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Articles in this Edition

RECENT LEGISLATIVE ACTIVITY

House, Senate Pass Transportation-Student Loan Package with Pension Provisions, Including Funding Stabilization

The U.S. Senate and House of Representatives each passed the conference report of the Moving Ahead for Progress in the 21st Century (MAP-21) Act (H.R. 4348), a legislative package combining an extension of surface transportation funding and an extension of the federal student loan interest rate. A summary of the changes in the conference agreement is also available, as is a Congressional Budget Office cost estimate of the bill.

The package includes over $18 billion in federal revenue offsets in the form of defined benefit pension funding interest rate stabilization and Pension Benefit Guaranty Corporation (PBGC) single-employer premium increases. The conference agreement also includes a number of other significant benefits provisions, including new PBGC governance requirements and a provision allowing the transfer of excess pension assets to fund retiree health benefits.

House Approves Legislation Addressing Consumer-Directed Health Arrangements

On June 7, the U.S. House of Representatives approved a package of three health-related measures previously approved by the Ways and Means Committee. The final bill, the Protect Medical Innovation Act (H.R. 436) incorporates three bills previously approved by the Ways and Means Committee:

- The Restoring Access to Medication Act (H.R. 5842), which would repeal the current disqualification of over-the-counter (OTC) drugs as eligible purchases through Health Savings Accounts (HSAs) and Flexible Spending Arrangements (FSAs). (This tax change was enacted as part of the Patient Protection and Affordable Care Act (PPACA) in 2010.) A new Congressional Budget Office (CBO) revenue score estimates the cost of H.R. 5842 at approximately $4 billion over ten years.
- The Medical Flexible Spending Account Improvement Act (H.R. 1004), which would allow participants to cash out up to $500 of any remaining FSA balances at the end of the FSA plan year (including any grace period allowed by the plan), with those funds treated as ordinary, taxable wages. A new CBO revenue score estimates the cost of H.R. 1004 at approximately $4 billion over ten years.
- The Protect Medical Innovation Act (the original H.R. 436), which would repeal the current excise tax on medical devices. A new CBO revenue score estimates the cost of this provision at more than $29 billion over ten years.

House Republicans have not yet revealed a floor strategy for H.R. 5858, an untitled bill – also approved by the Ways and Means Committee on May 31– that would make a number of modest improvements to HSAs, such as (1) permitting veterans who receive medical benefits for a service-connected disability under a program of the Department of Veterans Affairs to be eligible to contribute to an HSA; (2) allowing distributions from HSAs to be used by retirees between the ages of 55 and 65 to pay for retiree health insurance under an employer-sponsored health plan; (3) allowing spouses who are at least 55 years old to contribute their combined "catch-up" contribution to one HSA; and (4) providing a 60-day window after an individual's high deductible health plan coverage begins for an HSA to be established and used to pay for qualified medical expenses within that 60-day period. A new CBO score estimates the cost of

H.R. 5858 at $4.7 billion over ten years. A Joint Committee on Taxation summary of the measure is also available.

During initial Ways and Means Committee consideration of these measures, Democrats decried the collective cost of the bills and the lack of a stated “pay-for” to offset the revenue loss. To offset the total federal revenue cost, The Health Care Cost Reduction Act also includes language to recapture overpayments resulting from certain federally-subsidized health insurance. The committee previously approved untitled legislation to this effect in an April 18 “mark-up” session designed to identify budgetary savings corresponding with the House budget resolution.

Under Section 1401(36B) of PPACA, a refundable tax credit is available to eligible individuals and families who purchase health insurance through a state health insurance exchange. Eligibility for the credit is extended to individuals (single or joint filers) with household incomes between 100 and 400 percent of the federal poverty level (with phase-outs as income increases) and who do not receive “affordable” health insurance through an employer or a spouse’s employer. Currently, if an individual receives the tax credit but experiences an increase in income or becomes eligible for affordable employer-sponsored insurance coverage, they can still keep a portion of the credit. (The amount of the subsidy that is subject to recapture was previously modified through enactment of the Small Business Paperwork Mandate Elimination Act (H.R. 4), which related to certain information reporting requirements under PPACA.) The committee-approved measure would repeal the present-law provision under which, in the case of an individual with household income below 400 percent of the federal poverty level, liability for an overpayment resulting from excess advance payments is limited to the applicable dollar amount. Thus, under the proposal, an individual would be liable for the full amount of the overpayment. A Joint Committee on Taxation summary of the measure is available.

Despite House passage of the package, Senate Majority Leader Harry Reid (D-NV) has already said that he will not bring it to the Senate floor for a vote and President Obama has indicated that he would veto it. As we have previously noted, the total package will effectively serve as a core component of Republican health care policy proposals and could see further consideration when Congress takes up comprehensive tax reform next year. Though less likely, it is possible these measures could be considered during a post-election “lame duck” session when Congress will have to confront numerous tax and spending measures before the end of 2012.

Senate Finance Committee Examines Comprehensive Tax Reform

On June 19, the U.S. Senate Finance Committee held a hearing, Confronting The Looming Fiscal Crisis, to discuss the need for comprehensive tax reform as a means of addressing the worsening federal debt. The hearing focused specifically on the prevailing 2001 and 2003 tax cuts that expire at the end of the year as well as the federal budget sequestration measures and Medicare physician payment cuts that will take place in 2013.

In his opening statement, Committee Chairman Max Baucus (D-MT) called for “a comprehensive debt reduction plan that does not shock the system with deep, immediate cuts. Instead, we need a practical, responsible plan that gives confidence to the markets and the country.” He outlined a number of principles for deficit reduction, saying that the plan should:

- substantially lower deficits and debt over the next ten years and beyond;

- balance spending cuts with revenue increases;
- stabilize and decrease debt held by the public as a percent of GDP, progressing slowly to allow the recovery to continue;
- not count any Social Security changes towards deficit and debt reduction; and
- meet the nation's obvious political challenges.

Deficit reduction (and these principles) comprises a prominent element of Baucus' framework for comprehensive tax reform, as outlined in a June 11 release. This framework also incorporates incentives for job growth, education improvements, commercial competitiveness and innovation.

Comprehensive tax reform – and, by extension, debt reduction – may pose a threat to certain fundamental aspects of employer-sponsored benefit programs. Numerous budget proposals, such as those developed by President Obama and House of Representatives Budget Committee Chairman Paul Ryan (R-WI) — as well as various bipartisan deficit commissions — have generally advocated fundamental tax reform under which income tax rates might be lowered and the tax base broadened by reducing or eliminating certain exclusions and deductions in the Internal Revenue Code. Such tax preferences include the exclusion of employer contributions for health insurance premiums and the deferral on contributions to retirement plans.

For example, Page 261 of the Analytical Perspectives document of President Obama's Fiscal Year 2013 budget, lists federal income tax expenditures ranked by total Fiscal Year 2013-2017 projected revenue effect. According to this table, the largest expenditure is the "exclusion of employer contributions for medical insurance premiums and medical care," accounting for more than $1 trillion of foregone tax revenue over the next five years. If we combine the tax deferrals for 401(k) plans and the tax exclusion for employer-provided pension contributions and earnings, the total foregone tax revenue is $728.8 billion over the next five years, which would be No. 2 on the list.

A March 22 report by the Congressional Research Service (CRS, a nonpartisan congressional think tank), The Challenge of Individual Income Tax Reform, examined some of the challenges underlying broad-based tax reform and found that only 39 percent of surveyed taxpayers were willing to sacrifice their tax exclusion for 401(k) plan contributions in return for a lower tax rate. Similarly, only 40 percent were willing to sacrifice the exclusion for employer-provided health insurance in return for a lower tax rate.

Nevertheless, proposals to change the tax treatment of benefit plans continue to receive attention on Capitol Hill. The two witnesses at the Senate Finance Committee hearing, former Senator Pete Domenici (R-NM) and former CBO and OMB Director Alice Rivlin (co-chairs of the Bipartisan Policy Center's (BPC) Debt Reduction Task Force) described the BPC's recently revised tax reform plan.

Besides simplifying and lowering income tax brackets and increasing the tax rates on capital gains and dividends, the BPC plan would adjust the tax treatment of employer-sponsored retirement benefit by providing a flat 15 percent refundable tax credit or a deduction (for those in the higher bracket) for contributions to retirement savings accounts (such as 401(k) plans) up to 20 percent of earnings or a maximum of $20,000.

The BPC plan would also cap and phase out over 10 years (beginning in 2015) the tax exclusion for employer-sponsored health insurance benefits.

The discussion portion of the hearing focused largely on the treatment of Medicare and Social Security. Though the panel's Democrats and Republicans as well as the witnesses agreed that entitlement reform will be essential in the coming years, they differed over methods (for example, the BPC suggests converting Medicare to a premium-assistance model with block grants, a strategy opposed by Democrats) and the context for entitlement reform (i.e., whether it should be part of tax reform and deficit reduction or considered on a separate track).

While lawmakers are unlikely to pursue comprehensive tax reform in earnest this year, Baucus' proposed framework and this hearing set the stage and established the parameters of policy discussions to take place in the coming months.

House Subcommittee Hears Testimony on Multiemployer Plans

The U.S. House of Representatives Education and the Workforce Committee's Subcommittee on Health, Employment, Labor, and Pensions held a June 20 hearing, Assessing the Challenges Facing Multiemployer Pension Plans, to discuss the obstacles to the long-term strength of these plans, including an aging workforce and a recovering economy. A number of multiemployer plan funding provisions from the Pension Protection Act of 2006 (PPA) are set to expire in 2014.

A news advisory announcing the hearing cited a Segal Company analysis that found approximately 27 percent of multiemployer plans are in "critical status" due to significant financial weaknesses. The hearing also set out to examine the role of the Pension Benefit Guaranty Corporation (PBGC), which estimates its future financial assistance to these plans at nearly $4.5 billion.

Subcommittee Chairman Phil Roe (R-TN) noted this statistical data as well as a recent Credit Suisse study that found multiemployer pensions to be collectively underfunded by approximately $369 billion, with only a small fraction of these plans considered stable and healthy. "While some plans have made responsible decisions to help ensure their long-term success, an aging workforce, weak economy, investment losses, and unsustainable promises are placing a great deal of strain on the multiemployer pension system. … While some pension plans are financially sound and prepared to meet their obligations, it is becoming increasingly clear the depth and breadth of the challenges facing the system will demand significant reform," Roe said.

The committee heard testimony from the following witnesses:

- Scott M. Henderson, treasurer and vice president for the Kroger Co., offered an overview of his company's multiemployer plan experience and called for greater flexibility for companies to use in meeting their funding obligations.
- Judy R. McReynolds, president and CEO of Arkansas Best Corporation, discussed the pension challenges faced by her company's largest operating subsidiary, ABF Freight System. "The biggest challenge to ABF's long-term viability and its competitiveness within the trucking industry is the current and future liabilities it faces under many of the multiemployer pension plans to which it contributes," she said. She also noted that "PBGC lacks the resources to fulfill the multiemployer plan obligations it expects to incur

under current law," and urged that lawmakers take steps to encourage more plan sponsorship.

- Michael Sander, administrative manager of the Western Conference of Teamsters pension plan, described the plan's efforts to achieve adequate funding in the current economic environment. He praised Congress for acting to provide funding relief to multiemployer plans in 2010.
- Josh Shapiro, deputy director for research and education at the National Coordinating Committee for Multiemployer Plans, identified a number of key objectives for future multiemployer plan funding rules, including regulatory flexibility and reduction in financial risks for plan sponsor companies.
- John F. Ring, partner at Morgan, Lewis & Bockius LLP, described the many layers of legislative regulatory oversight for multiemployer pension plans and recommended a number of reform options, including promoting mergers or multiemployer plan "alliances," allowing for partitioning of certain participants and beneficiaries, permitting reduction of vested benefits under certain limited circumstances and changing current law to avoid the imposition of employer contribution rates that are not sustainable.

The legislative and regulatory treatment of multiemployer plans is significant because they face similar pressures as the single-employer plan system. Though the two systems are subject to different rules, relief for one system can come in tandem with the other.

RECENT REGULATORY ACTIVITY

EBSA Chief Outlines Forthcoming Revised Fiduciary Definition Proposal

In **a June 20 letter** to the leadership of the U.S. House of Representatives Education and the Workforce Committee, Assistant Secretary of Labor for the Employee Benefits Security Administration (EBSA) Phyllis Borzi provided an update on the U.S. Department of Labor's (DOL) fiduciary definition project.

DOL/EBSA originally issued proposed regulations in October 2010 intended to protect recipients of investment advice from conflicts of interest and self-dealing by clarifying ERISA's fiduciary standards with respect to the providers of such advice. The proposal would have greatly expanded the definition of a fiduciary. However, in the face of bipartisan congressional criticism, DOL announced in September 2011 that EBSA would withdraw and re-propose the regulations. In December 2011, Borzi announced that the agency would re-propose the regulations, including a more vigorous cost analysis, amendments to existing prohibited transaction exemptions (PTEs), one new PTE and an update of DOL Interpretive Bulletin 96-1 (which distinguishes investment education from investment advice).

The June 30 letter follows on a March 21 hearing before the Education and the Workforce Committee to discuss the U.S. Department of Labor's Fiscal Year 2013 budget request, at which committee members pressed Labor Secretary Hilda Solis on the status of the fiduciary definition project. In the letter, Borzi wrote:

- DOL has "consulted extensively" with the Securities and Exchange Commission (SEC) to ensure that the fiduciary rules are not contradictory or overly burdensome;
- The agency is conducting a "more robust economic analysis" that will focus on the economic impact of a new rule on workers, retirees and plan sponsors, using data

obtained by request of financial services industry groups (though, Borzi noted, not the full complement of data the agency had requested); and

- The final proposed rule "will be transparent and fully subject to the appropriate notice-and-comment rulemaking process."

Borzi did not indicate when a re-proposed rule might be publicly released, though recent informal comments by DOL officials appear to indicate the re-proposal will not occur before the November elections.

Senate Committee Examines Possible SEC Money Market Reforms

In a June 21 hearing, Perspectives on Money Market Mutual Fund Reforms, the U.S. Senate Banking, Housing and Urban Affairs Committee heard testimony from U.S. Securities and Exchange Commission (SEC) Chair Mary Schapiro and mutual fund stakeholders on possible forthcoming regulation of money market funds.

In 2010, the SEC changed the rules for money market funds to improve their liquidity and transparency. The SEC is now considering more significant changes to money market fund regulation, including:

- a possible new requirement that a money market fund's net asset value (NAV) "float" on a daily basis; or
- a requirement that the fund hold back some percentage of an investor's shares as a "liquidity fee" for 30 days when investors redeem their shares.

Sponsors of defined contribution and defined benefit plans use money market funds as part of their benefit plan design. These funds are valued by both plan sponsors and participants for their stability and full liquidity. Additionally, many plan sponsors of participant-directed plans use money market funds to satisfy U.S. Department of Labor "low risk investment option" requirements.

In an opening statement, Committee Chairman Tim Johnson (D-SD) said that "questions still remain about what risk [money market] funds present to investors and the American economy, and whether more action needs to be taken to address that risk." He also noted, however, that some funds and users "have raised concerns that new regulatory changes might increase risks or disrupt or damage their operations."

Ranking Republican committee member Richard Shelby (R-AL) was more pointed in his opening statement, noting that the U.S. Treasury Department has "put the U.S. taxpayer in the position of guaranteeing that no other money market fund in the country would 'break the buck'" (i.e., allow the NAV to decline below $1). Shelby also suggested that Federal Reserve Board Chairman Ben Bernanke should be called upon to produce testimony on the subject, since the Fed has also highlighted the need for additional reform.

Schapiro, in her written testimony, said, "While the commission's 2010 reforms made meaningful improvements in the liquidity of money market funds, they remain susceptible to the risk of destabilizing runs." If the risk that a money market fund can "break the buck" persists, Schapiro argued, "policymakers would again be left with two unacceptable choices: a bailout or a crisis." Schapiro went on to discuss the history of money market funds, the perceived risk they pose to the reformed financial system, and the two reform elements the SEC is considering, as described above.

Members of the committee questioned Schapiro thoroughly about the evidentiary basis for her recommendations, including analytical studies and the success or failure of the 2010 reforms. Shapiro acknowledged that these recommendations are her own and do not represent the views of a majority of the SEC commissioners at this time.

Schapiro also conceded that her suggested reforms would come at a cost to users and investors, but pledged to analyze the potential changes to "the full range of costs and benefits," including operational costs, opportunity costs and competitive issues. But she also said that "the costs ... would be far, far outweighed by the benefits of forestalling another potentially devastating run as we saw in 2008."

Asked by Shelby whether the SEC or the Fed should be the primary regulator of money market funds, Schapiro replied that the SEC is a "fine regulator of money market funds," since the funds are investment products, and "the SEC is the federal government's expert on investment products," though that analysis is complicated by the fact that money market funds do not fluctuate like most other investment products.

The committee also heard testimony from a second panel, comprised of other stakeholders in the money market fund universe, with the following witnesses:

- Nancy Kopp, treasurer of the State of Maryland (testifying on behalf of the National Association of State Treasurers), described state and municipal governments' reliance on money market funds for managing short-term investments and ensuring proper cash flow management.
- Paul Schott Stevens, president of the Investment Company Institute, argued that money market funds remained a reliable investment even during the financial crisis and argued that any additional reforms must preserve the stable NAV and ready liquidity that are fundamental to money market funds.
- Christopher Donahue, president, CEO and director of Federated Investors, Inc. (a money market fund manager), described the research that his organization provided to the SEC and suggested that the efforts of certain policymakers "to eliminate risk from money market funds [have] resulted in draconian proposals that would eliminate money market funds, if not altogether, then as a meaningful component of the U.S. cash markets."
- Bradley S. Fox, vice president and treasurer of Safeway, Inc. (testifying on behalf of the U.S. Chamber of Commerce), described the critical role that money market funds play for companies in terms of investment and short-term financing. Fox described how the specific changes under consideration at the SEC would severely limit these funds' utility for company treasurers.
- David S. Scharfstein, Edmund Cogswell Converse Professor of Finance and Banking at Harvard Business School, expressed support for the proposed reforms, which he said would promote a more stable financial system.

Schapiro has not yet obtained the necessary majority of the SEC commissioners to issue proposed regulations, so a timeline for future action is unclear. Committee member Pat Toomey (R-PA) has reportedly indicated that he would consider introducing legislation to block the rules if necessary.

IRS Proposes New Rules for Defined Benefit Plans in Bankruptcy

On June 20, the Internal Revenue Service (IRS) released proposed regulations that would allow employer plan sponsors in bankruptcy to amend their defined benefit plans to eliminate the issuance of lump sums without violating the anti-cutback rules under the Pension Protection Act of 2006 (PPA). Under PPA, employers are prohibited from eliminating lump sums if they do not meet their statutory funding targets.

In particular, the proposed regulations would permit a single-employer plan that is covered under Section 4021 of ERISA to be amended, effective for a plan amendment that is both adopted and effective after August 31, 2012, to eliminate an optional form of benefit (such as a lump sum) that includes a prohibited payment, provided that four conditions are satisfied on the later of the date the amendment is adopted or effective:

- The enrolled actuary of the plan must certify that the plan's adjusted funding target attainment percentage for the plan year that contains the applicable amendment date is less than 100 percent;
- The plan is not permitted to pay any prohibited payment because the plan sponsor is a debtor in a bankruptcy case;
- The court overseeing the bankruptcy must issue an order, after notice to each affected party and a hearing, finding that the adoption of the amendment eliminating that optional form of benefit is necessary to avoid a distress termination of the plan or an involuntary termination of the plan before the plan sponsor emerges from bankruptcy (or before the bankruptcy case is otherwise completed); and
- PBGC must determine that the adoption of the amendment eliminating that optional form of benefit is necessary to avoid a distress or involuntary termination of the plan before the plan sponsor emerges from bankruptcy (or before the bankruptcy case is otherwise completed) and that the plan does not have sufficient assets for guaranteed benefits.

IRS Proposes Easing Reporting and Notice Requirements for Deferred Vested Benefits

On June 20, the Internal Revenue Service (IRS) proposed new regulations that formally designate the Form 8955-SSA as the form used to satisfy the relevant reporting requirements of the former "Schedule SSA" and also permit employers to file an extension for Form 8955-SSA without a signature.

Since the 2009 plan year, all Form 5500s have been required to be filed electronically using the department's new EFAST2 system. Under current law, while employers (and service providers acting on their behalf) are generally provided automatic Form 5500 filing extensions upon filing of a Form 5558 request, Form 8955-SSA extension requests require a plan sponsor signature. The new regulations propose eliminating this requirement, allowing employers to obtain automatic extensions for both the Form 5500 and the Form 8955-SSA through the use of the Form 5558, without the signature requirement.

CCIIO Provides Calculator for SBC Coverage Examples

The Center for Consumer Information and Insurance Oversight (CCIIO) (of the U.S. Department of Health and Human Services Centers for Medicare and Medicaid Services) has released a coverage example calculator that plans and issuers can use to complete the coverage examples for the Summary of Benefits and Coverage (SBC) document as required under the Patient Protection and Affordable Care Act (PPACA). Use of the calculator will be considered as a safe harbor for the first year of applicability. Plans and issuers will be required to provide comprehensive coverage examples, based on information specific to each benefit package, no later than January 1, 2014.

On May 11, the U.S. Departments of Labor (DOL), HHS and Treasury (collectively, "the Departments") jointly issued Frequently Asked Questions (FAQs) About Affordable Care Act Implementation (Part IX) related to the implementation of SBC requirements. As described in FAQ No. 9, which first reported the development of this calculator, "the calculator will allow plans and issuers to input a discrete number of elements about the benefit package. Calculator inputs generally are expected to be taken from data fields used to populate the front portion of the SBC template."

Instructions and model logic (describing the algorithm used to create the calculator) have also been provided.

As clarified in the DOL's previously issued set of FAQs (Part VIII), for group health plan coverage, the regulations provide that, for disclosures with respect to participants and beneficiaries who enroll or re-enroll through an open enrollment period (including late enrollees and re-enrollees), the SBC must be provided beginning on the first day of the first open enrollment period that begins on or after September 23, 2012. For disclosures with respect to participants and beneficiaries who enroll in coverage other than through an open enrollment period (including individuals who are newly eligible for coverage and special enrollees), the SBC must be provided beginning on the first day of the first plan year that begins on or after September 23, 2012.

GASB Updates Public Pension Accounting, Reporting Standards

On June 25, the Governmental Accounting Standards Board (GASB) voted to approve two new standards updating the accounting and financial reporting of public employee pensions by state and local governments. Statement No. 67: *Financial Reporting for Pension Plans*, revises existing guidance for the financial reports of most pension plans. Statement No. 68: *Accounting and Financial Reporting for Pensions*, revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits.

Specifically, Statement No. 67: *Financial Reporting for Pension Plans* builds upon the existing framework for financial reports of defined benefit pension plans, which includes a statement of fiduciary net position (the amount held in a trust for paying retirement benefits) and a statement of changes in fiduciary net position. Statement 67 also expands note disclosures and required supplementary information (RSI) for both defined benefit and defined contribution pension plans and requires the presentation of new information about annual money-weighted rates of return in the notes to the financial statements and in 10-year RSI schedules.

Specifically, Statement No. 68: *Accounting and Financial Reporting for Pensions* requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. Statement No. 68 also enhances accountability and transparency through revised and new note disclosures and RSI, as well as application of the rules to defined contribution plans.

More information is available through **GASB's June 25 news release**. The text of statements 67 and 68 will become publicly available in August.

The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014.

RECENT JUDICIAL ACTIVITY – Nothing to Report This Month