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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 Partner in the Cleveland Office of Baker & Hostetler LLP; ctyler@bakerlaw.com.

Articles in this Edition

RECENT REGULATORY ACTIVITY

IRS Hears Testimony on Benefit Restrictions for Underfunded Pension Plans

The Internal Revenue Service (IRS) recently held a hearing on the proposed regulations on benefit restrictions for certain underfunded defined benefit plans under the Pension Protection Act of 2006 (PPA).

As earlier reported, the proposed regulations make clear that benefit accrual restrictions will cease to apply to a plan as of the measurement date when the 60 percent funding target is met unless the plan specifically provides otherwise. In addition, a plan can be amended to provide that any benefit accruals that were previously limited under the benefit accrual restrictions will be credited once the limitation no longer applies, subject to applicable qualification requirements.

The testimony heard by the IRS echoed many of the principles espoused by the business community, noting that:

- It is critical that the IRS issue guidance very promptly stating that, until plan years beginning at least six months after the issuance of final regulations, good faith compliance with a reasonable interpretation of either the statute or the proposed regulations will constitute compliance with the benefit restriction rules;
- The proposed regulations should be revised to permit valuations based on roll-forwards of liabilities, which would make the rules far more administrable without any material loss of accuracy; and
- Multiple employers treated as if maintaining separate plans for purposes of the funding rules should be subject to benefit restrictions only if both the plan as a whole and the portion of the plan attributable to the employer are below the particular funding threshold.

Recent IRS Effective Date Interpretation Applies to Earlier Proposed Regulations

The IRS application of the effective date for previously released regulations (for hybrid plans and defined benefit plan funding requirements, will similarly apply to the proposed regulations for employer-specific mortality tables (issued in May 2007) and benefit restrictions (issued in August 2007). The ruling was announced informally in an IRS news release regarding the proposed funding regulations but has not been officially issued.

As previously reported, the proposed regulations are generally proposed to be effective for plan years beginning on or after January 1, 2009. However, the proposal points out that the new PPA statutory requirements are generally effective for years beginning after December 31, 2007 (with some provisions effective for periods beginning on or after June 29, 2005), and that plans are permitted to rely on the proposed regulations prior to 2009. Since the proposed regulations do not otherwise provide any alternative for plans attempting to meet the new statutory requirements, this "permissive" language could be interpreted as "essentially mandatory." This same effective date status will be applied to the rules for mortality tables and the proposed benefit restriction regulations according to the IRS release. Since the benefit restriction regulation's actual effective date will change to 2009, some plans may decide they can support an alternative interpretation of the statutory benefit restriction requirements (perhaps altering certain automatic restrictions which would have been required by the regulations). Affected plan sponsors should consult their attorneys and actuaries.

IRS Issues Further Guidance on Corporate Bond Rate
The IRS has issued Notice 2008-17, providing guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under the defined benefit plan funding requirements of the Code (as amended by the Pension Funding Equity Act of 2004 and the PPA.

The notice provides guidance on the required corporate bond monthly yield curve (and the corresponding spot segment rates), the 24-month average segment rates, and the funding transitional segment rates as required under the tax code. The notice also provides guidance as to the interest rate on 30-year Treasury securities (in effect for plan years beginning before 2008) as well as the minimum present value segment rates (in effect for plan years beginning after 2007) for determining the present value of assets for cash-outs.

EEOC Final Regulations on Retiree Health Benefits
The Equal Employment Opportunity Commission's (EEOC) final regulations permitting the coordination of retiree health benefits with Medicare eligibility were published in the Federal Register on December 26, 2007, and clarify that employers and labor unions may adopt or maintain a wide range of retiree health plan designs that coordinate with Medicare, such as bridge or wrap-around plans, without violating the Age Discrimination in Employment Act of 1967 (ADEA).

The legality of coordinating retiree health coverage with Medicare eligibility was called into question in 2000 by the Erie County decision, when the U.S. Court of Appeals for the 3rd Circuit held that an employer violated the ADEA if it reduced or eliminated retiree health benefits when retirees became eligible for Medicare unless the employer could show that the benefit available to Medicare-eligible retirees could satisfy a complex equal benefit or equal cost test.

The final rule establishes a narrow exception from the ADEA for the practice of coordinating employer-sponsored retiree health benefits with eligibility for Medicare or a comparable state health benefits program. Under the ADEA, the EEOC may establish such reasonable exemptions as it "may find necessary and proper in the public interest." The authority of the EEOC to issue such an exemption was the subject of a legal challenge by the AARP. Publication of the final regulation was stayed pending a decision of the 3rd Circuit, which ruled in June 2007 that the agency properly exercised its exemption power. As explained in the preamble to the final regulation, the EEOC concluded that the exemption was appropriate after conducting a comprehensive study of the relationship between the ADEA and retiree health benefits after it published its proposed rule. The study indicated that labor unions, benefits consultants, private and public sector employers were in agreement that the EEOC's implementation of the Erie County decision would further erode employer-sponsored retire health benefits by creating an additional incentive for employers to reduce, or eliminate entirely, health benefits for retirees.

The final regulation makes clear that the exemption is to be narrowly construed and concerns only the ADEA. It does not affect any non-ADEA obligations that employers may have to provide benefits under Medicare or any other law (for example, employer obligations to use Medicare as a secondary payor when required by Medicare law). The exemption only applies to retiree health benefits and not non-health retiree benefits. The exemption applies to existing as well newly created retiree benefits that coordinate with Medicare or a comparable state health benefit plan. The regulation includes an appendix of explanatory questions and answers which clarifies that the exemption applies to dependent and spousal health benefits that are included as part of benefits provided to the retired participants. The appendix states, however, that the dependent and/or spousal benefits need not be identical to the health benefits provided to retired participants. As a result, dependent and/or spousal benefits may be altered, reduced or eliminated pursuant to the exemption, regardless of whether the health benefits provided to the retired participant are similarly altered, reduced or eliminated.

By allowing employers to offer retiree benefits to the greatest extent possible, the final rule benefits employees, particularly early or pre-Medicare eligible retirees, who were most vulnerable to the deleterious impact of the Erie County decision. Although the AARP has asked the U.S. Supreme Court to hear an appeal of the 3rd Circuit's decision upholding the regulation, its request does not affect employers' ability to rely on the final regulation which became effective December 26, 2007.

Treasury, IRS Propose Employer Stock Diversification Regulations

The U.S. Treasury Department (Treasury) and the IRS recently released proposed regulations concerning the new employer stock diversification rules added in the PPA. The PPA created a new section of the Code (Section 401(a)(35)) that requires many defined contribution plans to allow plan participants and beneficiaries to diversify out of employer stock into other investment options (immediately for employee contributions and after three years of service for employer contributions).

The new Code section was first effective for plan years beginning in 2007 and IRS issued interim guidance, Notice 2006-107, on December 18, 2006. The regulations, which adopt much of the guidance contained in Notice 2006-107, are proposed to be effective for plan years beginning in 2009. For plan years beginning in 2008, plan fiduciaries can meet the requirements of Notice 2006-107 (with an extension and expansion of the transition relief for stable value funds described more fully below), or rely on the proposed regulations.

Notice 2006-107 generally provided that prohibitions or restrictions or conditions can not be placed on the investment (or divestiture) of employer securities that are not imposed on other investments available under the plan. However, the notice allowed an exception during 2007 for restrictions imposed on the employer stock fund but not imposed on stable value funds (transition rule). As anticipated by Notice 2008-07, issued on December 19, the proposed regulations make permanent this exception for stable value funds, and expand the relief to "similar funds."

Unlike Notice 2006-107, the proposed regulations would allow reasonable restrictions on the timing and number of investment elections that an individual can make to invest in employer securities if the restrictions are designed to limit short-term trading. However, plans are not permitted to restrict sales of employer securities. The example provided allows a limit on the purchase of employer securities if there has been a sale within a short period of time, such as seven days.

Notice 2006-107 also allows a plan to impose restrictions on investment in employer stock that are "reasonably designed to comply with securities law" and the proposed regulations clarify that the example in the earlier notice (which is incorporated in the proposed regulations) is merely an example and broader restrictions are permitted. The regulations provide an additional example that a smaller entity might be able to restrict divestiture to only once a quarter.

The proposed regulations generally prohibit indirect restrictions on the individual's exercise of diversification rights but allow (1) prohibition on investing additional amounts in employer securities if more than 10 percent of that participant's account balance is (or would be after the change) invested in employer securities, or (2) termination of any further investment in employer securities.

The proposed regulations clarify that it generally does not violate the new regulations for plans to impose fees on other investment options that are not imposed on investment in employer securities or to impose a reasonable fee for the divestment of employer securities.

Notice 2006-107 provided that a plan is not treated as holding employer securities to which the new requirements apply if the securities are part of an investment vehicle diversified to minimize the risk of large losses held through either an investment company registered under the Investment Company Act of 1940 or a similar pooled investment vehicle subject to certain requirements. The proposed regulations further define "pooled investment vehicle" as a common or collective trust fund or pooled investment fund maintained by a bank or trust company supervised by a state or federal agency, a pooled investment fund of an insurance company that is qualified to do business in a state, or an investment fund designated by the commissioner. The proposed regulations also limit employer securities held by such a fund to no more than 10 percent of the total value of all of the fund's investment.

The proposed regulations apply to defined contribution plans that hold any publicly traded employer securities (or is a member of a controlled group of corporations which includes the employer, determined by applying Code Section 1563(a) but substituting 50 percent for 80 percent, which has issued stock that is publicly traded). The proposed regulations define "publicly traded" as "readily tradable on an established securities market" and provide separate rules for securities traded on domestic securities exchanges and foreign securities exchanges.

Comments and requests for public hearing are due by April 2, 2008 and it is understood that the Treasury is especially interested in comments on the foreign securities exchange guidance.

RECENT JUDICIAL ACTIVITY

Federal District Court Rejects San Francisco Health Plan Law but Ninth Circuit Ruling Allows Implementation of Employer Health Spending Mandate

In late December, 2007, the U.S. District Court for the Northern District of California ruled that San Francisco's local health care mandate violated ERISA's federal preemption standard. The San Francisco Health Care Security Ordinance contains an employer health spending requirement and a government health care program, funded in part by those employer contributions. The ordinance mandated medium and large businesses to make minimum health care expenditures on behalf of covered workers, beginning January 1, 2008. A private employer with 20-99 employees and a nonprofit with 50 or more employees would make expenditures of $1.17 per hour on behalf of each covered employee. A private employer with 100 or more employees would make health care expenditures of $1.76 per our hour. The ordinance set out a non-exclusive list of "qualifying" health care expenditures, such as contributions to HSAs, direct reimbursement to employees for health care expenses, payments to third parties for providing health care services, costs incurred for the direct delivery of health care services, or payments to the city "to be used on behalf of covered employees." The ordinance also required employers to maintain records and proof of health care expenditures, to allow city officials "reasonable access" to such records and annually report "such other information" that the city required.

The employer spending requirement was challenged by the Golden Gate Restaurant Association which argued that the requirement was preempted by ERISA. The district court ruled in favor of the Restaurant Association, holding that the ordinance had an impermissible connection with ERISA plans and the expenditure requirements made unlawful reference to employee benefit plans. Noting that the U.S. Supreme Court has regularly stated that the preemption clause of ERISA indicates Congress' intent to establish the regulation of employee welfare benefit plans "as exclusively a federal concern," U.S. District Judge Jeffrey White concluded that "by mandating employee health benefit structures and administration, those requirements interfere with preserving employer autonomy over whether and how to provide employee health coverage, and ensuring uniform national regulation of such coverage." The decision also cited a 2007 decision of the U.S. Fourth Circuit Court in *RILA v. Fielder*, in which Maryland's "Fair Share Act" health program was rejected on similar grounds. An amicus (friend of the court) brief supporting RILA was jointly submitted by the American Benefits Council, HR Policy Association and the Society of Human Resource Management in the Fourth Circuit Court of Appeals.

Although city officials appealed the district court ruling in a unanimous decision on January 9, a three-judge panel of the U. S. Court of Appeals for the 9th Circuit granted an emergency stay of the lower district court ruling, which held that ERISA preempts the employer spending requirement of San Francisco's Health Care Security Ordinance. The appeals court decision allows the City to enforce the employer spending requirement, pending the City's appeal on the merits.

Under the spending requirement, employers engaging in business within San Francisco must make minimum hourly health expenditures for employees or pay the City to provide health care to its uninsured residents. As earlier reported, the Golden Gate Restaurant Association prevailed in a legal challenge brought in federal district court arguing that the City ordinance violated ERISA.

The Ninth Circuit granted the stay based on its conclusions that the City had shown a strong likelihood of success on the merits. Contrary to the lower court decision, the Ninth Circuit reasoned that spending requirement was not preempted under ERISA because it did not require an employer to adopt an ERISA plan or dictate specific benefits that an employer must provide. Although the court acknowledged that the San Francisco ordinance imposed an administrative burden on covered employers by requiring employers to track payment obligations and maintain records, it held that such burdens were imposed on the employer, not the ERISA plan. The appeals court also held that the hardships on individuals seeking health care and the public interest in the health of city workers favored granting the stay and allowing the implementation of the spending requirement to go forward.

According to press reports, this case has been fast-tracked and full arguments on the appeal are expected later this spring, with an appeals decision on the merits possible by summer or early fall. If the 9th Circuit ultimately reverses the lower court decision, its decision would create a conflict with the 2007 4th Circuit ruling in RILA v. Fiedler which held that Maryland's "Fair Share Act" was preempted by ERISA. A conflict in circuit court rulings increases the potential for an appeal to the U.S. Supreme Court. In addition, the 9th Circuit's rulings have implications for how California and other states or local jurisdictions structure their health care reform initiatives.

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