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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 Christopher M. Smith, Employee Benefits attorney and Principal of Flexible Benefits Systems, Inc., csmith@fbsi.com.

Articles in this Edition

RECENT LEGISLATIVE ACTIVITY

House and Senate Recess, to Return November 15

The U.S. Senate and House of Representatives voted to recess their sessions on September 29 and will return on November 15, after the mid-term elections. Lawmakers may still hold hearings, but no votes will be taken during the recess. When Congress returns, Democratic leaders will set the agenda for a possible "lame duck" session prior to final adjournment for the year.

Senate Defeats Resolution to Reject PPACA Grandfather Rules

In a procedural vote on September 29, the U.S. Senate defeated **a Senate Joint resolution (S.J. Res. 39)**, offered by Health, Education, Labor and Pensions Committee ranking Republican member Michael Enzi (R-WY), expressing "disapproval of the grandfathered health plan regulation," in reference to the interim final regulations (IFR) implementing the "grandfather" provisions of the Patient Protection and Affordable Care Act (PPACA). The resolution would also have subjected the grandfather rule to the Congressional Review Act, which in turn provides a mechanism for Congress to vote on whether to overturn regulations.

The interim final rules were released on June 17, along with a fact sheet, a table on applicability of provisions to grandfathered plans and DOL model disclosure language.

The resolution sponsored by Senator Enzi was supported by a number of organizations representing primarily small employers, including the U.S. Chamber of Commerce, the Small Business & Entrepreneurship Council, the National Association of Manufacturers and the National Retail Federation. The White House released a statement of administration policy in opposition to the resolution, arguing that it "would undermine important protections offered to Americans and businesses under [PPACA]".

Though the resolution has been defeated, the issue could receive renewed attention if Republicans gain a majority in Congress following the November election, or if the courts rule adversely on certain elements of PPACA.

Congress Approves Small Business Bill Including Plan Conversion Language, President Obama Signs Bill

On September 23, the U.S. House of Representatives approved, by a vote of 237-187, the Small Business Jobs and Credit Act (H.R. 5297) a small business tax bill including revenue-raising language providing for conversions of traditional pre-tax contributions to "Roth"-style (post-tax) contributions within a defined contribution plan. The Senate approved the measure by a vote 61-38 on September 16. No changes were made to the Senate bill before it was passed by the House. The bill was signed into law by President Obama on September 27, 2010.

Specifically, H.R. 5297 provides for "in-plan" conversions from traditional 401(k) or 403(b) defined contribution plan accounts to "Roth"-style accounts (for amounts that would otherwise be distributable from the plan) and creation of Roth accounts for state and local 457 plans. The measure also provides for partial annuitization of a nonqualified annuity contract. Holders of nonqualified annuities (i.e., annuity contracts held outside of a tax-qualified retirement plan or IRA) may elect to receive a portion of the contract in the form of a stream of annuity payments (and remit income taxes accordingly), leaving the remainder of the contract to accumulate income on a tax-deferred basis.

Some employers have expressed an interest in allowing the "in-plan" conversions but timing considerations remain a concern. Although the provision would be effective upon enactment, immediate implementation may be difficult. Some participants are interested in converting during 2010 because tax rates are scheduled to increase in 2011 (legislative activity may prevent all or some of the scheduled increases). Alternatively, some participants want to defer taxation of the conversion income for two years (half each in 2011 and 2012), a possibility only available for 2010 conversions.

Worker Classification Bill Introduced in Senate, House

On September 15, Senator John Kerry (D-MA) and Representative Jim McDermott (D-WA) each introduced the Fair Playing Field Act (S. 3786 in the Senate, H.R. 6128 in the House of Representatives), legislation to prevent certain workers from being classified as independent contractors. An official draft summary of the legislation is available. Such legislation would dramatically impact employment practices and benefit plans, and raise significant federal revenue.

Under current law, a “safe harbor” permits employers to treat a worker as not being an "employee" for employment tax purposes unless the employer has no reasonable basis for such treatment or fails to meet certain requirements. Specifically, S. 3786/H.R. 6128 will:

- end the moratorium on Internal Revenue Service (IRS) guidance addressing worker classification;
- require the Treasury Department to issue prospective guidance clarifying the employment status of individuals for federal employment tax purposes;
- increase penalties on employers for failure to deduct and withhold income taxes and the employee’s share of FICA taxes;
- require those who employ independent contractors on a regular and ongoing basis to provide a written statement to each independent contractor of the federal tax obligations of independent contractors, the labor and employment law protections that do not apply to independent contractors, and the right of the independent contractor to seek a status determination from the IRS; and
- require the Treasury Department to issue annual reports on worker classification.

S. 3786 has been referred to the Senate Finance Committee and H.R. 6128 has been referred to the House Ways and Means Committee. According to a news release from Kerry's office, President Obama has already given the legislation his endorsement. (In 2007 then-Senator Obama (along with the late Senator Edward Kennedy (D-MA)) introduced the Independent Contractor Proper Classification Act (S.2044).)

Senator Sherrod Brown (D-OH) and Representative Lynn Woolsey (D-CA) introduced similar worker classification legislation, the Employee Misclassification Prevention Act (EMPA, S. 3254/H.R. 5107), in April. S. 3254 was referred to the Senate Health, Education, Labor and Pensions (HELP) Committee and H.R. 5107 was referred to both the House Education and Labor Committee and the Ways and Means Committee.

Congress is not expected to take action on worker classification measures before the end of the year, but the introduction of new legislation suggests increased attention on this issue in future months. The Obama Administration's Fiscal Year 2011 budget includes legislative proposals to "increase certainty with respect to worker classification" (See page 179 of the Office of Management and Budget's Analytical Perspectives document) and the U.S. Treasury

Department's General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals document estimates that new worker classification standards could raise $7.3 billion over ten years, with an additional $376 million in possible penalties.

Tax Extenders Bill Introduced Including Pension Relief Act Technical Corrections

Senate Finance Committee Chairman Max Baucus (D-MT) has introduced the Job Creation and Tax Cut Act, also known as tax "extenders" legislation, including technical corrections to the defined benefit pension funding relief provisions of the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief (PRA) Act (H.R. 3962). An official summary is also available, along with a list of modifications from the American Jobs and Closing Tax Loopholes Act (H.R. 4213), the original tax extenders bill introduced on June 23.

The bill primarily extends certain expiring tax provisions for individuals, families and employers, including a one-year extension of the research and development tax credit.

Most notably for employer sponsors of defined benefit pension plans, the legislation includes a narrow list of technical corrections to the PRA provisions of H.R. 3962, including:

- A correction that allows relief with respect to a year if the due date for contributions for that year occurs on or after March 10, 2010, rather than on or after the date of enactment (June 25, 2010);
- A correction to the effective date of the provision providing relief for Social Security "level income options" from the prohibited payment rules applicable to certain underfunded plans, so that the relief is prospective only;
- A one-year extension of the relief from the rule requiring underfunded plans to be frozen, so that if a plan is at least 60% funded for 2008, it need not be frozen in 2009, 2010, or 2011;
- A series of provisions correcting and strengthening relief for multiemployer plans; and
- A modification of the definition of an eligible charity plan. (Under the June legislation, such plans are retroactively subject to the pre-PPA funding rules. Under the modification, the definition is narrowed so that it only applies to plans that are maintained by charities that serve children and that operate in at least 20 states. Also, a plan is not an eligible charity plan unless the plan sponsor elects to be so treated. Finally, the provision is effective for 2010 unless the plan sponsor elects to have the provision apply earlier. These changes would solve the problem that some plans were being inadvertently made subject to the pre-PPA funding rules on a retroactive basis. On the other hand, this provision takes away relief from some charities that might have wanted their plans to be treated as eligible charity plans.)

The tax extender language, including the PRA technical corrections, had previously been attached to, and then removed from, the Small Business Jobs Act (H.R. 5297).

GAO Report Examines State and Local Government Pension Plans

On September 20, the Government Accountability Office (GAO) issued the report State and Local Government Pension Plans: Governance Practices and Long-term Investment Strategies Have Evolved Gradually as Plans Take on Increased Investment Risk. The report, requested by Senator Charles Grassley (R-IA), ranking Republican member on the Senate Finance Committee, examines who makes investment decisions for state and local defined benefit pension plans and what guides their decision making; how plans allocate their assets and manage their investments; and practices that plans are using to meet a range of challenges in governance, investment, or funding.

As private-sector defined benefit pension plan sponsors are aware, funding volatility has significantly diminished the asset value of pension plans worldwide. In particular, state and local plans, which are not covered by ERISA, are estimated to have unfunded liabilities in the hundreds of billions of dollars. The struggles of these plans to meet their future obligations could motivate lawmakers to develop new pension reform legislation that could include provisions that affect employer-sponsored ERISA plans as well.

The GAO report finds that state and local plans reported gradually changing their asset portfolios over many years by increasing their allocations in higher risk investments, with about two-thirds of public pension funds invested in such higher risk assets. This has been partly in pursuit of higher returns, but also for diversification, following well-accepted techniques of portfolio management given their long investment horizon. The plans surveyed by GAO reported having sufficient assets to cover years of benefit payments. Still, an estimated 60 percent of large and medium plans anticipate changes to their investment strategies in response to the current economic environment.

RECENT REGULATORY ACTIVITY

HHS Issues Statement Offering Flexibility in MLR Standards under PPACA

On September 30, the U.S. Department of Health and Human Services Office of Consumer Information and Insurance Oversight released **a public statement** suggesting some flexibility in the application of medical loss ratio (MLR) standards to certain plans – including limited benefit or "mini-med" plans – under interim final regulations (IFR) for patient protections under the Patient Protection and Affordable Care Act (PPACA).

The statement acknowledges that questions have arisen regarding the applicability of new MLR standards to limited benefit plans. As a September 30 *Wall Street Journal* article indicates, the 2011 requirement that a plan sponsor spend at least 80 to 85 percent of its premium revenue on medical care "may be unrealistic for mini-med plans because of high administrative costs owing to frequent worker turnover, combined with relatively low spending on claims." The U.S. departments of Treasury, Labor and Health and Human Services (HHS) are currently developing regulations on MLR standards based on recommendations developed by the National Association of Insurance Commissioners (NAIC), as required under the new law.

HHS has already provided a waiver process, which according to the guidance, health plans or health insurers may apply for a waiver from the restricted annual limits set out in the IFR if such a plan or the coverage offered by such an issuer was offered prior to September 23, 2010 for the plan or policy year beginning between September 23, 2010 and September 23, 2011. Applications must include:

- The terms of the plan or policy form(s) for which a waiver is sought;
- The number of individuals covered by the plan or policy form(s) submitted;
- The annual limit(s) and rates applicable to the plan or policy form(s) submitted;
- A brief description of why compliance with the interim final regulations would result in a significant decrease in access to benefits for those currently covered by such plans or policies, or significant increase in premiums paid by those covered by such plans or policies, along with any supporting documentation; and

- An attestation, signed by the plan administrator or Chief Executive Officer of the issuer of the coverage, certifying (1) that the plan was in force prior to September 23, 2010; and (2) that the application of restricted annual limits to such plans or policies would result in a significant decrease in access to benefits for those currently covered by such plans or policies, or a significant increase in premiums paid by those covered by such plans or policies.

The guidance further states that HHS will process complete waiver applications within 30 days of receipt, with the exception that complete applications submitted for plan or policy years beginning before November 2, 2010, will be processed no later than five days in advance of such plan or policy year. A waiver approval granted under the process will apply only for the plan or policy year beginning between September 23, 2010, and September 23, 2011. A group health plan or health insurance issuer must reapply for any subsequent plan or policy year prior to January 1, 2014 when the waiver expires in accordance with future guidance from HHS.

The HHS statement indicates that HHS will exercise some discretion in implementing this element of the new law, noting that "According to the Affordable Care Act, medical loss ratio 'methodologies shall be designed to take into account the special circumstance of smaller plans, different types of plans, and newer plans.' The [HHS] Secretary recognizes that mini-med plans are often characterized by a relatively high expense structure relative to the lower premiums charged for these types of policies. We intend to address these and other special circumstances in forthcoming regulations."

New PPACA Guidance Released, Including Enforcement Grace Period for Certain Appeals Standards and Clarification of "Adult Child" Coverage

Late on September 20, the U.S. Departments of Labor (DOL), Treasury and Health and Human Services collectively issued new guidance relating to implementation of the Patient Protection and Affordable Care Act (PPACA). The new guidance includes DOL Technical Release 2010-02 regarding internal claims and appeals, a revised model notice of adverse benefit determination and a set of "frequently asked questions" (FAQs).

DOL Technical Release 2010-02

On July 22 the regulatory agencies issued interim final regulations (IFR) relating to internal claims and appeals and external review processes under PPACA. The agencies subsequently released guidance along with Technical Release 2010-01, relating to interim procedures for self-insured plans with respect to the federal external review process. The guidance essentially established an interim enforcement safe harbor that applies for plan years beginning on or after September 23, 2010 and until superseded by future guidance.

The newly issued DOL Technical Release 2010-02 sets forth an enforcement grace period through July 1, 2011 for employers and health plans to comply with several significant changes in the federal claims review and appeals standards and expanded the safe harbor standard for complying with the new external review requirements included in PPACA.

Model Notice of Adverse Benefit Determination

Along with the new technical release, the agencies have issued a revised model notice of adverse benefit determination (Microsoft Word version | PDF version), eliminating confusion in the earlier version issued on August 23 regarding the application of shortened timeframes for initial determinations with respect to urgent claims.

Frequently Asked Questions and Answers

The agencies have also issued a new Frequently Asked Questions (FAQ) document, the first in a series of FAQs providing guidance to a range of issues of concern to plan sponsors and service providers. This initial document covers issues relating to:

- Grandfathered health plans;
- Claims, internal appeals, and external review;
- Dependent coverage of children;
- Out-of-network emergency services; and
- Highly compensated employees.

Included in the FAQ document is a clarification regarding the definition of “adult child” for purposes of PPACA’s requirement for coverage for such individuals until age 26. According to Question 14 of the new guidance, plans may limit coverage for children up to age 26 to only those children described in section 152(f)(1) of the Internal Revenue Code (this section defines children to include sons, daughters, stepchildren, adopted children (including children place for adoption) and foster children). The new guidance further states that for an individual who is not described in 152(f)(1), including grandchildren, nieces and nephews, plans may impose additional conditions for eligibility for health coverage, such as a condition that the individual be a dependent for tax purposes.

The FAQ document also states that the agencies' approach to implementation "is and will continue to be marked by an emphasis on assisting (rather than imposing penalties on) plans, issuers and others that are working diligently and in good faith to understand and come into compliance with the new law. This approach includes, where appropriate, transition provisions, grace periods, safe harbors, and other policies to ensure that the new provisions take effect smoothly, minimizing any disruption to existing plans and practices."

IRS Issues Request for Comments on Nondiscrimination Requirements Under PPACA; Additional Guidance to Be Released Shortly

On September 20, the U.S. Department of the Treasury and Internal Revenue Service (IRS) issued Notice 2010-63, inviting public comments concerning the application of rules prohibiting insured group health plans from discriminating in favor of highly compensated individuals under the Patient Protection and Affordable Care Act (PPACA). The U.S. Departments of Labor and Health and Human Services reviewed and endorsed the Notice as well. The Treasury Department and IRS are considering issuing guidance on the extension of nondiscrimination rules to insured plans as required by PPACA.

The PPACA amended the Public Health Service (PHS) Act to extend the Internal Revenue Code Section 105(h) nondiscrimination rules to insured health plans. PPACA prohibits fully-insured group health plans from discriminating in favor of highly compensated individuals with respect to eligibility and benefits. These requirements apply to non-grandfathered plans and are effective for plan years beginning on or after September 23, 2010. The rules of section 105(h) continue to apply to any self-insured plan regardless of whether the plan is a grandfathered plan.

Notice 2010-63 explains that if a self-insured plan fails to comply with Code section 105(h), highly compensated individuals lose a tax benefit; whereas if an insured group health plan fails to comply with Code section 105(h), the plan is subject to civil action to compel it to provide nondiscriminatory benefits and the plan or plan sponsor is subject to an excise tax or civil money penalty of $100 per day per individual discriminated against.

The Notice requests comments from interested parties regarding what additional guidance relating to the application of section 105(h)(2) would be helpful with respect to insured group health plans.

IRS Publishes Guidance on FSA, HRA, HSA, MSA Reimbursement of OTC Drugs

On September 3, The Internal Revenue Service (IRS) issued guidance regarding revision to the definition of medical expenses as it relates to over-the-counter (OTC) drugs and reimbursement under flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs), health savings accounts (HSAs), and Archer Medical Savings Accounts (Archer MSAs) under the Patient Protection and Affordable Care Act (PPACA).

PPACA includes several statutory changes under which the cost of an OTC medicine or drug cannot be reimbursed from FSA or HRA accounts unless a prescription is obtained. (The change does not affect insulin, even if purchased without a prescription, or other health care expenses such as medical devices, eye glasses, contact lenses, co-pays and deductibles.) The new standard applies only to purchases made on or after January 1, 2011, so claims for medicines or drugs purchased without a prescription in 2010 can still be reimbursed in 2011, if allowed by the employer's plan. A similar rule goes into effect on the same day for Health Savings Accounts (HSAs), and Archer Medical Savings Accounts (Archer MSAs).

IRS Notice 2010-59 and Revenue Ruling 2010-23 officially implement these PPACA changes. The current rules are set forth in IRS Publication 969.

FASB Approves Position on Retirement Plan Loans

The Financial Accounting Standards Board (FASB) unanimously approved its position on the reporting of loans to participants from defined contribution plans. As set forth in the Emerging Issues Task Force (EITF) Topic 10-C exposure draft, participant loans should be classified as notes receivable from participants in the financial statements of a defined contribution pension plan, measured at the outstanding principal amount plus accrued but unpaid interest.

An employee benefit plan should apply the classification guidance retrospectively to all prior periods presented. The amendments to the Accounting Standards Codification resulting from this consensus are effective for fiscal years ending after December 15, 2010, with early adoption permitted.

In 2008, the Senate Special Committee on Aging held the hearing Saving Smart for Retirement: Are Americans Being Encouraged to Break Open the Piggy Bank? focusing on "leakage" — the depletion of retirement assets prior to retirement age, with particular attention to plan loans.

FASB Proposes New Multiemployer Plan Disclosure Rules

In an August 18 exposure draft, Plan Accounting—Defined Contribution Pension Plans (Topic 962): Reporting Loans to Participants by Defined Contribution Pension Plans (A consensus of the FASB Emerging Issues Task Force), the Financial Accounting Standards Board (FASB) proposed new financial reporting disclosure rules for entities that participate in multiemployer pension and other postretirement benefit plans, including retiree medical plans. FASB is the designated organization in the private sector for establishing standards of financial accounting and reporting.

Currently, employers are required to disclose the total contributions made to multiemployer plans but not the plans' funding status. The proposal substantially increases these requirements to "help users of financial statements better assess the potential risks faced by employers participating in multiemployer plans." These expanded disclosures include a description of the plans in which the employer is involved, the employer's contractual commitments to the plans, and the expected impact of participating in the plans on the employer's future cash flows (including the potential impact of plan withdrawal obligations). See Page 7 of the exposure draft for a full list of the required disclosures.

Under the exposure draft, public companies would be required to provide the enhanced disclosures for fiscal years ending after December 15, 2010, and in subsequent fiscal years. A non-public company would be required to provide the enhanced disclosures for fiscal years beginning on or after December 15, 2010, and in subsequent fiscal years (one year later than a public company). Separate disclosures would be required for all post-employment benefit plans and for overfunded and underfunded plans.

FASB is soliciting comments on the proposal through November 1, 2010.

RECENT JUDICIAL ACTIVITY – NO ACTIVITY TO REPORT THIS MONTH