants who must have been eligible to commence payment (and met other requirements) during the look-back period (participants taken into account). One of those other requirements specified that participants taken into account must not have elected a single-sum distribution with respect to at least 25 percent of their accrued benefit. The final rule allows plans to disregard the lump-sum payments (and take those participants into account) if at least 1,000 participants are taken into account.

- *Modification of redundancy.* The final rules modify the previous final rules on elimination of redundant forms of payment by allowing separate treatment if a plan provides separate elections with respect to separate portions of a participant's benefit. The redundancy rules apply separately to each set of distribution options.

RECENT JUDICIAL ACTIVITY

Plaintiffs Law Firm Files Multiple 401(k) Plan Fee Cases

During the week of September 11, a plaintiffs' law firm filed class action lawsuits against a number of large companies and plan fiduciaries claiming breach of fiduciary duties related to plan fees. The lawsuits were filed by the St. Louis law firm of Schlichter, Bogard & Denton, which had previously advertised for potential plaintiffs.

Court Refuses Appeal of Cooper-IBM Cash Balance Case

The full U.S. Seventh Circuit Court of Appeals has declined to reconsider the case of *Cooper v. IBM*, a class-action lawsuit concerning an IBM cash balance plan as it relates to the age discrimination provisions of ERISA. This decision lets stand the ruling by three of the court's judges in August 2006 that IBM's cash balance plan was not age discriminatory.

As we have previously reported, in July 2003, the U.S. District Court for the Southern District of Illinois ruled in favor of the plaintiffs, contrary to the legislative history of ERISA, U.S. Treasury Department regulations and several other federal court cases. In August 2006, the Seventh Circuit appeals court overturned that decision, accepting many of the arguments in an *amicus* (friend of the court) brief filed jointly by the American Benefits Council and the ERISA Industry Committee.

The original plaintiffs may still renew their appeal, this time with the U.S. Supreme Court. The Council will keep you informed as events occur.