



**BENEFITS INSIDER**  
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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 much of its core content.

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## RECENT JUDICIAL ACTIVITY

### **AARP v. EEOC Retiree Health Case to be Reconsidered at District Court Level**

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.

Judge Brody, who issued the District Court order, has asked both the AARP and the U.S. Justice Department on behalf of the EEOC to file briefs for her to reconsider AARP v. EEOC in light of the Supreme Court's recent decision in [National Cable & Telecommunications Assoc. v. Brand X Internet Services](#). A key question addressed in the case is what standard courts should use to evaluate whether an agency appropriately interpreted a specific statute. Judge Brody's opinion in EEOC v. AARP analyzed whether the EEOC's final rule on retiree health appropriately interpreted the Age Discrimination in Employment Act. While the Brand X case does not relate to age discrimination, presumably Judge Brody intends to review whether applying the new test established by the Supreme Court would lead to a different result in AARP v. EEOC.

Both parties have agreed to submit briefs to Judge Brody; the court's schedule for review has not yet been announced. Previously the Justice Department filed a notice of appeal with the U.S. Court of Appeals for the Third Circuit. However, Judge Brody has also requested the parties to file a motion in the Third Circuit asking for the case to be remanded to Judge Brody so that she may re-examine her decision in light of the Brand X Supreme Court decision.

These are important developments because had the case gone to the Third Circuit for appeal, it was expected that the Justice Department's primary argument would have been that the EEOC had discretion granted by Congress to issue its retiree health rule. That question will now be addressed by the lower court under the reconsideration action. The Council, which joined in an [amicus \(friend of the court\) brief in support of the EEOC](#) in the District Court case, will continue to support the EEOC's efforts.

## RECENT REGULATIONS AND GUIDANCE

### **IRS Eliminates Tax-Free Medical Expense Distributions from DC Plans**

The Internal Revenue Service (IRS) has ruled that defined contribution (DC) plans that combine retirement savings with savings for medical expenses (limiting distributions from a portion of the account to reimbursement of medical expenses) will not remain qualified retirement plans unless they are amended in a way that will eliminate tax-free distributions for medical expenses – typically retiree health programs.

According to [Revenue Ruling 2005-55](#), DC plans that limit distributions from a portion of the DC account to amounts necessary to reimburse medical expenses of the employee and his/her family will not meet qualification requirements for DC plans. The ruling states such plans must be amended to permit distribution for reasons other than

reimbursement of medical expenses, effective as of the first day of the plan year beginning on or after August 15, 2005. However, once amended, amounts paid from the plan to reimburse medical expenses will be taxable to the employee because the amounts are available for purposes other than the reimbursement of medical expenses.

### **Summary of CMS Retiree Drug Subsidy National Conference**

On July 12 and 13, the Centers for Medicare & Medicaid Services (CMS) held a Retiree Drug Subsidy (RDS) National Conference in Dallas, Texas. The conference was intended to help employers and their partners in administering their retiree health plans prepare for the implementation of the retiree drug subsidy program. The content of the program focused on the operational aspects of the rules, though several comments provided insight about CMS staff's current thinking regarding open policy questions. Detailed presentation materials from the conference are available on the [RDS Web site](#). Council staff has prepared [a summary of information shared by CMS and RDS Center staff](#) that supplements the presentation materials and may be of interest to employers planning to apply for the retiree drug subsidy.

The conference was videotaped and copies will be available for purchase. The answers to all questions asked during the conference will be posted on a [special page of the CMS Web site](#). In addition, individuals can submit questions about RDS operations through the [RDS Web site](#); the RDS Center has a goal of responding to all questions within 48 hours. A help line is also available by calling 1-877-RDS-HELP or emailing via the website.

In addition, CMS has posted [new file layouts for retiree data and layouts for response files](#) on the RDS Web site. Employers who apply to receive the subsidy will be required to submit information about eligible retirees with their application and update the information monthly. The information may be submitted via any of the following: mainframe to mainframe via AT&T Global Network Services (AGNS), upload to the RDS website, or Voluntary Data Sharing Agreements (VDSA). Whenever an employer submits retiree information, a response file will be sent back to the employer with any problems encountered or further requests for information.

### **Treasury, IRS Issue Proposed Regulations on Electronic Transmissions**

On July 13, the Treasury Department and Internal Revenue Service (IRS) issued proposed regulations regarding electronic transmission of employee benefit plan information. Specifically, the proposed regulations coordinate existing guidance on the use by plans of electronic media with the requirements of the electronic signatures statute. The Council has prepared [a brief summary of the regulations](#).

## **RECENT LEGISLATIVE ACTIVITY**

### **House Acts in "Health Care Week" by Approving AHP Legislation, Patient Safety Legislation**

The House of Representatives has begun to consider a series of health care measures as part of "Health Care Week." By a vote of 263-165, the House approved the [Small](#)

[Business Health Fairness Act \(H.R. 525\)](#), sponsored by House Education and the Workforce Employer-Employee Relations Subcommittee Chairman Sam Johnson (R-TX), to amend ERISA to allow for the establishment of association health plans (AHPs), which are group health plans whose sponsors are associations, and which meet certain ERISA certification requirements and are exempted from state regulation of health insurance and state benefit mandate laws.

#### *Association Health Plans (AHPs)*

AHP legislation has passed the House numerous times but never the Senate, and the outlook for the legislation in the Senate is uncertain. The President is a longtime supporter of the legislation and a companion bill has been introduced (S. 406), but Senate Democrats and a number of Republicans remain opposed due to concerns about AHPs leading to increased premiums for individuals in the insured market and unbalanced regulatory oversight between standards applied by states to insurers and federal standards applied by the Department of Labor (DOL) to AHPs. Senate Health, Education, Labor and Pensions (HELP) Committee Chairman Mike Enzi (R-WY) is working on an alternative to AHPs to help small employers with rising health care costs while also addressing his concerns that the current AHP legislation could lead to adverse selection. Enzi plans to introduce his proposal in September.

#### *Patient Safety*

The House also approved, by a vote of 428-3, the Patient Safety and Quality Improvement Act (S. 544). The bill, which was unanimously approved by the Senate on July 21, would establish legal protections for medical error information that is voluntarily reported by health care providers to certified patient safety organizations (PSOs).

And on July 29, President Bush signed into law the [Patient Safety and Quality Improvement Act \(S. 544\)](#). The bill would establish legal protections for medical error information that is voluntarily reported by health care providers to certified patient safety organizations (PSOs).

#### *Health Insurance Purchases Across State Lines*

The House was expected to vote on [the Health Care Choice Act \(H.R. 2355\)](#), sponsored by Representative John Shadegg (R-AZ), which would allow health insurance companies to sell health insurance in the individual market across state lines, but although the House Energy & Commerce approved the measure last week by a largely party-line vote of 24-23, House leaders decided that since so many Members continue to have questions about the bill, that consideration of the measure would be postponed until after the August recess. Under H.R. 2355, health insurance companies may file an individual health policy in the state they choose (called the "primary state") and sell the coverage in any state ("secondary state") under the laws of the primary state. This would allow health insurers to be exempt from state mandates and rating rules of the secondary states and according to the bill's sponsor it would allow consumers to purchase the coverage they need at more affordable prices and reduce the number of uninsured. Opponents of the measure have expressed serious concerns that the bill would encourage insurers to license their individual policies in states with the fewest regulations and consumer protections.

#### *Medical Liability Reform*

On July 28, the House of Representatives approved the [Help Efficient, Accessible, Low-](#)

[cost, Timely Healthcare \(HEALTH\) Act \(H.R. 5\)](#) by a vote of 230 to 194. This medical liability reform legislation, which would establish a \$250,000 cap on non-economic damages and allow punitive damages only under a strict statutory standard for malicious actions limited to \$250,000 or twice the amount of economic damages, has been approved by the House of Representatives many times over the past several Congresses. Moving the bill through the Senate, however, has been an uphill battle and it appears the measure is once again stalled in that chamber.

[The Council endorsed](#) H.R. 5 but also recommended that a provision be added to the bill to require responsible third parties to pay the medical expenses of an injured individual and avoid double-recovery of medical expenses. The bill currently eliminates existing subrogation rights that allow employers and insurers to be reimbursed for funds they have spent on behalf of parties who subsequently recover such funds through a lawsuit against the party responsible for their injuries. The Council also recommended that Section 13 of H.R. 5, expressing the "Sense of Congress" regarding the liability of health insurance plans be deleted from the bill. These recommendations were not incorporated before passage.

#### *State High Risk Pool Funding*

On July 28, the House also approved, by voice vote, the [State High Risk Pool Funding Extension Act \(H.R. 3204\)](#) which would provide \$15 million to help states launch new high risk pools in addition to providing \$50 million annually to extend and increase funding to states that already have risk pools. The high-risk pool grant program was established by the Trade Adjustment Assistance Act of 2002 to help states create high-risk pools to assist individuals who cannot otherwise obtain health insurance in the individual market due to preexisting conditions or can only obtain coverage at very high rates. The Senate Health, Education, Labor and Pensions (HELP) Committee approved its [version of the legislation \(S. 288\)](#) by voice vote on February 9.

#### *Senate GOP Leadership Health Reform Bill*

In the Senate, Majority Leader Bill Frist (R-TN) introduced the text [of S. 4, the GOP Leadership bill on health care reform](#), that includes a provision to permit up to \$500 in unused Flexible Spending Arrangement (FSA) funds to be carried forward to the following year's FSA. The bill also includes provisions on medical liability reform, long-term care insurance, and proposals to help the uninsured such as funding for state high-risk health insurance pools and tax credits for the purchase of insurance. The bill includes the President's proposals to expand HSAs by providing incentives for lower-income individuals and their families and small businesses to establish HSAs.

#### **Technical Corrections Bill Includes Some Changes to Definition of Dependent and Deferred Compensation Provision**

On July 21, [the Tax Technical Corrections Act](#) was introduced in the House of Representatives (H.R. 3376) by Ways and Means Committee Chairman Bill Thomas (R-CA) and in the Senate (S. 1447) by Senate Finance Committee Chairman Charles Grassley (R-IA) and Ranking Member Max Baucus (D-MT). The legislation contains technical corrections with respect to the Working Families Tax Relief Act and the American Jobs Creation Act, passed in 2004. [A Joint Tax Committee description of the bill](#) is available on the Council Web site.

The bill includes an amendment to the Working Families Tax Relief Act of 2004 that would exempt the income limitation from the definition of dependent for Health Savings Accounts (HSAs) and Dependent Care Spending Arrangements. The Working Families Tax Relief Act of 2004 made changes to the definition of dependent that were intended to make the definition more uniform. However, because many other Code sections and regulations reference Code Section 152, the change in definition had broad implications for health, dependent care spending arrangements, hardship distributions from 401(k) plans, and unforeseeable emergency distributions from 457 plans and non-qualified deferred compensation plans. (See the Council's [comprehensive analysis](#) of the unintended effects of the change on employee benefit plans.)

The Council has been actively working on this issue since it came to light last fall and [sent a letter to Chairmen Grassley and Thomas](#) urging passage of a technical corrections bill and organized [a group letter](#) signed by other employer and health plan organizations. Since the House and Senate tax technical corrections bills are identical, the measure could be passed soon after Congress returns from its August break.

Of key importance to Council members is the section on nonqualified deferred compensation plans, described on Page 13 of the [Joint Tax Committee summary](#). Among other provisions is a clarification that the January 1, 2005 effective date of the funding provisions relating to offshore trusts and financial triggers has a retroactive application to assets already accrued in such trusts.

Since the House and Senate bills are identical, the measure could be passed very quickly.

### **Senate Finance Committee Approves Pension Funding Reform in New NESTEG Bill**

On July 26, the Senate Finance Committee approved a modified version of the National Employee Savings and Trust Equity Guarantee (NESTEG) Act by voice vote. This bill, introduced by Committee Chairman Charles Grassley (R-IA) and Ranking Member Max Baucus (D-MT), makes significant changes to the single-employer pension funding rules as well as limited changes to the funding rules for multiemployer plans. Also included in the bill are provisions dealing with corporate-owned life insurance and many elements from previous iterations of the NESTEG bill regarding defined contribution plans such as company stock diversification and investment advice. U.S. Labor Secretary Elaine Chao praised Grassley for his leadership and swift action in [a news release following NESTEG's passage](#).

Formal bill text has not yet been released, though [a Joint Committee on Taxation description of the bill](#) is available, along with [a list of modifications](#) introduced just prior to approval as well as [a table describing the federal tax revenue implications](#) of the measure.

Among the modifications approved by the committee is a provision regarding the treatment of hybrid plans and hybrid plan conversions under the law. The amendment clarifies the age-appropriateness of the hybrid pension designs on a prospective-only basis and outlines specific requirements for future conversions. Despite the inclusion of language that states that "no inference" one way or the other is to be drawn as to the legal treatment of hybrid plans under present law, Council members have expressed



lingering concerns about the negative impact this provision could have on companies that previously implemented conversions.

The bill as modified also includes rules applicable to the frozen plans maintained by commercial airlines, as well as modifications to the benefit limitations in plans when the plan sponsor enters bankruptcy and a tightening of the prohibition on the funding of nonqualified deferred compensation when the corresponding defined benefit plan is underfunded.

Senate Health, Education, Labor and Pensions Committee staff have indicated that Committee Chairman Mike Enzi (R-WY) and Ranking Member Edward Kennedy (D-MA) are considering the introduction of an alternative bill addressing funding reform. This would not occur, however, until after the August congressional recess.

The Council will continue to work closely with Congressional staff on many of these pension reform elements including credit ratings, at-risk liability requirements and the interest rate, as well as the hybrid plan issues.

Senator Tom Harkin (D-IA) has introduced the [Pension Benefits Preservation Act \(S. 1304\)](#), addressing hybrid plan conversions. The legislation would prevent any plan conversion that reduces the rate of future benefit accrual, unless plan participants with a certain level of tenure – age 40 or above or with at least ten years of service – are given a choice of enrolling in the old plan or the new plan.

### **House Continues Pension Work: Democrats Announce AmeriSave Legislation**

On July 26, Democrats in the House of Representatives announced their intention to introduce legislation addressing retirement security and released [a two-page abbreviated summary](#) of principal components of the anticipated legislation. Democratic representatives provided a few additional details to the Council but indicated many of the specifics are still being worked out.

For example, the bill will include automatic enrollment and acceleration provisions but Democrats are looking at bills introduced by both Rahm Emanuel (D-IL) and Ben Cardin (D-MD) to determine their approach. As reported in previous Benefits Bytes, Emanuel's approach would add automatic enrollment and acceleration requirements onto the existing 401(k) safe harbor and require employers seeking fiduciary relief for default investments and relief from state withholding requirements to meet the safe harbor requirements. Cardin's approach involves a new safe harbor and universal default investment and state withholding relief for plans using automatic enrollment/acceleration even if the plan sponsor does not choose to meet the requirements of the new safe harbor. Democrats told the Council their bill may also require three-year, 100 percent vesting for employer matching contributions.

The centerpiece of the proposed legislation is expected to be the AmeriSave matching contributions, funded with federal dollars, which would provide matching contributions on a dollar-for-dollar basis for the first \$1,000 contributed to an IRA, 401(k) or similar plan. According to the Council's sources, 401(k) plans could choose whether to accept these matching contributions. Under the current proposal, the full match would be available for persons earning less than \$50,000 per year and persons with compensation between

\$50,000 and \$70,000 would receive a partial match or a portion of the \$1,000 match (phase-out range).

The anticipated legislation is also expected to address hybrid plan issues and Democratic sources told the Council that the Democrats' likely approach would include safe harbors for conversions of traditional plans to hybrid plans. However, the Democrats have not discussed whether to make the legislation retroactive.

### **House Energy & Commerce Committee Approves Number of Health Bills**

During a lengthy and often contentious mark-up on July 20, the House Energy and Commerce Committee approved a number of health bills, including:

- [the State High Risk Pool Funding Extension Act of 2005 \(H.R. 3204\)](#)
- [the Patient Safety and Quality Improvement Act \(H.R. 3205\)](#), a bill to reduce medical errors by encouraging voluntary reporting, and
- [the National All Schedules Prescription Electronic Reporting Act \(H.R. 1132\)](#), a measure to create state databases to monitor dispersal of controlled substance prescription medications to minimize drug abuse.

These three bills were all approved by voice vote.

H.R. 3204 would provide \$15 million to help states launch new high risk pools in addition to providing \$50 million annually to extend and increase funding to states that already have risk pools. The high-risk pool grant program was established by the Trade Adjustment Assistance Act of 2002 to help states create high-risk pools to assist individuals who cannot otherwise obtain health insurance in the individual market due to preexisting conditions or can only obtain coverage at very high rates. The Senate Health, Education, Labor and Pensions (HELP) Committee approved [its version of the legislation \(S. 288\)](#) by voice vote on February 9.

H.R. 3205 The patient safety/medical errors bill would establish legal protections for medical error information that is voluntarily reported by health care providers to certified patient safety organizations (PSOs). During the markup, Chairman Joe Barton (R-TX) indicated that H.R. 3205 reflects a bipartisan, bicameral compromise that was negotiated with the Senate HELP Committee. This means patient safety/medical errors legislation could be approved in both chambers and sent to the President before the August recess. The Senate HELP Committee approved [its own patient safety bill \(S. 544\)](#) on March 9.

The committee also approved [the Health Care Choice Act \(H.R. 2355\)](#), sponsored by Representative John Shadegg (R-AZ)), which would allow health insurance companies to sell health insurance in the individual market across state lines, by a largely party-line vote of 24-23. Under H.R. 2355, health insurance companies may file an individual health policy in the state they choose (called the "primary state") and sell the coverage in any state ("secondary state") under the laws of the primary state. This would allow health insurers to be exempt from state mandates and rating rules of the secondary states and according to the bill's sponsor it would allow consumers to purchase the coverage they need at more affordable prices and reduce the number of uninsured. Opponents of the measure expressed serious concerns that the bill would encourage insurers to license their individual policies in states with the fewest regulations and consumer protections,



and during debate Democrats offered a slew of consumer protection amendments, none of which were adopted.

The House of Representatives is expected to consider all of these measures plus medical liability reform ([H.R. 534](#)) and legislation on association health plans (AHPs) ([H.R. 525](#)) during “Health Week” which is likely to begin the week of July 25. Some of the measures, such as patient safety, may then be quickly approved by the Senate. Others, such as the AHP bill, the Consumer Choice Act and medical liability reform, will likely face a more difficult time getting through the Senate although the Senate may hold its own “Health Week” in September.

### **Senate HELP Committee Approves Bipartisan Health Information Technology Bill**

On July 20, the Senate Health, Education, Labor and Pensions (HELP) Committee approved [the Wired for Health Care Quality Act \(S. 1418\)](#) by voice vote. The bipartisan measure combined proposals offered by HELP Committee Chairman Mike Enzi (R-WY) and ranking member Edward Kennedy (D-MA) (S. 1355) and by Senate Majority Leader Bill Frist (R-TN) and Senator Hillary Clinton (D-NY) (S. 1262). The bipartisan bill approved by the HELP Committee aims to improve health care and reduce administrative costs and medical errors by requiring the development of standards on interoperability and other measures through public-private consultation. The bill authorizes the establishment of a National Coordinator for Health IT and provides grants to health providers to enhance their use of health information technology (IT).

The bill requires the Secretary of Health and Human Services (HHS) to adopt national uniform standards for the electronic exchange of health information and while the federal government would be required to adopt the standards for government IT systems, the standards would be technically “voluntary” for the private sector. Without federal preemption, national uniform standards cannot be achieved, so the Council is working with other groups representing employers, health plans and health providers to add a strong federal preemption provision to the legislation. This provision would ensure federal preemption for contrary state laws on standards, similar to a provision adopted by Congress for the HIPAA transactions and code sets, which established standards for administrative and financial health transactions.

### **House Ways and Means Likely to Delay Debate on Social Security and Pension Funding Reform**

Though Chairman of the House of Representatives Ways and Means Committee Bill Thomas (R-CA) had previously indicated it was his intention to begin debate soon over Social Security, pension funding reform and other retirement related issues, the timetable has slipped until after Congress adjourned for the month of August. After the August recess the committee is expected to consider Social Security reform, and along with that the committee will consider the Pension Protection Act (H.R. 2830), as approved by the House Committee on Education and the Workforce on June 29. To facilitate your review of the bill, [the Council has made available a summary](#) prepared by Groom Law Group.

Though H.R. 2830 is generally viewed as steering a more moderate course than the Administration’s proposal, several concerns have been raised with respect to the bill. These include among other issues: the interest rate calculation and the Treasury discretion regarding the segment rates in the modified yield curve, transition to the 100%

funding target and inclusion of lump sum distributions and reduction of plan assets by credit balances. [An outline of the concerns that have been raised with the Council](#), prepared by the Benefits Group of Davis and Harman, is now available

Meanwhile, House Education and the Workforce Committee Chairman John Boehner (R-OH), along with Employer-Employee Relations Subcommittee Chairman Sam Johnson (R-TX), [released a statement](#) calling on Congress to enact comprehensive pension reform before the end of the year. Stressing the need for permanent reform, Boehner expressed opposition to another temporary corporate bond-based interest rate fix as enacted in 2004. [Boehner's Pension Protection Act \(H.R. 2830\)](#) includes a permanent interest rate based on a modified yield curve.

The Bush Administration has also entered the debate on pension funding reform. In [a June 29 letter to Boehner](#), U.S. Department of Labor Secretary Elaine Chao (who also serves as the chair of the Pension Benefit Guaranty Corporation Board of Directors) praised the chairman's leadership on this issue but expressed serious concerns with the legislation. Specifically, Chao asserted that H.R. 2830's approach to measuring plan assets and liabilities, with its smoothing mechanisms and use of credit balances, would lead to inaccurate measurements and chronic underfunding. Boehner has not formally responded to the letter.