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Articles in this Edition

RECENT REGULATIONS AND GUIDANCE

Justice Department Files Appeal in Retiree Health Case

On May 31, the U.S. Justice Department filed a notice of appeal with the U.S. Court of Appeals for the Third Circuit in *AARP v. EEOC*. The court has not yet issued the briefing notice, which will set the briefing schedule, or provided information about the timing for hearing the case.

On March 30, the U.S. District Court for the Eastern District of Pennsylvania issued an order that delayed the effective date of the Equal Employment Opportunity Commission's (EEOC) final regulations on age discrimination and retiree health plans. These rules would clarify that an employer-sponsored retiree health plan would not violate the Age Discrimination in Employment Act (ADEA) even if it does not provide the same level of benefits to early retirees and to older retirees who are eligible for coverage under Medicare.

The EEOC originally intended to finalize these regulations in early February, until AARP filed suit with the district court to obtain a preliminary injunction against the rule's publication. While the court did not criticize the substance of the proposed rule, which has been thoroughly vetted through interagency review, the court did question the EEOC's authority to issue the rule under ADEA. Furthermore, the judge in the case indicated that she felt bound by the decision of the Third Circuit Court of Appeals, which issued the original decision in *Erie County Retirees Association v. County of Erie*.

Medicare Guidance Issued on New Required Disclosure Notices for Prescription Drug Coverage

The Centers for Medicare and Medicaid Services (CMS) has released guidance on new required notices to individuals who are eligible for Medicare's new prescription drug benefit to inform them whether they are currently enrolled in "creditable coverage." Under the Medicare Modernization Act (MMA), an individual is enrolled in creditable coverage if the expected amount of paid claims for prescription drug coverage is at least as much as the expected amount of paid claims under Medicare's standard drug benefit, which becomes effective on January 1, 2006. The first required notice from employers, health plans or others to eligible individuals must be sent prior to the November 15, 2005, start date for the initial enrollment period under the new Medicare drug benefit. Individuals who maintain creditable coverage — for example, by continuing their enrollment in an employer-sponsored retiree health plan that meets the Medicare creditable coverage standard — will not be subject to a late enrollment penalty (also known as a "higher premium charge") if they later decide to enroll in a Medicare prescription drug plan after May 15, 2006, when the initial enrollment period ends.

The new guidance from CMS also provides model notices that employers and health plans may use to notify individuals whether they are currently enrolled in creditable coverage. The guidance makes clear that the model notices merely provide sample language, and states that employers and others are not required to use the same language as the language contained in the CMS models.

IRS, Treasury Issue Proposed 415 Regulations

On May 25, the Internal Revenue Service (IRS) and the U.S. Department of Treasury issued proposed regulations regarding Internal Revenue Code Section 415 limitations on benefits and contributions under qualified retirement plans. Comprehensive regulations under Section 415 were last issued in 1981 with most of the statutory changes since then reflected in notices and other guidance.

The proposed regulations include several significant clarifications to Section 415. Some of the more significant provisions in the proposed regulations exclude most post-employment compensation unless it meets very narrow requirements, but another provision specifically includes differential pay paid to some employees who are performing military service (allowing them to continue making 401(k) deferrals if they choose). The proposed regulations also "clarify" the interaction of 415 and 401(a)(17), requiring plans to limit compensation used in calculating the 415(b) limit to compensation as limited by 401(a)(17).

The regulation is generally proposed to apply to limitation years beginning on or after January 1, 2007. However, certain provisions, including the post-severance compensation provisions, can be relied upon until final regulations are issued.

Treasury Issues Guidance on FSA Spending Extension

On May 18, the Treasury Department and Internal Revenue Service issued Notice 2005-42, allowing employers to modify Flexible Spending Arrangements (FSAs) to extend the deadline for reimbursement of health and dependent care expenses up to two and a half months after the end of the plan year. Previously, employees were required to "use or lose" FSA funds by the end of the 12-month plan year. According to the press release issued by Treasury Secretary John Snow, "The new rule will give workers with FSAs more time to pay for medical and dependent care expenses and will ease the year-end spending rush prompted by the prior rule."

Employers have the option to amend their plans to include the additional window for spending employee's funds. It is hoped that this administrative change will help reduce the estimated federal revenue cost of legislation authorizing more meaningful FSA reform, such as allowing up to $500 of unspent funds to carry over into the following year's FSA or Health Savings Account (HSA).

SEC Issues Report on Pension Consultant Examinations

On May 16, the Securities and Exchange Commission's (SEC) Office of Compliance Inspections and Examinations released the Staff Report Concerning Examinations of Select Pension Consultants following an examination of the practices of 24 pension consultants who were registered with the SEC as investment advisers. The report focused on conflicts of interests and was initiated as part of the SEC's program to identify and investigate risks in the securities industry. On June 1, the SEC and the U.S. Department of Labor (DOL) published tips for plan fiduciaries in selecting and monitoring pension consultants. The tips directly result from the findings in the SEC report.

In a press release accompanying the report, the SEC stated that although investment advisers have fiduciary duties to their clients — including the mandate to adequately disclose all material conflicts of interest — some pension consultants appear to have erroneously concluded that they are not fiduciaries to their clients. The report clearly focuses on the fiduciary duty of an SEC-registered investment advisor to its clients instead of the duties of a fiduciary of the plan under ERISA. However, in a press release accompanying the tips, the DOL clearly indicates that all investment advisers to plans (regardless of whether they registered with the SEC) have a fiduciary duty to the plan and indirectly suggests that plan advisers acknowledge in writing that they have fiduciary obligations.

The SEC examinations reviewed (1) the products and services provided by the pension consultants, (2) the method of payment for such services, and (3) the disclosure provided to their clients. The report details the findings, including:

- More than half of the pension consultants or their affiliates provided products and services to both pension plan advisory clients and to money managers and mutual funds on an ongoing basis;
- A majority of the pension consultants have affiliated broker-dealers or relationships with unaffiliated broker-dealers which may provide a mechanism for money managers to compensate pension consultants; and
- Many pension consultants have affiliates that also provide services to pension plan clients.

The SEC found that many pension consultants do not adequately disclose material conflicts of interest and the report indicates that the consultants should identify conflicts and other compliance factors creating risk exposure for the firm and its clients and then design policies and procedures that address those risks (which includes adequate disclosure). This increased attention by the SEC is indicative of the overall growing concerns about fiduciary responsibilities and how they relate to defined contribution plans.

Treasury Department Considers Reinstatement of 30-Year Treasury Bonds

On May 4, the U.S. Treasury Department announced that it is considering whether to resume issuing 30-year bonds, the standard previously used to calculate pension plan liabilities, lump sums and any Pension Benefit Guaranty Corporation variable rate premiums. The 30-year bond was replaced on a temporary basis in April 2004 by the Pension Funding Equity Act of 2004, which instituted a composite long-term corporate bond rate for two years (though lump sums were not affected). Treasury intends to announce their decision in August.

Should Treasury move forward on this issue, legislators may be tempted to return to the 30-year bond as a benchmark for pension calculations. This would obviously complicate current efforts to achieve a long-term replacement based on a four-year weighted average of corporate bond rates.

In a related matter, House Education and the Workforce Committee Chairman John Boehner (R-OH), in collaboration with House Ways and Means Committee Chairman Bill Thomas (R-CA), introduced a broad pension reform bill on June 9. This legislation contains elements from the Administration's proposal but made efforts to address some of the major concerns with that proposal that have been raised by the business community. These concerns include the increased unpredictability of the use of a spot rate for asset valuations, a near-spot rate interest rate for determining funding obligations (some smoothing is permitted under the bill), the complexity of a yield curve (the bill would use a modified yield curve), loss of the use of credit balances (the bill would allow continued use of credit balances unless the plan is less than 80 percent funded), and the use of a company's credit rating to determine funding and premium obligations (no credit rating provisions are included in the bill).

Meanwhile, Thomas has also signaled his interest in crafting comprehensive Social Security legislation that would not only institute Social Security private accounts, but would also contain elements of the Boehner bill as well as provisions addressing long-term care, flexible spending account rollovers and increased limits for defined contribution plans and individual retirement accounts, while possibly paying for the changes by reducing or eliminating the exclusion from taxes of employer-provided health insurance. It is yet unclear how much support such a bill could gain in Congress.

RECENT LEGISLATION AND ACTIVITY

Long-Term Care Bill Introduced in the House

On May 26, Representatives Nancy Johnson (R-CT) and Earl Pomeroy (D-ND) introduced the Long-Term Care and Retirement Security Act (H.R. 2682) that would provide federal tax incentives for the purchase of long-term care insurance. Johnson chairs the House Ways and Means Subcommittee on Health and Pomeroy is a member of the full committee.

The bill would provide an above-the-line tax deduction for long-term care insurance premiums; a tax credit for caregivers; and it would allow long-term care insurance to be offered under employer-sponsored cafeteria plans and for premiums to be paid premiums to be paid through cafeteria plans and flexible spending arrangements (FSAs). Senate Finance Committee Chairman Charles Grassley (R-IA) is expected to introduce a companion bill in the Senate soon.

The prospects for congressional action on long-term care issues have increased in recent weeks largely because House Ways and Means Committee Chairman Bill Thomas (R-CA) has suggested that retiree health issues and retirement security should be wrapped into the Social Security reform debate.

Social Security Hearings Continue on Capitol Hill

On May 26, 20 members of the House of Representatives testified at a hearing of the House Ways and Means Subcommittee on Social Security. Subcommittee Chairman Jim McCrery (R-La) invited both Republican and Democratic representatives to testify regarding their own plans and ideas for strengthening Social Security. The subcommittee hearing was one of three congressional hearings on Social Security held the week of May 23; the same subcommittee held another hearing on May 24 and the Senate Finance Committee held a hearing on May 25. A list of representatives and their testimony is available on the subcommittee's hearing page.

At the May 26 hearing, the subcommittee heard testimony from 11 Democrats and nine Republicans. Several of these witnesses — including one Democrat, Representative Allen Boyd (D-FL) — have sponsored or co-sponsored specific legislation designed to address Social Security solvency. McCrery congratulated Boyd and his co-sponsor, Jim Kolbe (R-AZ) for sponsoring the one bipartisan bill that has been introduced (H.R. 440). Democrats who testified generally expressed concern with "privatizing" Social Security, while Republican proponents of plans that include payroll tax-funded personal accounts objected to descriptions of their proposals as "privatization."

At the May 24 hearing, McCrery indicated that key House lawmakers likely would be ready to write a Social Security bill by July 1 but that leadership would make the decision on how and when to proceed on Social Security legislation. Stephen Goss, the Social Security Administration's chief actuary, was the sole witness at the hearing. His testimony is available on the subcommittee's hearing page.

On May 25, the Senate Finance Committee held a hearing on achieving sustainable solvency for the Social Security system. At the request of Finance Committee Chairman Grassley (R-IA), the Congressional Budget Office (CBO) prepared a menu of options for slowing the growth of Social Security benefits. Also at this hearing, CBO Director Douglas Holtz-Eakin testified on three options described further in his written statement: (1) price indexing of initial benefit awards as outlined by the President's Commission to Strengthen Social Security, (2) progressive price indexing, and (3) a hybrid provision that would make other changes to the benefit formula and adjust benefits for longevity. A list of witnesses and their testimony is available on the committee's hearing page.

Other hearings also took place in May. On May 19, the House of Representatives Ways and Means Committee held a Hearing on the Retirement Policy Challenges and Opportunities of our Aging Society. Chairman Bill Thomas (R-CA) and others spoke about automatic enrollment, annuitization and long-term care in addition to Social Security reform. Thomas spoke about not limiting retirement security discussions to existing pension and retirement savings vehicles and mentioned in subsequent media reports the possibility of creating a new savings vehicle — what he called a "hybrid" with an annuity — which is different than a 401(k). "There is no reason why we can't reinvent the defined benefit plan in a personal savings structure," Thomas said.

On May 17, the Social Security Subcommittee of the House Ways and Means Committee held a hearing on Protecting and Strengthening Social Security. Much of the discussion focused on whether disability and survivor benefits would be affected by the Bush Administration's Social Security reform plan. Ranking Member Sander Levin (D-MI) argued that progressive indexing (with lower income seniors initial benefit indexed to wage inflation, higher income seniors to price inflation and middle income seniors to a mixture of the two) would result in a 40 percent middle class reduction for "widows and children too."

House Subcommittee Holds Hearing on Pay-for-Performance Measures and Other Trends in Employer-Sponsored Health Care

On May 17, the House Education and the Workforce Subcommittee on Employer-Employee Relations held a hearing to examine Pay-for-Performance Measures and Other Trends in Employer-Sponsored Health Care. Witness testimony and the opening statement from Subcommittee Chairman Sam Johnson (R-TX) are available on the subcommittee's hearing Web site.

American Benefits Council staff have prepared a summary of the hearing detailing the issues and testimony presented by the witnesses.

Democrats Introduce Numerous Pension Bills

A number of pension-related bills have recently been introduced, adding more uncertainty to the process of developing comprehensive pension and funding reform legislation.

Representative George Miller (D-CA), ranking member of the House Education and the Workforce Committee, has introduced the Pension Fairness and Full Disclosure Act (H.R. 2233), which would prohibit employers from paying or promising deferred compensation to executive officers or directors (as defined in the Sarbanes-Oxley accounting reform bill of 2002) for five years following a shift in pension liabilities to the Pension Benefit Guaranty Corporation during bankruptcy, or conversion to a cash balance plan (where choice between the new plan and the prior plan is not offered to participants with at least 10 years of service). This bill is similar to a bill introduced by Miller in October 2004. Senator Edward Kennedy (D-MA) has already introduced a companion bill in the Senate (S. 991).

Miller has also introduced H.R. 2327, a bill which would impose a six-month moratorium on the termination of certain plans under ERISA, effectively preventing bankrupt companies from transferring their pension assets and liabilities to the Pension Benefit Guaranty Corporation (PBGC). This legislation is likely a response to the recent agreement in which the PBGC will assume responsibility for United Airlines' pension plan.

Representative Lloyd Doggett (D-TX), along with Miller, has introduced the Pension Security Disclosure Act (H.R. 2321), which would openly release certain confidential information required to be submitted to the PBGC by plans that are underfunded by more than $50 million (as required under Section 4010 of ERISA). This legislation was introduced previously by Doggett in September 2003.

While these measures are unlikely to receive broad support as stand-alone bills, they do illustrate the complexity of the politics that surround the debate on pension and funding reform and will complicate efforts to achieve a comprehensive bipartisan solution. It is also possible that some specific elements of these bills — particularly the deferred compensation prohibition in H.R. 2233/S. 991 — will be included in final legislation.

House Subcommittee Approves Bill to Allow Federal Civilian and Military Retirees to Pay Health Insurance Premiums on a Pretax Basis

On May 17, the House Government Federal Workforce and Agency Organization Subcommittee approved a bill (H.R. 994) that would allow federal civilian and military retirees to pay their retiree health insurance premiums for the Federal Employees Health Benefits Program (FEHBP) and Tricare (Defense Department's health care system) on a pretax basis. The bill would also allow active military employees to deduct their premiums for Tricare whether or not they itemize on their tax return. Similar legislation was approved by the House Government Reform Committee during the 108th Congress. The bill, which was introduced by Representative Tom Davis (R-VA) and has 158 cosponsors, has also been referred to the House Ways and Means Committee and the House Armed Services Committee. A companion bill (S. 484) has been introduced by Senate Armed Services Committee Chairman John Warner (R-VA).

While the bill would only affect federal civilian and military retirees, it is still of interest because it highlights to Congress how increasingly difficult it is for retirees to pay their portion of retiree health insurance. There have been a variety of proposals to encourage savings for retiree health including the establishment of Retiree Medical Benefit Accounts (RMBAs), which would use existing individual and workplace savings systems to allow individuals and workers to elect annually to allocate a portion of their pre-tax retirement contributions into a separate RMBA within their retirement plan. Distributions from a RMBA would be tax-free and penalty-free if made after a certain age and used for "medical care" as defined in section 213(d) of the Internal Revenue Code. Other proposals allow retirees to use retirement plan distributions on a pre-tax basis to pay their share of the cost of retiree health plan coverage. In addition, changes to HSAs would promote retiree health savings such as permitting contributions to HSAs that are above the deductible and allowing early retirees to pay for retiree health insurance coverage out of their HSA funds.

House Subcommittee Hears Testimony on Hard 4 Rule, 12b-1 Fees

On May 10, the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises held a hearing on Mutual Funds: A Review of the Regulatory Landscape. The subcommittee heard testimony from Meyer Eisenberg, acting director of the Securities and Exchange Commission's (SEC) Division of Investment Management, as well as from a panel of witnesses representing financial service providers.

The hearing covered numerous topics, most notably the SEC's proposed "hard 4 p.m. close" rule, designed to combat late trading, market timing and other abuses. Subcommittee Chairman Richard Baker (R-LA) indicated in his opening statement that he had concerns about the proposed rule with regard to investors located on the west coast and retirement plan participants. Eisenberg told the subcommittee that the SEC is now considering alternatives to the proposal, and the SEC will take whatever time is necessary to develop a workable final rule.

The witnesses also discussed the disclosure of mutual fund costs, specifically 12b-1 fees. Under rule 12b-1, which was issued under the Investment Company Act of 1940, fees can be assessed against the assets of mutual funds to cover advertising and distribution costs. However, these fees are commonly used to pay for the services of retirement plan administrators and recordkeepers. Eisenberg noted in his testimony that a review of this issue is ongoing.

Witness testimony is available on the subcommittee's hearing page.

Highway Bill Includes Deferred Compensation Provision as Revenue Raiser

Senate Environment and Public Works Committee Chairman James Inhofe (R-OK) has introduced a substitute to the Highway Reauthorization and Excise Tax Simplification Act of 2005 (H.R. 3) that includes a prohibition on the deferral of stock option gains and other employer security-based property. The provision was added to the highway bill as part of a series of revenue raisers prepared by Senate Finance Committee Chairman Charles Grassley (R-IA) and Ranking Member Max Baucus (D-MT) to offset the cost of additional funding added to the bill.

Specifically, section 5515 of the substitute amendment (No. 605) would amend section 83 of the Internal Revenue Code to tax taxpayers immediately on the present value of the right to receive future payments obtained in "exchange" for stock options, employer securities, or other property based on employer securities. It would be effective for any exchange after the date of enactment. The provision is identical to the one included in the Senate version, but not the final conference report, of the FSC/ETI corporate tax legislation (American Jobs Creation Act of 2004; H.R. 4520; Pub. Law 108-357). It also was included in the "NESTEG" pension reform legislation approved by the Finance Committee in the last Congress.

According to the Joint Committee on Taxation, the provision would raise $64 million over 10 years.

HSA Expansion and Health Insurance Tax Credit Bill Introduced in the House

On April 27, Representative Sam Johnson (R-TX), who chairs the House Education and the Workforce Employer-Employee Relations Subcommittee and serves on the House Ways & Means Committee, introduced the Health Coverage for the Uninsured Act (H.R. 1872) along with Reps. Eric Cantor (R-VA), Paul Ryan (R-WI), J.D. Hayworth (R-AZ) and sixteen other cosponsors. Senator Rick Santorum (R-PA) introduced the companion measure (S. 978) in the Senate on May 9.

The bill, which would implement many of the President's health care proposals, is intended to reduce the number of uninsured largely by building upon the early successes of Health Savings Accounts (HSAs). It would provide an above-the-line tax deduction for individuals who purchase high deductible health plans, provide tax credits to small businesses who offer high-deductible health plans to their employees and make contributions to employee HSAs, and help lower-income individuals and their families by providing a refundable, advanceable and assignable tax credit for the purchase of health insurance and permitting up to one-third of the credit to be contributed to an HSA.

Healthcare Information Technology Legislative Update

Healthcare information technology (IT) is one of the few policy areas where there is bipartisan agreement that the issue should be a top priority in the 109th Congress. This means chances are good that Congress will pass some type of health IT legislation possibly this year.

Senate Majority Leader Bill Frist (R-TN) is drafting legislation on healthcare IT that may be part of a broader Senate GOP healthcare proposal. The healthcare IT portion would provide financial incentives to promote widespread use of information technology in the health care arena and address various regulatory barriers that prevent the electronic exchange of health data. In addition, the budget approved by Congress in April includes a reserve fund for healthcare IT that allows Congress to fund health IT and pay-for-performance projects without the normal requirements for budget-neutral offsets to pay for these projects. The reserve fund does not allocate new money to health IT but it does allow the committees of jurisdiction more flexibility for funding proposals.

Representatives Patrick Kennedy (D-RI) and Tim Murphy (R-PA), who co-chair the House 21st Century Health Care Caucus, introduced the 21st Century Health Information Act (H.R. 2234) on May 11. Senator Hillary Rodham Clinton (D-NY) is said to be preparing to reintroduce a health IT measure (S. 2003) that she proposed during the 108th Congress.