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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 LEGISLATIVE ACTIVITY

Older Workers Legislation Introduced

Senators Gordon H. Smith (R-OR), Herb Kohl (D-WI), and Kent Conrad (D-ND) recently introduced the Incentives for Older Workers Act. Kohl and Smith are the chairman and ranking member, respectively, of the Senate Special Aging Committee, while Conrad serves on the Senate Finance Committee. An official summary of the bill is available.

The legislation aims to provide incentives and eliminate barriers for older Americans wishing to stay in the workforce longer, and encourage employers to recruit and retain older workers. Provisions include:

- Removing penalties in certain pension plans for workers who receive reduced pay for reduced hours while phasing into retirement;
- Allowing seniors to earn delayed retirement credits for Social Security purposes for an additional two years until age 72 instead of age 70;
- Reducing the amount of Social Security benefits lost to seniors who claim benefits before reaching normal retirement age while they continue working;
- Forming a National Resource Center on Aging and the Workforce within the Department of Labor to collect, organize and disseminate older worker information;
- Changing how Civil Service Retirement System (CSRS) annuities are calculated by correcting a glitch that results in a disproportionate reduction in benefits for certain employees who phase into retirement by working part-time;
- Requiring states to include older worker representatives on the state and local workforce investment boards and set aside five percent of the Workforce Investment Act (WIA) funds to assist older individuals;
- Expanding eligibility of the Work Opportunity Tax Credit (WOTC) to include older workers; and
- Clarifying that certain defined benefit pension plans can define normal retirement age under their plans as the earlier of (1) the attainment of a specified age, or (2) the attainment of 30 or more years of service.

In 2005, Kohl introduced The Older Worker Opportunity Act, a similar bill designed to encourage use of phased retirement programs by employers. Testimony was provided for a February 28, 2007, Senate Special Aging Committee hearing on "The Aging Workforce: What Does it Mean for Businesses and the Economy?" The committee collected testimony from government and academic witnesses on the special challenges of an older workforce.

The Senate Special Aging Committee will likely hold a hearing on the legislation but consideration by the full Senate is unlikely this year. Phased retirement is an emerging policy issue as more and more companies grapple with the shortage of talent and look for ways to retain older workers longer. Even though a key provision allowing for distributions from pension plans while the participant continues working was added by the Pension Protection Act of 2006 (PPA), many employers are looking for additional ideas and opportunities to facilitate the retention of talent. Introduction of the Incentives for Older Workers Act indicates increased awareness of employers' need to retain valuable older workers and the implications of workers retiring too early. It also suggests increased attention being focused by the Democratic congressional majority on older workers' needs.

Senate Will Consider FAA Bill with Numerous Benefits Provisions

The Senate recently voted to limit debate on the Federal Aviation Administration (FAA) Reauthorization Act (H.R. 2881) and will vote on the measure soon. The bill's primary purpose is to modernize the nation's air traffic control system and fund other transportation reforms, but it also contains a number of revenue-raising provisions affecting employer-sponsored benefit plans:

- *Required funding of new accruals under air carrier pension plans (Section 808 of the legislation):* Under this provision, the defined benefit pension plan funding regime for certain employers (plans of commercial airlines that elected to not freeze accruals or increase benefits) would be revised. If such an employer wished to make use of the special funding rules under the PPA, the minimum required contribution of the employer must not be less than the target normal cost of the plan which is to be calculated using the segment rates specified in the PPA.

- *Participants in government Section 457 plans allowed to treat elective deferrals as Roth contributions (Section 832):* Under this provision, participants in certain state and local government or tax exempt organization retirement plans are permitted to designate elective deferrals that could be otherwise deferred under the plan as Roth contributions subject to the present-law rules. A designated distribution of such contributions (and the income on those contributions) is excluded from gross income if the distribution is a qualified distribution. The provision would be effective for taxable years after December 31, 2008.

- *Revision of tax rules on expatriation (Sec. 838):* This provision mandates taxation of realized gains on the present value of retirement benefits (including IRAs, tax-qualified plans, and 457(b) and 403(b) plans) and requires U.S. employers to withhold income tax at a 30 percent rate on any distributions from pension or deferred compensation for an expatriate (or a permanent resident who gives up U.S. status). This provision would apply to all expatriation after the law's enactment.

The Senate will debate the measure over the next several days, and if the Senate's version of H.R. 2881 is approved, it will be referred to a conference committee to resolve any differences with the House-passed measure (which does not contain the offset provisions above). President Bush has already threatened to veto the House-passed version of the bill.

Pay Discrimination Act Fails in Senate

The Senate recently considered the Lilly Ledbetter Fair Pay Act (H.R. 2831) – a pay discrimination bill with implications for employee benefit plans – but failed to obtain the 60 votes necessary to bring debate to a close. This procedural action prevented a yes/no vote on H.R. 2831, but the bill is still eligible to be considered again by the Senate at a later time. The 56-42 vote broke down generally along party lines, with six Republican Senators voting in favor of the bill: Olympia Snowe (R-ME), Susan Collins (R-ME), Arlen Spector (R-PA), Norm Coleman (R-MN), Gordon Smith (R-OR) and John Sununu (R-NH). (Senate Majority Leader Harry Reid (D-NV) changed his vote to oppose the bill as a procedural device to preserve his ability to take up the bill again.)

H.R. 2831, which passed the House of Representatives on July 31, 2007, is a response to the decision of the Supreme Court in *Ledbetter v. Goodyear*, which held that employees must sue for pay discrimination within a specific statutory period of time (180 days of the date of the alleged discriminatory act). The plaintiff in the case had failed to file suit within that time frame. The legislation would allow the statute of limitations to begin again each time a payment of wages or benefits (including pensions) was made.

Prior to the vote, a letter to Senate offices was sent, expressing concern that the legislation could unintentionally expose retirement plans to liability for decades of alleged discrimination, both for defined benefit plans and for defined contribution plans through both the elective contribution of the plaintiff and the matching contribution, if any. The sponsors of H.R. 2831 included in the "findings" sections of the bill a provision saying that it was not intended to change any retirement plans, but this intention was not reflected in the body of the bill. A statement for the record was previously submitted in a hearing by the Senate Health, Education, Labor and Pensions Committee.

There is not currently a timetable for reconsideration of the bill.

Senate Approves Genetic Nondiscrimination Legislation

The U.S. Senate approved the Genetic Information Nondiscrimination Act (GINA) of 2007 (H.R. 493) without a dissenting vote (95 to 0) in late April. The original version of H.R. 493 was approved overwhelmingly by the U.S. House of Representatives exactly one year ago, on April 25, 2007, and prohibits employer-sponsored group health plans and health insurers providing group and individual health insurance from restricting enrollment or adjusting premiums based on genetic information or requiring or requesting genetic testing. H.R. 493 also prohibits employers from using genetic information to discriminate against an individual in hiring or other employment opportunities.

Clarification that ERISA and the Public Health Services Act would provide the exclusive remedies for the enforcement of the provisions of Title I of H.R. 493 was sought, which apply to employer sponsors of group health plans and health insurers – *not* the broader remedies under the Civil Rights Act which apply to an employment discrimination under Title II of H.R. 493.

The version of H.R. 493 approved by the Senate did make some small changes to the liability provisions, including an attempt to strengthen the “firewall” precluding dual remedies for the same discriminatory violation. However, these are still concerns with some technical aspects of the bill that could affect employers and health plans.

The House has already approved H.R. 493 twice – once as a standalone measure and once as part of The Paul Wellstone Mental Health and Addiction Equity Act (H.R. 1424) – and could consider the Senate-passed version of the bill, thereby avoiding the necessity of a House-Senate conference to reconcile the differences between the respective versions of the two bills.

Senate Finance Committee Introduces Tax Extenders Bill

The Senate Finance Committee Chairman Max Baucus (D-MT) and Ranking Member Charles Grassley (R-IA) recently introduced the Alternative Minimum Tax and Extenders Tax Relief Act (commonly known as the “tax extenders” bill) which extends certain expiring provisions of the tax code. This legislation includes two benefits-related provisions that were previously included in the Senate-passed (but never enacted) Defenders of Freedom Tax Relief Act (H.R. 3997):

Penalty-free withdrawals from IRAs for Reservists: Currently, a reservist may make an early withdrawal from a retirement plan without triggering a 10 percent early withdrawal tax and a reservist has two-years from the last day of the active duty period to contribute distributions to an IRA. This exception expired on December 31, 2007. The proposal would make this exception permanent. Parity in Mental Health Benefits: This provision is a one-year extension of existing law addressing application of certain limits to mental health benefits parity. This provision would be superceded by subsequently enacted legislation such as H.R. 1424 or S. 558.

Currently, the tax extenders bill does not contain "offsets" or revenue-raising provisions. Such provisions are expected to be added as the legislation progresses through the Senate and the House of Representatives. It has been speculated that these offsets could include changes in the taxation of offshore deferred compensation, but it is possible that the changes will be limited to investment fund managers.

House Committee Approves 401(k) Fee Legislation

The House of Representatives Committee on Education and Labor recently approved the 401(k) Fair Disclosure for Retirement Security Act (H.R. 3185), a fee disclosure bill sponsored by Committee Chairman George Miller (D-CA), by a vote of 25 to 19 (with one approved amendment). The version of H.R. 3185 approved by the committee contains a number of revisions from the bill as originally introduced after extensive negotiations with various employer groups.

Generally, H.R. 3185 would impose new requirements on the part of plan sponsors and service providers and step up government oversight of disclosures. Most notably, the bill would encourage 401(k)-style plans to include at least one index fund in its investment line-up.

As approved by the committee, requirements for service providers would include:

- Disclosure of all fees assessed for services to the plan, broken down into four categories: administrative fees, investment management fees, transaction fees, and other fees; and
- Outlining of any financial relationships of interest to plan sponsors, revised from the prior version of the bill.

Requirements for plan administrators would include:

- Disclosure of all fees assessed on the participant's account, broken down into four categories similar (but not identical) to the categories of disclosure to the plan fiduciaries;
- Identification of the name, risk level, and investment objective of each available investment option;
- Listing of the historical returns for and fees assessed on each investment option; and
- Specification of additional plan and investment information for plan participants.

The measure would also require the Labor Department to review compliance with new disclosure requirements and impose penalties for violations.

During committee debate, a number of amendments to the bill were offered:

- Rep. Buck McKeon (R-CA) introduced an amendment that would eliminate the requirement to "unbundle" and list fees for combined products or services that may not be priced separately. This amendment was defeated by a vote of 19 to 25.
- Rep. Rob Andrews (D-NJ) introduced an amendment to eliminate the required inclusion of an index fund, making it voluntary. However, the amendment would institute a set of liability protections for plans that did include an index fund option. This amendment was approved by a vote of 26 to 19. A second-degree amendment was offered by Rep. Tom Price (R-GA) that would have simply made the inclusion of an index fund voluntary,

without the liability protection language. This second-degree amendment was defeated by a vote of 20 to 25.

- Rep. John Kline (R-MN) introduced an amendment asserting that a plan can satisfy ERISA requirements simply by evaluating the services based on the total charge for the services. This amendment was withdrawn under an agreement with the committee chairman.

- Rep. Susan Davis (D-CA) introduced an amendment directing the U.S. Department of Labor to work with the Securities and Exchange Commission to determine a market-rate-based point of comparison for evaluating fund options. The amendment would also direct the U.S. Secretary of Labor to publicize the results of an annual survey of 401(k) plan offerings. This amendment was withdrawn for further study of the issue.

- Rep. Price introduced one amendment regarding the Social Security program, which was withdrawn, and another amendment expressing the need for greater comparison information for evaluating fund options, provided by the Social Security trustees report, which was rejected by a vote of 18 to 25.

H.R. 3185 is entirely within the jurisdiction of the Education and Labor committee, but it is still unclear whether the House Ways and Means Committee will act on the issue or if the bill will now proceed to consideration by the entire House. The Senate has not yet considered 401(k) fee legislation, though some Senators have expressed interest in the topic.

Business Groups Write in Support of Long-Term Care Legislation
Various business and individual interest groups recently sent a letter to Congress urging support for the Long-Term Care Affordability and Security Act (H.R. 3363 / S. 2337). The legislation would encourage individuals to plan for their long-term care and retirement security needs by allowing long-term care insurance to be offered in employer-sponsored cafeteria plans and flexible spending arrangements while providing additional consumer protections for tax-qualified long-term care insurance policies. H.R. 3363 is sponsored by Representative Earl Pomeroy (D-ND), a member of the House of Representatives Ways and Means Committee, and S. 2337 is sponsored by Senator Charles Grassley (R-IA), chairman of the Senate Finance Committee.

House Approves Tax Bill with HSA Substantiation Provision
The House of Representatives recently approved the Taxpayer Assistance and Simplification Act (H.R. 5719), by a vote of 238 to 179. Section 17 of H.R. 5719 includes a revenue-raising provision that would require an owner of an HSA who requests a distribution from that HSA to prove to the trustee or custodian that the distribution will be used for qualified medical expenses. If the purpose of the distribution is not substantiated in a manner similar to the requirements applicable to flexible spending arrangements (FSAs), then the distribution would be subject to income tax and a 10 percent additional tax. This provision is estimated to raise $485 million over ten years. (An official summary and a Joint Committee on Taxation revenue estimate are available.)

The provision, the full impact of which has not been studied, could unnecessarily increase administrative costs and complexity for plan sponsors and adversely affect individuals who depend on high deductible health plans, coupled with HSAs, for health coverage. A letter to all House members was sent, urging its removal from H.R. 5719 and suggesting further examination of the issue. The letter also argues that the rules governing FSAs are not necessarily applicable to HSAs, and the provision should be considered separately on its own health care policy merits – not as a revenue-raising measure to offset the cost of completely unrelated legislation. A similar letter was sent to the House Ways and Means Committee on April 8, urging them to delay action on this issue.)

Representative Paul Ryan (R-WI) introduced an amendment that would have eliminated the HSA provision, but the amendment was defeated by a vote of 15 to 25. Representatives Jim McCrery (R-LA), the committee's ranking Republican, and Sam Johnson (R-TX) also spoke out against the HSA provision during general debate.

The Ways and Means Committee is the only House committee with jurisdiction over H.R. 5719. There is not yet a timetable for consideration of the bill by the full House.

The Bush Administration released a statement of administration policy indicating that if H.R. 5719 were presented to the President with these provisions, his senior advisors would recommend he veto the bill.

RECENT REGULATORY ACTIVITY

CBO Letter Analyzes PBGC Shift in Investment Strategy

The Congressional Budget Office, in response to a recent request by House of Representatives Education and Labor Committee Chairman George Miller (D-CA), has provided a brief analysis of the new investment policy recently adopted by the Pension Benefit Guaranty Corporation (PBGC). The PBGC, the governmental agency that insures defined benefit pension plans, has adjusted its strategy to diversify its invested assets including an increase of investment in equities: The PBGC will allocate 45 percent of its assets to a diversified set of fixed-income investments, 45 percent to diversified equity investments and 10 percent to alternative investment classes.

The CBO analysis concludes that "if policies governing future premiums and benefits remain unaffected by the new investment policy, taxpayers' increased risk of substantial losses will be balanced by the higher expected returns that the new policy allows. However, if the higher expected returns mean that premiums are reduced or benefits increased relative to what would otherwise occur, plan sponsors or beneficiaries will reap some of the benefits of the change in investment policy, but taxpayers will bear the added risks."

The CBO further suggests that additional tightening of defined benefit pension funding rules may be necessary, stating that "the funding reforms implemented by the PPA fail to address the underlying structural problems facing PBGC because the increased premiums are not commensurate with the amount of unfunded pension claims from terminated plans that PBGC is likely to assume in the future."

The previous investment strategy was consistently questioned and calculation assumptions of the PBGC, recommending in the September 2005 report Promises to Keep: The True Nature of the Risks to the Defined Benefit Pension System that the agency employ an investment strategy with more appropriate use of equities for long-term growth.

The CBO analysis may provide a rationale for those in Congress who might wish to consider further revisions of the defined benefit pension funding rules.

DOL Corrects QDIA Regulations, Issues Further Guidance

The Department of Labor (DOL) recently released correcting amendments to the final qualified default investment alternative (QDIA) regulations published on October 24, 2007 and a Field Assistance Bulletin (FAB) providing guidance clarifying the QDIA regulations. The DOL also revised its fact sheet on QDIAs.

The correcting amendments modify three provisions in the final regulations — one in the preamble to the regulations and two in the final regulation itself — and are effective on the date they are published in the Federal Register, which was expected to be April 30, 2008, but apply on and after December 24, 2007. The QDIA regulations provide fiduciary liability protection for certain default investments when a participant does not make an investment selection such as would occur with automatic enrollment arrangements.

The first amendment relates to the preamble and addresses the restriction-free 90-day period required for QDIAs under the final regulations. The amendment revised one of the examples provided in the preamble and made clear that "round-trip" restrictions (restrictions on reinvesting in the QDIA following a transfer out of the QDIA) generally are not prohibited by the final regulations. However, the amendment contains some caveat language about affecting the participant's ability to liquidate or transfer from a QDIA that should be reviewed by plan fiduciaries planning to use a QDIA with round-trip restrictions.

Second, the DOL expanded the list of persons who may manage QDIAs to include a committee of the plan sponsor (in addition to the plan sponsor itself) that is a named fiduciary of the plan and comprised primarily of employees of the plan sponsor. Third, the amendments revised the description of "grandfathered" stable value products and funds to eliminate language indicating that a stable value fund must be "designed to guarantee" principal and a rate of return and instead requires products "designed to preserve principal…[and] provide a rate of return" consistent with intermediate investment grade bonds. In addition, the amendment further provided that "stable value products or funds [must] invest primarily in investment products that are backed by state or federally regulated financial institutions."

The FAB provided clarification question and answers in the following areas:

- Scope of the regulation;
- Notice requirements;
- Limitations on fees and restrictions during the 90-day period following the initial default investment;
- QDIA management and asset allocation;
- The 120-day capital preservation QDIA; and
- Grandfather relief for stable value funds.

Follow-up: IRS Regulations for Minimum Required Pension Contributions

As you may be aware, the Treasury Department (Treasury) and the Internal Revenue Service (IRS) have released proposed regulations on minimum required contributions under the new funding rules enacted by the PPA that apply to single-employer defined benefit plans. According to the IRS and Treasury, the new proposed regulations – together with three other sets of regulations previously released (the proposed mortality tables for determining asset values, proposed regulations on the determination of plan assets and benefit liabilities and proposed regulations on benefit restrictions and use of credit balances) – should allow plan sponsors to determine minimum required contributions under the new PPA rules, including any required quarterly contributions.

The new funding rules under PPA are generally effective for single-employer defined benefit plans for plan years beginning in 2008, and the proposed regulations are proposed to be effective for plan years beginning in 2009. However, the regulations indicate plan sponsors can rely on the proposed regulations for purposes of meeting minimum contribution rules for 2008. Written comments on the proposed regulations are due by July 14 and a public hearing will be held on August 4.

The proposed regulations provide guidance on determining the new minimum required contributions based on whether the value of plan assets, reduced by certain funding [credit] balances exceeds the plan's funding target for the plan year. The regulations reflect the transition rule that phases in the 100 percent funding target and provides for taxes upon failure to meet minimum funding standards. The regulations also request comment on whether it should add a "deemed election" to use a funding [credit] balance to avoid a failure to make a quarterly contribution.

One significant issue, particularly for plan sponsors intending to use their credit balances to satisfy their quarterly contribution requirements, is the regulations appear to require that plan sponsor to make an affirmative election to use the credit balance for the payment prior to the due date for the quarterly payment. The quarterly payments were due April 15 but the proposed regulations were released April 11 and published April 14, leaving insufficient time to digest the regulations and implement the new requirement. This timeframe supports the need for a good faith standard for plan years beginning in 2008.

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