BENEFITS INSIDER
A Member Exclusive Publication

Volume 101, November 1, 2013 (covering news from October 17-31, 2013)

WEB's ***Benefits Insider*** is a bi-monthly member exclusive publication providing the latest developments from Washington, DC, on matters of interest to employee benefits professionals. The content of this newsletter is being provided through 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 2

Benefits Issues on the Table in Budget Conference Negotiations 2

House Approves Measure Including Delay of DOL Fiduciary Definition Rule 5

House Committee Continues Examination of Multiemployer Pension System 6

RECENT REGULATORY ACTIVITY 7

IRS Announces Changes in Retirement Plan Limits for 2014 7

IRS Issues Guidance on FSA Use-It-or-Lose-It Rules 8

HHS Final Rule Indicates Possible Exemptions for Transitional Reinsurance Program Fees 9

PBGC Update: Agency Deficit to Be Announced Soon; Independent Study Released..10

RECENT JUDICIAL ACTIVITY - NOTHING TO REPORT THIS MONTH

RECENT LEGISLATIVE ACTIVITY

Benefits Issues on the Table in Budget Conference Negotiations

As part of the continuing resolution enacted on October 17 to re-open the government (through January 15) and raise the debt ceiling (through February 7), leadership in the U.S. Senate and U.S. House of Representatives agreed to convene Senate-House negotiations, with a December 13 deadline, to reach a final compromise on a budget for Fiscal Year 2014 (which began on October 1).

Most notably, a unified budget could establish a framework for discussions over comprehensive tax and entitlement reform, including whether such reform must be "revenue-neutral" (i.e., fully offset by tax increases and/or spending reductions). Certainly, there is a schism between those who prefer to raise taxes and those who prefer to reduce spending, with some willing to do both as a means of lowering personal and corporate tax rates.

This is a critical matter for sponsors of employee benefit plans because the tax incentives supporting these plans such as the exclusion of employer-paid health care premium contributions and deferrals of tax on contributions to retirement plans, represent foregone federal tax revenue. (According to the President's Analytical Perspectives on the Budget document, the largest projected federal "tax expenditures" over the next five years are the "exclusion of employer contributions for medical insurance premiums and medical care," ($1.2 trillion over the next five years) and the combined tax deferrals for 401(k) plans ($477 billion) and the tax exclusion for employer-provided pension contributions and earnings ($308 billion)).

For example, President Obama's Fiscal Year 2014 budget proposal recommended reductions in the value of itemized deductions and other tax preferences (including employer-sponsored health insurance and employee retirement contributions) to 28 percent, along with a cap on "an individual's total balance across tax preferred accounts to an amount sufficient to finance an annuity of not more than $205,000 per year in retirement" (commonly referred to as "the $3 million cap"). The House and Senate budgets, as described below, contemplate similar reductions in tax incentives. A **new chart**, prepared by Davis & Harman, LLP, describes the tax-raising provisions that have arisen in various budget measures and other contexts.

While many such proposals remain conceptual in nature, complex in practice and unpopular in many corners, any need to raise federal revenue is likely to target benefit plans in some way. The following is a brief review of the competing budget resolutions and the benefits-related provisions that could be "in play" as the negotiations proceed:

Senate

On March 23, the Senate narrowly approved Senate Concurrent Resolution No. 8, its Fiscal Year 2014 budget resolution, by a vote of 50 to 49. The resolution was developed by Senate Budget Committee Chair Patty Murray (D-WA), who also released a blueprint document, Foundation for Growth: Restoring the Promise of American Opportunity. Its focus consists of infrastructure investment, preservation of existing entitlement programs and tax reform to benefit middle-class and lower-income families, though it also includes various provisions affecting employer-sponsored benefits.

- The Senate proposal seeks to reduce the federal deficit by "$975 billion by eliminating loopholes and cutting waste in the tax code that benefits those who need it the least." This

language seems to mirror criticisms of the current defined contribution system that characterize the tax deferral as unfairly favoring higher-paid individuals. Two potential approaches cited in the proposal are "an across-the-board limit on tax expenditures claimed by high-income taxpayers," in the form of limiting the rate of deductibility or imposing a cap on the amount of allowable deductions, or conversion of certain itemized deductions into limited tax credits.

- The Senate proposal projects that measures to realign health provider incentives and payments under the Patient Protection and Affordable Care Act (PPACA) will save $275 billion over 10 years. For employer sponsors, the concern would be that such savings could result in cost-shifting to employer purchasers of health coverage.
- Under the heading "keeping the promise of a secure retirement," the Senate blueprint describes reforms to "rebuild" the private pension system and suggests "establishing risk-based premiums for companies with underfunded pension plans." This could entail increases in premiums paid to the Pension Benefit Guaranty Corporation (PBGC), though no dollar figure is prescribed. Any shift to a more "risk-based" premium system would likely require shifting more responsibility for measuring risk and setting premiums to the PBGC itself.

During Senate debate over the budget resolution, many health benefits-related amendments were considered and approved, including:

- Amendment No. 144, offered by Senator Susan Collins (R-ME), to "restore a sensible definition of full-time employee" under PPACA;
- No. 297, offered by Sen. Orrin Hatch (R-UT), to repeal the PPACA excise tax on medical devices;
- No. 438, offered by Sen. Jeanne Shaheen (D-NH), to "protect women's access to health care, including primary and preventative health care, family planning and birth control, and employer-provided contraceptive coverage" as provided under PPACA;
- No. 624, offered by Sen. Mike Johanns (R-NE), to repeal the $2,500 federal cap on flexible spending accounts, as well as the requirement that individuals obtain a prescription from a physician before purchasing over-the-counter drugs with flexible spending account (FSA) or health savings account (HSA) funds; and
- No. 705, offered by Sen. Robert Menendez (D-NJ), to "address the eligibility criteria for certain undocumented immigrant individuals with respect to certain health insurance plans."

House of Representatives

On March 21, the House approved House Concurrent Resolution No. 25, its Fiscal Year 2014 budget resolution, by a mostly party-line vote of 221 to 207. The resolution was developed by House Budget Committee Chair Paul Ryan (R-WI) and based on the blueprint document Path to Prosperity: A Responsible, Balanced Budget. The House plan is centered around structural changes to federal entitlement programs (Medicare, Medicaid and Social Security) and reductions in discretionary spending while eliminating as much as $4.6 trillion in unspecified tax expenditures to finance a reduction in tax rates.

This proposal also addresses two particular areas of employee benefit plan sponsorship and participation:

- The proposal assumes the full repeal of the Patient Protection and Affordable Care Act (PPACA), projected to save $1.8 trillion over the next ten years. In addition to again proposing overall repeal of the 2010 health reform law, the GOP blueprint specifically calls

for repeal of certain PPACA provisions including the statute's expansion of Medicaid eligibility, the income-related subsidies for health coverage obtained in health insurance exchanges, and the Independent Payment Advisory Board (IPAB). The plan also calls for enactment of medical liability reform with caps on non-economic and punitive damages. Since Republicans were unsuccessful in de-funding PPACA as part of the government shutdown deal, and President Obama's personal commitment to the law, it is extremely unlikely that sweeping changes will be made to the law as part of the budget agreement. However, if problems persist with individuals' ability to sign up for coverage through state insurance exchanges, pressure will again rise to delay the individual mandate.

- The blueprint includes "Reform the Pension Benefit Guaranty Corporation" (PBGC) as one element of its retirement policy agenda, which otherwise focuses on shoring up the Social Security program. While no specific measures are included in the proposal, the blueprint reportedly contemplates $950 million over ten years through increased premiums.

White House

Though it is not yet clear what direct role President Obama will play in the conference negotiations, it is possible that lawmakers will consider elements of his budget proposal from earlier this year. In addition to the revenue measures noted earlier, his Fiscal Year 2014 budget proposal would:

- implement a "Chained Consumer Price Index (Chained CPI)" calculation that would replace the current methodology for calculating cost-of-living adjustments applicable to most federal programs and tax provisions (including Section 415 retirement contribution caps, the excise tax on high cost health plans and many other programs).
- raise $25 billion over ten years by giving the PBGC the authority to set its own risk-based premiums, similar to both the Senate and House approaches.
- establish an "automatic workplace pensions" initiative. Under the proposal, employers who do not currently offer a retirement plan will be required to enroll their employees in a direct-deposit IRA account that is compatible with existing direct-deposit payroll systems. Employees would be permitted to opt-out if they choose. Small employers (ten employees or fewer) would be exempt, though they would also be entitled to an additional credit of $25 per participating employee — up to a total of $250 per year — for six years.
- eliminate "stretch IRAs," meaning that certain non-spouse beneficiaries of IRA owners and retirement plan participants would be required to take inherited distributions over no more than five years.
- repeal the current deduction for dividends or distributions paid with respect to stock held by an ESOP that is sponsored by a C corporation (subject to an exception for C corporations with annual receipts of $5 million or less). The current law rules allowing for immediate payment or use of an applicable dividend would remain intact, without a deduction, and be moved to a different section of the tax code.
- double the small employer pension plan startup credit from $500 a year to $1,000 per year for up to four years under certain circumstances.
- exempt individuals from minimum required distribution requirements if the aggregate value of the individual's IRA and tax-favored retirement plan accumulations does not exceed $75,000 at the beginning of the year in which the individual turns 70½ or, if earlier, the year in which the individual dies.
- support initiatives that would move up the date when states will be eligible to apply for waivers from PPACA to develop their own health reform standards from 2017 to 2014. Currently, states may apply for five-year "State Innovation Waivers" from certain coverage requirements beginning in 2017, as long as the state program provides the same amount

of coverage without increasing the federal deficit. A White House fact sheet supporting state innovation was prepared in February 2011.

- reform certain Medicare and Medicaid policies, including a $50 billion proposal to restructure income-related premiums under Medicare Parts B and D by increasing the lowest income-related premium five percentage points (from 35 percent to 40 percent) and also increasing other income brackets until capping the highest tier at 90 percent. The proposal would also impose premium increases for beneficiaries in Medicare Parts B and D with "higher incomes" and a surcharge on Medicare Part B premiums for new beneficiaries and those that purchase near or full first-dollar Medigap coverage.
- Institute a program to establish payment amounts for Employer Group Waiver Plans (EGWPs) based on the average Medicare Advantage plan bid in each individual market, beginning in 2015.
- establish a program to penalize and eliminate misclassification of employees as "independent contractors."

It is important to note that the final budget product could incorporate any or none of the aforementioned provisions. New proposals could arise for consideration or much older provisions could be resurrected. For example, there has recently been renewed interest in converting or transitioning certain savings vehicles to "Roth"-style accounts, in which contributions (or a set percentage thereof) would have to be made with after-tax dollars.

The Senate and the House have already named their representatives to the conference committee. Senate conferees include all 22 members of the Senate Budget Committee: In addition to Murray, Senators Ron Wyden (D-OR), Bill Nelson (D-FL), Debbie Stabenow (D-MI), Bernie Sanders (I-VT), Sheldon Whitehouse (D-RI), Mark Warner (D-VA), Jeff Merkley (D-OR), Chris Coons (D-DE), Tammy Baldwin (D-WI), Tim Kaine (D-VA) and Angus King (I-ME), Committee ranking Republican Jeff Sessions (R-AL), Charles Grassley (R-IA), Mike Enzi (R-WY), Mike Crapo (R-ID), Lindsey Graham (R-SC), Rob Portman (R-OH), Pat Toomey (R-PA), Ron Johnson (R-WI), Kelly Ayotte (R-NH) and Roger Wicker (R-MS).

The House conferees, led by Ryan, are Representatives Tom Cole (R-OK), Tom Price (R-GA), Diane Black (R-TN), Budget Committee ranking Democrat Chris Van Hollen (D-MD), James Clyburn (D-SC) and Appropriations Committee ranking Democrat Nita Lowey (D-NY).

House Approves Measure Including Delay of DOL Fiduciary Definition Rule

The **Retail Investors Protection Act (H.R. 2374)**, approved by the House of Representatives on October 29, would further delay the issuance of forthcoming U.S. Department of Labor (DOL) proposed regulations defining the term "fiduciary" with regard to investment advice, pending an SEC rule addressing conduct standards for broker-dealers.

As we have previously reported, DOL and the Employee Benefits Security Administration (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 and concerns expressed by employer plan sponsors, DOL subsequently announced that EBSA would withdraw and 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). Publication of the new proposal was expected within the next several months.

H.R. 2374 seeks primarily to delay the issuance of the fiduciary proposal until 60 days after the SEC issues a final rule relating to standards of conduct for broker-dealers, pursuant to the Wall Street Reform and Consumer Protection (Dodd-Frank) Act. The bill directs SEC to follow a specific approach for the finalization of its rule.

The measure was sponsored by Ann Wagner (R-MO) and passed with mostly Republican support (along with 30 Democrats). Senate action is unclear, but less likely. This legislative effort is unrelated to the ongoing bipartisan effort to address plan sponsors' more specific concerns with the fiduciary proposal, which is proceeding on a separate, more deliberate track.

House Committee Continues Examination of Multiemployer Pension System

The U.S. House of Representatives Education and the Workforce Committee's Health, Employment, Labor, and Pensions Subcommittee, led by Chairman Phil Roe (R-TX), held the hearing Strengthening the Multiemployer Pension System: How Will Proposed Reforms Affect Employers, Workers, and Retirees? on October 29, the latest in a series of discussions on the multiemployer pension system.

This is the third hearing on multiemployer plans held by the subcommittee this year, following similar hearings on June 12 and March 5. The multiemployer pension funding provisions of the Pension Protection Act of 2006 (PPA) are scheduled to expire after 2014 and a substantial minority of multiemployer plans are reportedly in so-called "critical" condition. According to the Pension Benefit Guaranty Corporation (PBGC), which insures multiemployer and single-employer defined benefit pensions, the multiemployer insurance fund is projected to be exhausted by 2023.

The Retirement Security Review Commission of the National Coordinating Committee for Multiemployer Plans (NCCMP) put forth its Solutions not Bailouts proposal earlier this year with recommended strategies for preserving, fixing and encouraging innovation in multiemployer plans. The NCCMP proposal was followed by a Government Accountability Office (GAO) report, PRIVATE PENSIONS: Timely Action Needed to Address Impending Multiemployer Plan Insolvencies, which recommended congressional action on the matter, with options including (1) the enactment of legislation permitting plans to reduce accrued benefits of both working participants and retirees or (2) giving PBGC additional authority and resources to assist the most severely underfunded plans, although GAO notes that these and other options would themselves have serious consequences.

Roe has said that his subcommittee and the full committee will be very active on this issue. Senate staff have also indicated interest in considering multiemployer plan legislation in 2014. In describing the problem, Roe said "our goal is to strengthen the multiemployer pensions. Part of that effort must include finding ways to encourage new employers to join the system. Raising contributions and premiums to punitive levels will undermine this important goal. In fact, I fear it will destroy jobs and drive even more employers out of the system, exacerbating the problems that already exist."

The committee heard from the following witnesses:

- David Certner, legislative counsel and legislative policy director, government affairs, at AARP, voiced his opposition to the NCCMP proposal, particularly an element that would

give plans the legal authority to cut the accrued pension benefits of current retirees. He recommended giving PBGC additional tools to manage multiemployer plan liabilities, including increased premium revenue, "partitioning" orphan plans and issuing low-interest loans from the government.

- Carol Duncan, president of General Sheet Metal Works (a small business in Oregon), described the challenges of paying into two struggling multiemployer plans – a national plan in "critical" status and a local plan with $178 million in unfunded vested benefits. She expressed interest in new plan designs that would have some of the characteristics of a defined benefit plan but would not entail such significant liabilities.
- Sean McGarvey, president of the Building and Construction Trades department of the AFL-CIO, suggested that the impending sunset of the PPA funding provisions offers an opportunity "for a more fundamental restructuring of some of the basic precepts of ERISA law in order to reduce or eliminate the drastic financial risks being incurred by contributing employers." He recommended eliminating withdrawal liability for future service and immediate steps to address the PBGC's funding shortfalls.
- Thomas C. Nyhan, executive director of the Central States Southeast and Southwest Areas Pension Fund, described his fund's struggle to stay afloat after the downsizing of the trucking industry, coupled with substantial investment losses during the economic downturn.

The lengthy question-and-answer period focused on the basic tension between the need to reduce employees' and retirees' earned benefits (which could run afoul of the Internal Revenue Code's anti-cutback rule) and the desire to provide workers with a secure retirement. Nyhan told the committee, "It's not a question of if there are going to be benefit cuts. There are going to be benefit cuts. The question is when and how they are going to happen" as a way to avoid system's total collapse.

Several committee members, along with panelists Certner and Duncan, called for increasing PBGC premiums, although it was acknowledged by ranking subcommittee Democrat Rob Andrews (D-NJ) that premium levels would have to be increased substantially – by as much as a factor of ten or more – simply to make up for existing reported deficits.

RECENT REGULATORY ACTIVITY

IRS Announces Changes in Retirement Plan Limits for 2014

Each year, various dollar limits applicable to health and retirement plan contributions and benefits are adjusted for inflation.

In **News Release 2013-86**, released October 31, the Internal Revenue Service (IRS) announced a series of retirement plan limits for Tax Year 2014. Section 415 of the Internal Revenue Code provides for dollar limitations on benefits and contributions under qualified retirement plans. In some cases, these amounts have not changed from the 2013 levels.

Annual Limit [Applicable Tax Code Section]	2013	2014
Maximum elective deferral [401(k) and 403(b)]	$17,500	$17,500
Maximum annual pension benefit [415(b)] (The limit applied is actually the lesser of the dollar limit or 100 percent of the participant's average compensation (generally the high three consecutive years of service))	$205,000	**$210,000**
Defined contribution maximum deferral [415(c)]	$51,000	**$52,000**
Maximum catch-up contribution for those age 50 and over [414(v)]	$5,500	$5,500
Qualified plan compensation limit [401(a)(17)]	$255,000	**$260,000**
Highly compensated threshold [414(q)]	$115,000	$115,000
Key employee definition in a top-heavy plan [416]	$165,000	**$170,000**
Deductible amount for individual making qualified retirement contributions to an IRA [219(b)(5)(A)]	$5,500	$5,500

In related regulatory news, the Social Security Administration has announced that the Social Security wage base – also known as the "contribution and benefit base" – which is the amount of earnings subject to taxation for a given year, based on the average wage index – will increase from $113,700 in 2013 to $117,000 in 2014.

This IRS table shows these and additional limits updated for 2014.

IRS Issues Guidance on FSA Use-It-or-Lose-It Rules

The Internal Revenue Service (IRS) will permit Internal Revenue Code Section 125 cafeteria plans to allow up to $500 of unused health flexible spending account (FSA) funds to be paid or reimbursed for qualified medical expenses in the following year under certain circumstances, as described in **Notice 2013-71** released on October 31.

Internal Revenue Code Section 125(i), added by Section 9005 of the Patient Protection and Affordable Care Act (PPACA), currently limits salary reduction contributions to an FSA for qualified health expenses to $2,500 per taxable year (adjusted for inflation). The prevailing "use-it-or-lose-it" rule prohibits any surplus contribution or benefit under an FSA from reverting to the employee or applying to a subsequent plan year or period of coverage. However, under the grace period rule established in 2005, employees are permitted to use cafeteria plan amounts remaining from the previous year (including amounts remaining in a health FSA) to pay expenses for a period of up to two months and 15 days immediately following the end of the plan year.

The newly issued Notice 2013-71 allows up to $500 of unused amounts remaining at the end of a plan year in a health FSA to be paid or reimbursed to plan participants for qualified medical expenses incurred during the following plan year, provided that the plan does not also incorporate the grace period rule. The carry-over does not affect the $2,500 maximum permitted contribution.

In addition, Section VI of the notice clarifies the scope of the transition relief provided in the preamble to proposed regulations governing the employer "shared responsibility" provisions of PPACA. Certain provisions in the preamble to the proposed regulations were intended to give individuals with non-calendar cafeteria plan years greater flexibility to make changes in salary reduction elections for accident and health plans under their Section 125 cafeteria plans, beginning in 2013. Generally, an employer can amend its cafeteria plans to (1) allow an employee to prospectively revoke or change his or her election once during that plan year; and (2) permit an employee who failed to make a salary reduction election before the deadline to make a prospective salary reduction election on or after the first day of the plan year.

HHS Final Rule Indicates Possible Exemptions for Transitional Reinsurance Program Fees

In **final regulations** issued on October 30 by the U.S. Department of Health and Human Services (HHS) Centers for Medicare and Medicaid Services (CMS), the Obama Administration has indicated the possibility of exempting "certain self-insured, self-administered" health plans from the Patient Protection and Affordable Care Act (PPACA) transitional reinsurance program (TRP) fee.

Under Section 1341 of the Patient Protection and Affordable Care Act (PPACA), during the first three years that state health insurance exchanges are operational (2014 through 2016), health insurance issuers and plan administrators (on behalf of self-insured group health plans) will be assessed a per-enrollee fee to finance a three-year transitional reinsurance program. The proposed national contribution rate for 2014 is $63 per covered life for the year.

The newly issued final regulations, which address a range of other issues including exchange eligibility verification, includes these statements:

"We also note that, to alleviate the upfront burden of the reinsurance contributions, we intend to propose in future rulemaking to collect reinsurance contributions in two installments – the reinsurance contributions for reinsurance payments and administrative expenses would be collected at the beginning of the calendar year following the applicable benefit year, and the contributions for payments to the U.S. Treasury would be collected at the end of the calendar year following the applicable benefit year. We also intend to propose in future rulemaking to exempt certain self-insured, self-administered plans from the requirement to make reinsurance contributions for the 2015 and 2016 years."

HHS officials have since informally clarified that the exemption they are contemplating would only apply to self-insured plans that are "self-administered" – i.e., plans that do not use a third-party administrator (TPA). This is expected to be a very small number of self-insured plans since the majority of self-insured plans use TPAs.

Additionally, the preamble suggests that HHS will soon propose a rule to allow for the collection of the full fee for each year in two phases, under which the actual reinsurance component of the fee would be due at the beginning of the following calendar year (i.e., in early 2015 for the 2014 fee) and the component of the fee attributable to the recollection of Early Retiree Reinsurance Program expenditures would be due at the end of the following calendar year (i.e., in late 2015 for the 2014 fee).

PBGC Update: Agency Deficit to Be Announced Soon; Independent Study Released

The Pension Benefit Guaranty Corporation (PBGC) will soon release its Fiscal Year 2013 Annual Report, including an announcement of its operating deficit (covering both single-employer and multiemployer plans). In the 2012 report, released November 16, 2012, PBGC reported a deficit of $34 billion, up from $26 billion in the previous year.

In recent years, PBGC has cited this deficit as a rationale for increasing premium amounts paid by defined benefit plan sponsors and for giving the agency additional authority to set its own premiums "based on the circumstances of the individual plans and their sponsors."

In September, in response to an invitation from the Social Security Administration, the National Bureau of Economic Research (NBER) and the Brookings Institution released **an independent study** of the assumptions and methodology behind PBGC's calculations, including its Pension Insurance Modeling System (PIMS). The researchers determined that "several key components of the model have not been revised to reflect the availability of new tools, new insights from the academic literature, or even new data," casting renewed doubt on the accuracy of PBGC's figures. However, the study also notes that "the limited treatment of correlated risk factors arising from the macroeconomic environment is likely to substantially understate the degree of fiscal risk to PBGC's insurance programs," which suggests that the agency may still feel justified in seeking additional premium revenue.

Because PBGC premium increases are scored as "revenue raisers" in federal budget estimates, such increases have frequently been contemplated as part of a bipartisan and bicameral deal on the federal budget or comprehensive tax reform (see story, **Benefits Issues on the Table in Budget Conference Negotiations**, above).

RECENT JUDICIAL ACTIVITY

Nothing to report this month.