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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.

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RECENT REGULATORY ACTIVITY

Senior Democrats Send Letter to DOL on Default Investments

On December 5, Senator Edward Kennedy (D-MA) and Representative George Miller (D-CA), along with Representative Rob Andrews (D-NJ) and Senator Barbara Mikulski (D-MD), sent [a letter to the U.S. Department of Labor \(DOL\)](#) expressing their concerns with the [proposed guidance on default investments for defined contribution plans](#). Kennedy is expected to assume the chairmanship of the Senate Health, Education, Labor and Pensions (HELP) Committee and Miller is expected to be the new chairman of the House of Representatives Committee on Education and the Workforce when the new Congress begins in January. Mikulski will likely chair the HELP Committee's Subcommittee on Retirement Security and Aging, while Andrews will likely chair the Education and Workforce Committee's Subcommittee on Employer-Employee relations.

In the letter, the Democrats:

- Suggest the addition of language indicating that inflation beating (or equaling) returns are generally understood as a basis for capital preservation;
- Ask the DOL to clarify that there is no need to “beat the market” through aggressive investing;
- Object to providing the required notice in a summary plan description;
- Suggest the DOL pay special attention to fees and conflicts of interest;
- Request that the DOL provide additional clarification on how fiduciaries can carry out their responsibilities instead of just appearing to endorse certain types of investment options; and
- Indicate the DOL should require the fiduciary to document the default investment selection process.

The Democrats' letter is a strong indicator of the forthcoming agenda for the committees with employee benefits jurisdiction.

Final HIPAA Non Discrimination and Wellness Program Regulations Released

On December 12, the U.S. Departments of Labor and Health and Human Services (HHS) and the Internal Revenue Service (IRS) jointly issued [final regulations governing the nondiscrimination provisions](#) of the Health Insurance Portability and Accountability Act

(HIPAA). These provisions prohibit discrimination in group health coverage based on a health factor of a participant or beneficiary. The final regulations, which also include requirements for wellness programs, become effective on February 12, 2007, and apply to plan years beginning on or after July 1, 2007.

Although the final regulations generally adopt the requirements of [the interim HIPAA rules](#) or [the proposed rules on wellness programs](#) released in January 2001, they do include some important changes and clarifications. The final regulations make clear that:

- Compliance with the HIPAA nondiscrimination rules is not determinative of compliance with other federal laws, such as the Americans with Disabilities Act (ADA) or state laws;
- Carryover of unused health reimbursement arrangement (HRA) amounts do not violate the HIPAA nondiscrimination rules; and
- Benefits may not be denied for injuries resulting from a medical condition, even if the medical condition was not diagnosed before the injury occurred.

The final regulations on wellness programs establish the maximum amount of an award under a wellness program may not exceed 20% of the cost of coverage. The wellness program final regulations also clarify some ambiguities in the proposed rules, make some changes in terminology (eliminates reference to “bona fide” in connection with wellness programs) and organization, and add a description of wellness programs that are not required to satisfy additional standards in order to comply with nondiscrimination programs.

IRS Releases: Transition Relief for Use of Debit, Credit and Stored Value Cards, and Cumulative List of Required Changes in Plan Qualification Requirements

On December 14, the IRS issued [Notice 2007-2](#), guidance that provides transition relief associated with the use of debit cards for medical expense reimbursements with non-health care related merchant category codes. Under the guidance, these retailers will be deemed to be an "other medical care provider." This would essentially expand debit card programs so the cards can be used to pay for medical expenses at retailers that are not specifically drug stores or pharmacies. These stores will have to qualify by meeting one of the following criteria: (1) the store must participate in the inventory information approval system as described in prior guidance [Notice 2006-69](#) or (2) on a store location by store location basis, 90 percent of the store's gross receipts during the prior taxable year must consist of items which qualify as expenses for medical care under tax code Section 213(d) of the Internal Revenue Code (Code).

The guidance also sets forth the substantiation rules for health plan validation of debit card purchases for drug stores and pharmacies as well as "other medical care providers." The IRS also issued regulations and guidance on a key retirement issue.

On December 14, the IRS released [Notice 2007-3, the 2006 Cumulative List of Changes in Plan Qualification Requirements](#) that provides a list of statutory and regulatory

changes that should be included in plans submitted under the determination letter program for individually designed plans and multiple employer plans eligible for Cycle B and the opinion and advisory letter programs for Master & Prototype and Volume Submitter defined benefit and pre-approved plans. Individually designed single-employer plans are eligible for Cycle B if the last digit of the plan sponsor's employer identification number is 2 or 7. The Notice is expected to be published in the IRS Bulletin dated January 8, 2007.

The IRS will start accepting these determination letter filings on February 1, 2007. The 12-month submission period for Cycle B individually designed plans and multiple employer plans will end January 31, 2008. The Notice provides sponsors with a list of issues that the IRS has identified for review in determining whether the plans have been properly updated.

PBGC Changes Mortality Assumptions for Missing Participants

On December 14, the Pension Benefit Guaranty Corporation (PBGC) published [final regulations](#) that (1) update the mortality rates used to value annuity benefits for missing participants in terminated plans (increasing the amount that must be paid to the PBGC on behalf of the missing participant), and (2) eliminate the mortality of a contingent annuitant during the deferral period for purposes of valuing deferred annuities in multiemployer plans following mass withdrawals.

Regulators Propose Additional Changes to Form 5500

On December 8, the DOL's Employee Benefits Security Administration (EBSA), the IRS and the PBGC released proposed additional [changes to the Form 5500 Annual Return/Report](#) that would be effective for 2008 plan year filings. The proposed changes, which reflect new funding requirements in the Pension Protection Act of 2006 (PPA), supplement revisions to the form proposed in July 2006.

The new proposals are generally limited to those needed to reflect the PPA annual reporting requirements and do not attempt to address comments received in connection with the July 2006 proposal. However, the new proposal moves the proposed asset allocation questions for defined benefit plans to Schedule R in response to comments received. It also creates two new schedules to replace Schedule B (Actuarial Information) filed by defined benefit plans – one for single employer plans and another for multiemployer plans – which are designed to collect the additional information required by the PPA.

The supplemental proposal also suggests using the Form 5500-SF Annual Return/Report (Short Form 5500) included in the July 2006 proposal to provide the simplified report required by the PPA for plans with fewer than 25 participants. Comments on the new proposals are due January 10, 2007.

HHS Secretary Leavitt Launches Employer Summit on Value-Driven Health Care

HHS Secretary Michael Leavitt addressed a November 17 employer summit on value-driven health care and called on employers to join in a nationwide effort to reform the health care system by supporting four "cornerstone" principles for health care purchasing:

- Using interoperable health information technology (through which data can be communicated and exchanged among different information systems, software applications and networks);
- Measuring and reporting health care quality;
- Collecting and reporting information on health care prices; and
- Implementing programs such as pay-for-performance reimbursement systems or high performance networks which encourage consumers to use high-quality, cost effective services.

In his remarks, Leavitt said that his initial focus has been on the nation's largest 200 companies. By spring 2007, when employers enter into contracts with health plans for the following year, the Secretary said his goal is for at least 60 percent of the marketplace to be incorporating the four cornerstone principles as they purchase health services. "For this to work," Leavitt said, "it has to be real. It has to become a meaningful part of the procurement process." The Secretary also said that as he has met with many employers so far, he has heard from many who have "their hair on fire" about rising health care costs and are urgently seeking solutions. He pledged that federal health programs — which spend 40 percent of the nation's health dollars — will not simply participate in the value-driven health care effort, "we will lead," he said. Leavitt is also calling on state-based health care programs to join this far-reaching collaborative health purchasing initiative.

The summit was sponsored by the Business Roundtable and several leading organizations representing employers.

All plan sponsors and service providers are encouraged to review the materials on the Secretary's initiative which are now available at [the Department's health care transparency Web site](#). The materials are also available on [the American Benefits Council's health care quality issue page](#). To participate in this unprecedented effort to drive health care quality and efficiency, supporters are asked to sign and return to HHS the short "statement of support" which pledges the organization's commitment to begin implementing measures to achieve each of the four value-driven cornerstone practices. Participation is voluntary and participants in the program are encouraged to take steps they determine appropriate in each of the four areas. A Frequently Asked Questions document, also available on the HHS's website, addresses how employers might choose to proceed as participants in the HHS initiative. The HHS has also provided a sample request for information (RFI) instrument which employers may elect to use or modify if

they find it useful to obtain information on each area addressed by the purchasing initiative.

Carol Kelly, director of the office of policy at the HHS Centers for Medicare and Medicaid services, is leading the employer outreach effort for this initiative. HHS staff have committed to working closely with the employer community as the effort moves forward.

PBGC Updates Deficit

On November 15, the PBGC reported in its [Fiscal Year 2006 Annual Management Report](#) that the agency's deficit for 2006 has fallen to \$18.1 billion. This represents a significant improvement over the \$22.8 million deficit reported in 2005 and the \$23.3 billion deficit reported in 2004. [An accompanying PBGC press release](#) attributed the improvement "mainly to the airline relief provisions in the PPA that led to a sharp reduction in the amount of 'probable' liabilities reflected on the agency's balance sheet." Interim Director Vince Snowbarger says in the release, "our current assets can cover pension payments coming due for a number of years into the future and our exposure to additional losses has declined."

IRS Issues Model Notice/Transition Guidance on Diversification Requirements

On November 30, the IRS and the Treasury issued transition guidance under the PPA employer stock diversification provision ([Notice 2006-107](#)) including a model notice that can be used to notify plan participants of their rights to diversify out of employer stock. The guidance states that the DOL has advised Treasury that plans are not required to furnish notice prior to January 1, 2007, but that the DOL encourages plans to furnish notices on the earliest possible date.

The PPA diversification provisions require that a defined contribution plan (other than certain employee stock ownership plans (ESOP)) must provide participants who have at least three years of service (as well as beneficiaries of such participants and alternate payees) with the right to divest employer securities in their accounts (attributable to employer contributions) and reinvest those amounts in diversified investments (employees can immediately diversify amounts attributable to employee contributions). The PPA also requires the plan to provide notice to participants of these rights no later than 30 days before the first date upon which the individuals are eligible to exercise these rights. Because the diversification requirements are effective with respect to plan years beginning after December 31, 2006, many plan fiduciaries were concerned that notices would be required by December 2, 2006, (30 days before January 1, 2007) for calendar year plans. The Notice makes it clear that no notice will be required before January 1, 2007.

The following is a brief summary of some of the other significant guidance provided in the Notice (see Notice for details):

- The diversification requirements do not apply to some diversified mutual funds and similar investment vehicles that are independent of the employer or any affiliate (e.g., S&P 500 Fund that includes employer stock);
- ESOP is only subject to diversification requirements if (1) it holds any contributions or earnings to which Code Section 401(k) or (m) applies, or (2) if it is a portion of a plan that holds any amounts that are not part of the ESOP;
- Three years of service occurs immediately after the end of the third vesting computation period provided for under the plan pursuant to Code Section 411(a)(5) unless the plan uses the elapsed time method of crediting services for vesting purposes or has immediate vesting. In the latter case, the three years of service is complete on the third anniversary of the participant's date of hire;
- The new diversification requirement includes a prohibition on placing restrictions on investments in employer securities that are not placed on other investments. A transition rule permits continuation of some existing restrictions or conditions through March 30, 2007;
- Transition rule permits, through 2007, restrictions on employer stock investments that do not apply to (1) a stable value fund, or (2) an investment that is not a generally available investment (e.g., limited to a fixed class of participants); and
- The Notice provides examples of restrictions or conditions that are not prohibited provided the limitations apply without regard to a prior exercise of rights to divest employer securities (not more than 10 percent of account balance invested in employer securities; an employer stock fund that is closed to new investments), but emphasized that the plan cannot restrict a participant from reinvesting in the employer securities for some period of time after divesting the employer securities.

IRS Releases Guidance on Reporting and Withholding Amounts from 409A Executive Compensation Plans

On November 30, the IRS and the Treasury released [Notice 2006-100](#) providing reporting and withholding requirements for calendar years 2005 and 2006 with respect to amounts includible in gross income under Code Section 409A. In addition, the notice provides relief from reporting deferrals not includable in income during such years. Under the provided relief, employers need not report annual deferrals of compensation that are not includable in income under Code Section 409A on Forms W-2 or 1099-MISC for calendar years 2005 and 2006. However, amounts includible in income under Code Section 409A for 2005 and 2006 must be reported on the applicable form. The notice supersedes IRS Notice 2005-94.

IRS Revises Instructions for Qualified Charitable Distributions from IRAs

On November 21, the IRS announced [changes to the instructions for Forms 1099-R and 5498](#) relating to qualified charitable distributions made from traditional IRAs and Roth

IRAs. These revisions reflect language included in Section 1201 of the PPA allowing tax-free distributions from these accounts to qualified charities if certain requirements are met.

The new form instructions clarify that the trustee of the traditional IRA or Roth IRA is not responsible for identifying if a charity qualifies as "charitable" under Code section 408(d)(8). This responsibility instead lies with the participant requesting the distribution. In preparation of 2006 Forms 1099-R and 5498 that reflect such a disbursement, IRA trustees [are directed to follow the general rules for reporting distributions to recipients age 70 1/2 or older](#) by entering code 7 in box 7 of the form.

IRS Releases 2007 Indexed Amounts for HDHPs, HSAs, and IRAs

On November 9, the Treasury and IRS released Revenue Procedure 2006-53, which lists the new indexed amounts for high-deductible health plans (HDHPs) and health savings accounts (HSAs) as adjusted for inflation. The following table lists the old 2006 amounts and the new 2007 amounts:

	2006		2007	
	Self-only	Family	Self-only	Family
Annual Contribution Limit (Monthly limit is 1/12 of the lesser of (1) the annual deductible or (2) the following amount)	\$2,700	\$5,450	\$2,850	\$5,650
Deductibles	\$1,050	\$2,100	\$1,100	\$2,200
Out-of-Pocket Limit (includes deductibles, co-payments and other amounts but not premiums)	\$5,250	\$10,500	\$5,500	\$11,000
Catch-up Contribution (age 55 and older)	\$700	\$700	\$800	\$800

Rev. Proc. 2006-53 also contains indexed 2007 limits on elective deferrals and individual retirement account (IRA) contributions and income tax deductions for Roth IRAs and certain qualified retirement contributions.

RECENT LEGISLATIVE ACTIVITY

Senate Approve Tax Measures Including HSA Improvements, ISO Relief

By a 79 to 9 vote very early in the morning of December 9, the Senate approved the Tax Relief and Health Care Act of 2006 (H.R. 6111). The same measure had earlier been

approved by the House of Representatives by a vote of 367 to 45. The measure includes several important improvements to HSAs, the most significant of which will allow individuals to contribute up to \$2,850 to their HSAs, while families will be permitted to contribute up to \$5,850. These new contribution limits are effective starting January 1, 2007, and apply without regard to the deductible amount for qualified HDHP coverage offered in combination with an HSA.

The Tax Relief and Health Care Act also includes tax relief for many employees who exercised incentive stock options (ISOs) in 2003 or earlier that faced significant tax liability under the Alternative Minimum Tax (AMT) rules even though the value of the stock purchased with the options decreased significantly after the exercise. Subject to income limitations, the Act will allow the employees to recoup 20 percent per year of their AMT credit generated by the ISO exercises in 2003 or before, rather than the currently allowed \$3,000 per year (if they do not have offsetting gains). The tax break will begin to phase out for taxpayers with incomes above certain threshold amounts. The income limits in the provision references Code Section 151(d)(3)(C) that contains threshold amounts subject to annual indexing for inflation (the married-filing-jointly phase-out is expected to start at approximately \$228,000 in 2007, the first year the provision is effective).

House Approves Tax Extenders Bill with HSA Provisions

The House of Representatives approved the [Tax Relief and Health Care Act \(brought to the House floor as H.R. 6408\)](#) on December 8 by a vote of 367-45. [A detailed summary of the bill prepared by the Joint Committee on Taxation](#), as well as [a new summary of the HSA provisions of the bill](#) (prepared by the Benefits Group of Davis and Harman) is available on the Council Web site.

The House vote included a procedure which combined the Tax Relief and Health Care Act to a tax bill which had previously been approved by both the House and Senate, resulting in the House bill number changing to H.R. 6111.

As reported previously, the Tax Relief and Health Care Act contains **all** of the HSA improvement provisions that were previously approved by the House Ways and Means Committee as [the Health Opportunity and Patient Empowerment Act \(H.R. 6134\)](#), originally introduced by Representatives Eric Cantor (R-VA) and Paul Ryan (R-WI).

These provisions increase the amount employees and employers may contribute to HSAs (by deleting the rule that generally restricts annual contributions to the amount of the deductible for the high deductible health plan offered in combination with an HSA, applying in its place a higher statutory limit which is indexed each year), permits employers to make available a one-time opportunity for funds to be directly transferred on a tax-free basis from a flexible spending arrangement (FSA) or HRA to an HSA, and allows mid-year enrollees in qualified HDHP coverage to make a full year contribution to an HSA. Other provisions permit employers to make higher contributions to the HSAs of their non-highly compensated employees, allows individuals to make a one-time tax-free direct transfer of funds from an IRA to an HSA (up to the HSA annual contribution limit)

and directs the Treasury to publish annually indexed adjustments to HSA contribution limits and other plan features by June 1 each year. Together, these provisions are estimated to result in \$287 million reduction in federal revenues over five years and \$1 billion over ten years.

The bill also contains numerous Medicare provisions, including a 1.5 percent payment incentive for doctors who begin reporting on standard quality measures in 2007. This provision is part of a shift toward performance-related reimbursement in government health programs, as suggested by President Bush's recent executive order.

Several companies and organizations deserve much credit for this success. These proposals were actively advocated by a broad coalition of businesses and health plan organizations known as the HSA Working Group that worked very collaboratively over the past several months.

GAO Releases 401(k) Fees Report Requested by Rep. George Miller

The U.S. Government Accountability Office (GAO) released a [report on Changes Needed to provide 401\(k\) Plan Participants and DOL with Better Information on Fees](#). In producing the document, GAO reviewed current types of 401(k) plan fees and who is responsible for paying them, how the DOL regulates these fees and plan administration in general, and plan fee disclosure methods in current common use. The report recommends that Congress amend ERISA to “require sponsors to disclose fee information on each 401(k) investment option in the plan to participants and to require that 401(k) service providers disclose to plan sponsors the compensation that providers receive from other service providers.” GAO also suggested that DOL require plan sponsors to report summaries of all fees paid from plan assets or by participants and indicated that the DOL has agreed with this recommendation.

This report was requested by Rep. George Miller (D-CA), who is expected to assume chairmanship of the House Education and the Workforce Committee in the 110th Congress. Miller had indicated he intends to hold committee hearings next year on laws regulating 401(k) defined contribution retirement plan fees, which has recently been the topic of some controversy and litigation.

Senate Democrats Announce New Leadership, Committee Positions; House Leadership Selected

Democrats in the U.S. Senate, having gained the majority in the 2006 elections, have announced new leadership appointments and committee assignments for the 110th Congress starting in 2007. Some of these new assignments will affect committees with jurisdiction over employee benefits matters:

Health, Education, Labor and Pensions (HELP) Committee: The new chairman will be current ranking minority member Senator Edward Kennedy (D-MA). New members will include Senators Sherrod Brown (D-OH), Barrack Obama (D-IL) and Bernard Sanders (I-VT).

Finance Committee: Current ranking minority member Max Baucus (D-MT) will be the new committee chairman. New members will include Senators Debby Stabenow (D-MI) and Ken Salazar (D-CO).

Appropriations: The new chairman will be Sen. Robert Byrd (D-WV). New members will include Senators Jack Reed (D-RI), Frank Lautenberg (D-NJ) and Ben Nelson (D-NE).

Banking: New members will include Senators Daniel Akaka (D-HI) with Brown, Bob Casey (D-PA) and Jon Tester (D-MT).

Special Committee on Aging: Sen. Herb Kohl (D-WI) will be the committee's new chairman. New senators Casey, Claire McCaskill (D-MO) and Sheldon Whitehouse (D-RI) will also join the committee.

We will continue to report on any further significant committee assignments in the Senate or House of Representatives.

The Democrats have also elected their new Senate leadership, approving Sen. Harry Reid (D-NV) as majority leader and Sen. Richard Durbin (D-IL) as majority whip, responsible for garnering votes for the Democratic agenda. On the other side of the aisle, current Senate Majority Whip Mitch McConnell (R-KY) was elected as the Republicans' minority leader for the 110th Congress by the members of the Republican caucus. Former Senate Majority Leader Trent Lott (R-MS) was elected to the position of minority whip.

In the House, Representative Nancy Pelosi (D-CA) has been elected Speaker of the House and Rep. Steny Hoyer (D-MD) will serve as the new House majority leader. Rep. James Clyburn (D-SC) will serve as the new majority whip. House Republicans, meanwhile, elected current House majority leader John Boehner (R-OH) as the minority leader. Rep. Roy Blunt (R-MO), the current majority whip, will serve as the new minority whip.

RECENT JUDICIAL ACTIVITY

Fourth Circuit Hears Appeal Arguments in Challenge to Maryland's "Fair-Share" Act

The state of Maryland's appeal of a federal district court decision invalidating Maryland's "Fair-Share" Act was argued on November 30 before the U.S. Court of Appeals for the Fourth Circuit. In [a July 19 decision, the U.S. District Court for the District 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," an employer who did not satisfy the 8 percent mandate would be required to pay the difference to the state. The 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. The Retail Industry Leaders Association (RILA) challenged the Act, arguing that it was preempted by ERISA. Although only one employer, Wal-Mart, was the direct target of the Act's spending requirement; the state law provides a model for legislation that could be considered in other states and localities.

An amicus curiae brief supporting RILA was jointly submitted by the Council, HR Policy Association and the Society of Human Resource Management. The Department of Labor also filed an amicus brief arguing that the Fair Share Act is preempted by ERISA. The litigation has been proceeding on a "fast track", given the January 1, 2007 effective date of the Maryland law. As a result, an appeals decision is expected in the near future.

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