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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 its core content, and is edited by Corinne M. Tyler, Employee Benefits attorney and Senior Associate in the Cleveland Office of Baker & Hostetler LLP; ctyler@bakerlaw.com.

Articles in this Edition

RECENT LEGISLATIVE ACTIVITY

House Ways and Means Committee Members Send Letter to Treasury on Backloading and Hybrid Plans

House of Representatives Ways and Means Committee Chairman Charles Rangel (D-NY) and the Committee's ranking member Jim McCrery (R-LA) have gathered signatures from 28 of their fellow Committee members for a letter to the U.S. Treasury Department (Treasury) regarding hybrid pension plans. The letter urges Treasury and the IRS to reconsider their interpretation of the backloading rules as they relate to "greater-of" transition formulas during hybrid plan conversions. Rangel and McCrery had issued a "dear colleague" letter to Committee members earlier in the week requesting their support on this issue.

The current IRS position on the application of the backloading rules to hybrid conversions would preclude the use of the "greater-of" transition formula. Under such formula, participants receive the greater of the benefits calculated under the traditional plan formula or benefits calculated under the hybrid formula. This interpretation of the backloading rules as applied to the generous pro-participant approach to conversions could also negatively affect "greater-of" formulas in other contexts (such as traditional plans with a minimum benefit, or plans that provide the greater of the buyer's plan formula or the seller's plan formula immediately following a corporate acquisition).

The “dear colleague” letter argues that a more reasonable and consistent interpretation would be to aggregate two benefit formulas in situations where one formula applies to a participant for a period of time, and a second formula applies after that date. It further emphasizes that "Congress recognized the need to protect plan participants in the event of a cash balance conversion under the PPA" and that the IRS "should not set up unnecessary roadblocks to this pro-participant practice."

In late August the leaders of the Senate Finance Committee and the Senate Health, Education, Labor and Pensions Committee sent a similar letter to Treasury. In this letter, Committee Chairman Edward Kennedy (D-MA) and Ranking Member Michael Enzi (R-WY) and Finance Committee Chairman Max Baucus (D-MT) and Ranking Member Charles Grassley (R-IA) strongly suggested that Treasury and IRS reconsider their current position because it conflicts with the IRS’s position in other transition situations, and further that the IRS should formally communicate this clarification to plan sponsors. Assistant Treasury Secretary for Legislative Affairs Kevin I. Fromer recently replied to Kennedy and Enzi and to Baucus and Grassley indicating that Treasury will issue additional guidance by the end of this year or earlier.

Evidently examination of the issue is currently underway, the timing of guidance on the Treasury and IRS position is uncertain and the extent to which relief will be provided is unclear. Of concern is that the solution will not be broad enough to sufficiently address the application of all “greater of” formulas. In the meantime, Treasury and the IRS will not be taking adverse actions on determination letter applications for cash balance plan conversions through the end of this calendar year.

A number of summaries have been prepared of this issue, including Action Alerts on July2 and September 10, group letters to Congress and the policy document "Effect of IRS Backloading Interpretation on Both Hybrid and Traditional Plans."

Legislation Introduced to Protect Pension Plan Participants in Business Bankruptcies

Legislation was recently introduced in both the House of Representatives (House) and the Senate to improve protections for employees' and retirees' pension plan funds in business bankruptcies. The Protecting Employees and Retirees in Business Bankruptcies Act is sponsored by Senator Dick Durbin (D-IL) in the Senate (S. 2092) and Representative John Conyers (D-MI) in the House (H.R. 3652).

Most notably, the legislation would:

- Raise the priority of worker benefit claims in bankruptcy litigation;
- Make it more difficult to change existing collective bargaining agreements when a company is in bankruptcy; and
- Strictly limit executive compensation in situations where qualified plans have been terminated.

The measure is supported by the AFL-CIO. Each bill will now be forwarded to the respective judiciary committees for review. The bill is being analyzed to determine its potential impact on employer plan sponsors.

Senate, House Ways and Means Committees Pass Mental Health Parity Legislation

The Senate and the House of Representatives' Ways and Means Committee both recently passed The Paul Wellstone Mental Health and Addiction Equity Act (H.R. 1424) by voice vote, in the process defeating a substitute amendment that would have incorporated language from the Senate-passed Mental Health Parity Act (S. 558).

However, certain trade organizations have voiced concerns with H.R. 1424, which:

- includes a broad mandate that employers and health plans must cover all mental health conditions and substance abuse disorders in the DSM-IV manual, if a plan covers any mental health benefits at all;
- broadly expands the ability of states to establish new remedies for plan participants in insured health plans, which would apply only to mental health coverage under their plan; and
- fails to fully protect the medical management practices of plans which are needed to ensure that plans only cover services determined to be medically necessary and appropriate.

Earlier in the year the Congressional Budget Office (CBO) issued a cost estimate of H.R. 1424 indicating that the cost of covering mental health services under the bill would be similar with those for treatments of other kinds of illnesses. Under the estimate, H.R. 1424 would reduce federal tax revenues by $1.1 billion over the 2008-2012 period and by $3.1 billion over the 2008-2017 period. The measure would also increase federal

Medicaid spending by $310 million in 2008-2012 and by $3.1 billion in 2008-2017, slightly higher than the S. 558 estimate, which covered 2009-2012 and 2009-2017.

Prior to the Committee mark-up, it was urged that the Senate approve a substitute amendment based on S. 558, which allows employers the flexibility to design their benefit plans; makes clear that medical management of these important benefits may not be prohibited; and maintains states' current authority to regulate insurance. The American Benefits Council (Council) has prepared side-by-side charts comparing the two bills in their entirety as well as the key differences between them.

The substitute amendment, offered by the Committee's Ranking Member Jim McCrery (R-LA) on behalf of Representative Dave Camp (R-MI), was defeated by a vote of 13-26. Prior to consideration of the substitute, the Committee also defeated several individual amendments that would have incorporated the approach of S. 558 addressing provisions on out-of-network coverage, medical management, and the use of the DSM-IV statistical manual for identifying disorders. The Committee also struck down an amendment by Rep. Ron Lewis (R-KY) that would have waived the mandates if employees saw a rise in their individual health care costs, mimicking a clause in the bill that allows employers to avoid mandates of their health care costs increase by a predetermined percentage.

The Bush Administration recently released a letter to Senators Edward Kennedy (D-MA) and Mike Enzi (R-WY) – who, along with Sen. Pete Domenici (D-NM), were the lead sponsors of S. 558 – expressing support for the Senate version of mental health parity legislation. The letter noted, "[w]e appreciate the work of the Senate thus far in drafting legislation that works to eliminate disparities between mental health benefits and medical or surgical benefits provided by health plans, and we support the goal of this legislation." The letter also expressed the Bush Administration's concern that the House bill "would undermine current law that provides for the uniform administration of employee benefit plans made possible by ERISA."

H.R. 1424 will now likely proceed to the House floor. Assuming the House declines to consider and accept the Senate bill, there will need to be a conference to reconcile differences between H.R. 1424 and S. 558. Representatives Patrick Kennedy (D-RI) and Jim Ramstad (R-MN), the lead sponsors of H.R. 1424, have vigorously opposed the more moderate Senate measure, but the Bush Administration statement and the unanimous Senate approval of S. 558 will give the Senate language increased prominence in the debate.

Hearings on Hedge Funds Held by Senate Finance and House Ways and Means Panels

Hedge funds were the topic of hearings on both sides of Capitol Hill in early September. The Senate Finance Committee (Finance Committee) held the third in a series of hearings on "carried interest", with three witnesses focusing particularly on the impact tax policy changes could have on pension fund investment returns. Finance Committee Chairman Max Baucus (D-MT) said the panel wanted to investigate testimony that any increase in the tax liability of private equity managers would be paid by pensioners, and not by equity fund managers. The September hearing then considered to what extent fund managers "pass through" tax increases to pension fund investors and how such "pass throughs" affect retirees and pension plans. During the hearing Ranking Member Charles Grassley (R-IA) announced that he and Chairman Baucus will expand their original request to the Government Accountability Office (GAO) to investigate pension plan investments in hedge funds to now include investments by pensions in private equity funds.

At the same time, the House Ways and Means Committee was hearing testimony from 20 witnesses on "fair and equitable tax policy for America's working families." Chairman Charles Rangel (D-NY) announced that the Committee was examining ways to address the growing Alternative Minimum Tax (AMT) problem, and in the course of that examination would be looking at simplifying the Internal Revenue Code (Code), ensuring that the Code is fair, and making the economy as strong as possible. Four witness panels discussed the AMT, the 2001 and 2003 tax cuts, and the tax treatment of hedge funds and partners in private equity firms. In the course of the hearing, some witnesses urged Congress to amend the current law that restrict the ability of most tax-exempt entities to invest directly in onshore hedge funds without being subject to the unrelated business income tax (UBIT). Also during the hearing, Congressman Sander Levin (D-MI) announced his intent to introduce legislation that would create an exception to the debt-finance rules that would allow all tax-exempt entities to invest directly in onshore hedge funds without being subject to UBIT.

Senate Special Aging Panel Hears Testimony on Financial Designations that May Mislead Older Investors

Also in September, the Senate Special Committee on Aging (Special Committee) held a hearing probing the practices of financial advisors who purportedly target senior citizens in order to gain access to their retirement savings. Of particular concern to the panel were allegations of seniors being misled by financial designations that some advisors might use to confuse a potential older client into thinking the advisor had broader educational experience than was actually true.

Testimony came from three different panels of witnesses including SEC Chairman Christopher Cox, who described the agency's new initiatives targeting senior investment fraud. Representatives from various state governments also outlined procedures in their jurisdictions currently available to combat these problems and the current rate of incidences about which they are receiving reports. During the third panel, there were responses to allegations of employing such advisors or offering them the certifications in question and what may be the true value of those. Witnesses on all three panels also suggested to the Special Committee that while some investment products marketed to seniors, such as annuities, may be appropriate in individual situations; the suitability of each product to the purchaser should not be affected by overly aggressive marketing tactics.

Chairman of the Special Committee, Herb Kohl (D-WI), announced at the hearing's conclusion that he intends to develop legislation prescribing a uniform accreditation standard for financial advisors to seniors and encouraging state regulators to adopt such requirements.

RECENT REGULATORY ACTIVITY

IRS Halts Determination Letter Applications for Certain Defined Contribution Plans

In IRS Announcement 2007-90, the agency stated that it will temporarily stop accepting applications for determination letters from employers adopting pre-approved (master, prototype or volume submitter) plans beginning on December 18, 2007. These applications are filed on Form 5307, "Application for Determination for Adopters of Master or Prototype or Volume Submitter Plans." Sponsors of pre-approved defined contribution plans previously submitted their restated plans for a determination that the form of the plan complies with the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Employers currently using the pre-EGTRRA version of the pre-approved plans will have a two-year period in which to adopt the restated plan once the sponsoring organization receives a favorable determination. The IRS indicated it would announce the two-year period for adoption (and submission on Form 5307 for the individual employer determination) of pre-approved plans early in 2008 and needed to impose the temporary halt to allow the agency time to prepare.

As previously reported, IRS Revenue Procedure 2007-44 updated previous guidance on staggered remedial amendment periods for individually designed and pre-approved qualified plans. Under the staggered determination letter filing system, first established in IRS Revenue Procedure 2005-66, plan sponsors generally file for determination letters within five-year staggered cycles that depend on the plan sponsor's taxpayer identification number for individually designed plans, and during a six-year cycle for pre-approved plans. As provided in Revenue Procedure 2007-44, when the review of the pre-approved defined contribution plans is near completion, the Service will publish an announcement providing the date by which adopting employers must adopt the newly approved plans (the two-year period anticipated by the Announcement).

Business Groups Write Treasury, Congress Advocating Asset Smoothing

Recently, a series of letters was sent to the Treasury and key congressional leaders urging that the smoothing of assets in defined benefit pension plans be retained as a viable valuation option for plan sponsors. The funding rules for defined benefit plans were dramatically altered with the enactment of the Pension Protection Act of 2006 (PPA) and the regulatory agencies are now developing regulations and guidance to implement the new law.

Treasury is now considering the publication of guidance that would effectively eliminate smoothing of interest rates and asset values as an option for plan sponsors. Among other reforms, the PPA reduced the smoothing period from 48 months under pre-PPA law to 24 months and used the term asset "averaging" rather than asset "smoothing". The legislative history of the PPA is extremely clear that the use of the term "averaging" was intended to refer to smoothing. However, the term "average value" under current law refers to a valuation technique that is not commonly used because it systematically undervalues plan assets.

As the letters note, "to avoid such artificially large obligations, companies would generally be compelled to not use asset averaging. Companies would be effectively forced to use the other available asset valuation methodology, i.e., spot valuations," which can create significant unpredictability.

Smoothing was a key issue for the employer plan sponsor community during the PPA debate.

PBGC Releases Five-Year Strategic Plan
In mid-September, the Pension Benefit Guaranty Corporation (PBGC) released a five-year (fiscal years 2008-2013) strategic plan for reaching three stated goals:

1. Safeguarding the federal pension insurance system for the benefit of participants, plan sponsors, and other stakeholders;

2. Providing exceptional service to customers and stakeholders; and

3. Exercising effective and efficient stewardship of PBGC resources.

Among the priority outcomes listed in the document is "[a] policy environment that appropriately balances the interests of the pension insurance program," developed through the principal strategy of eliminating the PBGC deficit and accounting for expected losses. The plan provides few details about this specific element, but Charles E.F. Millard, interim director of the PBGC, stated in a Senate Health, Education, Labor, and Pensions (HELP) Committee hearing that the agency is reviewing its investment policy with an eye toward moving to one that is more aggressive.

The PBGC is seeking public comment on the plan. Interested parties can send feedback to strategicplan@pbgc.gov.

DOL Issues Proposed Regulations on Multiemployer Plans and Information Availability
The DOL recently issued proposed regulations that would give multi-employer plan participants, their union representatives and contributing employers the right to request financial documents relating to the plan. Under the proposed regulations, the employer would have 30 days after the request to provide the documents (one copy per report within a 12-month period). The rule is being implemented as part of the PPA.

Comments on the proposed regulations were due to the DOL by October 15.

Treasury Letter to Congress Confirms that Application of Excise Tax for Exceeding Combined Plan Limit will Follow PPA Technical Corrections Language

The IRS has indicated that the agency is taking a position that plan sponsors that contributed in excess of 100 percent of the current liability of their defined benefit plans for 2006 (relying on modifications to contribution limits including the combined plan limit in the PPA needed to file an excise tax return and pay the 10 percent tax by July 31, 2007, for calendar year plans. However, the IRS believed that if Congress later passes a technical corrections bill including a clarification of the combined limit changes, plan sponsors will be able to request a refund using procedures similar to the process outlined in IRS Announcement 1996-26 (p. 13) (a new announcement would be published).

The excise tax and potential refund stems from IRS Notice 2007-28, published in March, 2007, which provides guidance on the 2006 and 2007 changes made by the PPA to the deductibility of contributions to qualified plans. One of the changes addressed by the notice was the newly revised combined plan limit on contributions where the employer maintains both a defined benefit (DB) and defined contribution (DC) plan. The combined plan limit generally limits total deductible contributions (other than elective deferrals) to the greater of 25 percent of the participants' compensation or the minimum required contribution to the DB plan (but no less than the DB plan's current liability).

Under the PPA, the combined plan limit only applies to the extent employer contributions exceed 6 percent of compensation. Unfortunately, Notice 2007-28 made clear that the combined plan limit would continue to apply to the DB plan even if contributions to the DC plan do not exceed 6 percent of compensation. The PPA technical corrections bills introduced in both the House of Representatives (H.R. 3361) and Senate (S. 1974) shortly before the August recess clarified that the combined plan limit does not apply if employer contributions to the DC plan do not exceed 6 percent of compensation.

The IRS has indicated it does not intend to "anticipate" passage of the technical corrections legislation by allowing plans to ignore the excise tax where (1) excess contributions stem from the combined plan limit, and (2) employer contributions to the DC plan did not exceed 6 percent of compensation. This interpretation of the combined plan limit is extremely unusual and obviously has not been formally announced.

Treasury officials recently released a letter to Congress stating that the Treasury and the IRS will, going forward, administer the applicable sections of the PPA regarding the combined plan deduction limit in accordance with Congress' clarified intent and the language of the recently introduced technical corrections legislation (H.R. 3361/S. 1974). Treasury's letter confirms that, based upon the technical correction language, if employer contributions to an employer's defined contribution plans do not exceed 6 percent of participants' compensation, the combined plan limit does not apply. This negates IRS Notice 2007-28 and many contributions to these plans will be deductible and relevant excise taxes on nondeductible contributions will not apply.

Treasury and IRS Provide Additional 409A Relief

As reported in the September issue of Benefits Insider, Treasury and the IRS recently published IRS Notice 2007-78, provided an extension of the deadline to adopt documents that comply with Internal Revenue Code Section 409A. The extension, to December 31, 2008, was subject to requirements regarding the timely written designation of a time and form of payment. The notice also announced that the IRS planed to issue guidance containing a limited voluntary compliance program that would permit taxpayers to correct certain unintentional operational violations of Section 409A and thereby limit the amount of additional taxes due under the section. On October 22, 2007, the IRS issued Notice 2007-86, which modified the relief provided in Notice 2007-78 by extending the transition relief under Code Section 409A through December 31, 2008. Pursuant to Notice 2007-86, nonqualified deferred compensation arrangements generally have until January 1, 2009, to comply with the final regulations. In the interim, such arrangements must be operated in good faith compliance.

Millard Suggests Possible PBGC Investment Structure Changes During Senate HELP Hearing

At his confirmation hearing before the Senate HELP Committee, Charles E.F. Millard, interim director of the PBGC, recently stated during panel questioning that the agency is pursuing its regular two-year review of its investment policy with an eye toward moving to a more aggressive investment policy than previously initiated. The agency's current practice is to invest 70 percent of total assets in fixed income vehicles such as U.S. Treasuries. Millard stated that, based on the PBGC's current requirement by the PPA to estimate returns for 2006 as if it had invested 60 percent of its assets in equities, plus his experience with several Wall Street investment firms, he would instead recommend an asset mix of 60 percent equities and 40 percent fixed income investments. This proposal would allow the PBGC's Board to change the policy and more rigorously address the agency's current $18.9 billion deficit.

Discussion of how to address the PBGC's long-standing budget deficit also focused on the procedure by which a company in Chapter 11 bankruptcy may relinquish its pension to the trusteeship of the agency. In response to questioning by HELP Retirement and Aging Subcommittee Chairwoman Barbara Mikulski (D-MD) and Committee Ranking Member Michael Enzi (R-WY), Millard asserted that the PBGC would tighten these requirements in order to further deter companies from taking this route and possibly adding to the already acknowledged agency deficit. Measures such as these, Millard told the HELP Committee, should improve the agency's financial status and ensure that in the future it remains a governmental safety net for pension plans. However, he did not reveal what specific "tightening" is contemplated.

Previously, the President's appointment of a PBGC director did not require Senate confirmation. However, the PPA now mandates approval by the Senate and Millard is the nominee first to undergo this process. The HELP Committee hearing is the second step, following approval in July by the Senate Finance Committee that will lead to a full Senate vote sometime this fall.

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