

## March 2007

The following news summaries were developed by Gabriel, Roeder, Smith & Company to inform clients and other benefit professionals of news in the benefits industry. Our thanks to Mary Ann Vitale for her diligent work on this issue. To receive this publication electronically, send an email to [web.admin@gabrielroeder.com](mailto:web.admin@gabrielroeder.com) with the message "SUBSCRIBE NEWS SCAN" in the subject line. To stop receiving this publication electronically, send the message "UNSUBSCRIBE NEWS SCAN" in the same manner. Copies of this and other benefit-related publications are available on the GRS web site at [www.gabrielroeder.com](http://www.gabrielroeder.com).

Note: The authors of these news summaries are not attorneys and the statements made are not legal advice or opinion. Qualified legal advice should be obtained before acting with regard to related laws and regulations.

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### **NCPERS Posts State Health and Retirement Benefit Protections Reports**

On March 15, 2007, the National Conference on Public Employee Retirement Systems (NCPERS) posted the following comprehensive state-by-state listings:

- 1) State Constitutional Protections for Public Sector Retirement Benefits, and
- 2) State Cases Addressing Public Sector Health Benefits.

NCPERS commissioned the research of constitutional, statutory, and case law protections of public sector retirement and health care benefits which was conducted by the law firm of Klausner & Kaufman.

The retirement and health benefit protections reports are available respectively on the NCPERS' website at: [http://www.ncpers.org/artman/uploads/retirement\\_benefit\\_protections.pdf](http://www.ncpers.org/artman/uploads/retirement_benefit_protections.pdf) and [http://www.ncpers.org/artman/uploads/health\\_benefit\\_protections.pdf](http://www.ncpers.org/artman/uploads/health_benefit_protections.pdf)

### **Ice Miller Issues Alert on PPA Changes Applicable to Hybrid Governmental Plans**

On February 2, 2007, the law firm of Ice Miller alerted governmental plans to Pension Protection Act (PPA) changes applicable to cash balance and other hybrid plans. PPA § 701 amended the Age Discrimination in Employment Act (ADEA), the Employee Retirement Income Security Act (ERISA), and the vesting and benefit accrual rules of Internal Revenue Code (IRC) § 411. These changes determine how benefits in cash balance and other such hybrid plans may accrue in ways that are not age discriminatory.

While governmental plans are generally not subject to ERISA or IRC § 411, they are subject to the ADEA. Under the new ADEA rules, a cash balance plan or other "applicable defined benefit plan" will not be treated as age discriminatory if, under the terms of the plan, a participant's "accrued benefit" is equal to or greater than that of a "similarly situated" younger individual. Similarly situated refers to an individual who is identical to the participant in every respect (e.g., period of service, compensation, position, date of hire, etc.) except for age. PPA § 701 defines an "applicable defined benefit plan," as a DB plan under which "the accrued benefit (or any portion thereof) is calculated as the balance of a hypothetical account maintained for the participant" or as an accumulated percentage of the participant's compensation.

Internal Revenue Service (IRS) Notice 2007-6 provides further guidance and uses the phrase “statutory hybrid plan” to describe an applicable plan, defining it broadly to include “either a lump sum based plan or a plan that has a similar effect to a lump sum based plan.” The Notice goes on to explain that such a plan would include a DB plan under “which the accumulated benefit of a participant is expressed as the balance of a hypothetical account maintained for the participant ... and does not depend on whether the plan provides for an optional form of benefit in the form of a lump sum payment.”

In the alert, Ice Miller notes that governmental plans with “fixed interest rate structures such as DROPs, guaranteed refunds of employee contributions, annuity savings accounts, money purchase options, or cash balance plans will want to evaluate these structures carefully in light of the PPA and Notice 2007-6.” Ice Miller also notes that, in Notice 2007-6, the IRS has requested comments on these issues, including applying the rules to plans in which “only certain participant’s accrued benefits, or only a portion of a participant’s accrued benefit, is determined by lump sum based accrual methods.” The IRS’s deadline for comments on Notice 2007-6 is April 16, 2007.

Ice Miller’s alert is at: [http://www.icemiller.com/enewsletter/Bulletins/Govt\\_020207.htm](http://www.icemiller.com/enewsletter/Bulletins/Govt_020207.htm)  
Notice 2007-6 is at: <http://www.irs.gov/pub/irs-drop/n-07-06.pdf>

### **U.S. Bureau of Labor Statistics Reports Consumer Price Index to Three Decimal Places**

Effective with the January 2007 release of the Consumer Price Index (CPI), the U.S. Bureau of Labor Statistics (BLS) has begun computing percent changes in the CPI based upon indexes with three decimal places rather than one decimal place. This change applies to the All Items Consumer Price Index and all component indexes for the CPI-U, CPI-W, and C-CPI-U, for the U.S. City Average and all other published areas. In addition, CPI index values are displayed to three decimal places in all paper and electronic publications. The percent changes will continue to be published to one decimal place.

This change addresses a rounding issue that has resulted in published percent changes that are 0.1 percentage point higher or lower than the same percent changes based on unrounded index values (i.e., indexes to three or more decimal places). These differences can be particularly important when percent changes are very small. Publishing the index values to three decimal places, and using these values to compute percent changes, essentially eliminates the rounding differences.

BLS states that the index values will continue to be calculated from underlying price data in the same manner as in the past, and no systematic upward or downward effect on the data is being introduced. The levels of future indexes will be affected only in that they will be published to three decimal places rather than one. Official CPI data previously published will not be revised.

BLS has posted additional information at: <http://www.bls.gov/cpi/cpithreedec.htm>

### **CalPERS Establishes Trust Fund to Prefund Retiree Health Benefits**

On February 22, 2007, the California Public Employees’ Retirement System (CalPERS) announced the creation of a new trust fund to allow public employers who contract with CalPERS for employee health benefits to prefund the future cost of retiree health insurance and other postemployment benefits (OPEB). Beginning March 1, 2007, the California Employers’ Retiree Benefit Trust Fund will allow participating employers to make contributions into the trust fund and use investment earnings to partially or fully fund OPEB obligations. The trust fund was created to help the entities comply with Governmental Accounting Standards Board Statement No. 45, requiring governmental employers to report OPEB liabilities in their financial statements.

To participate in the trust fund, employers must:

- 1) Certify that their agency is eligible under applicable laws and regulations.
- 2) Obtain an actuarial valuation prepared in accordance with CalPERS guidelines.
- 3) Adopt the CalPERS agreement to prefund OPEB costs.
- 4) Submit an original signed agreement, actuarial valuation report, certification that the actuarial valuation satisfies CalPERS requirements, and a summary of the actuarial information in the proper format for CalPERS approval.

Detailed information about the Trust Fund Program is available at:

<http://www.calpers.ca.gov/index.jsp?bc=/employer/retiree-ben-trust/home.xml&pat=PAER>

### **Standard & Poor's Optimistic that State Pension Funding Levels Will Stabilize and Improve**

On February 28, 2007, Standard & Poor's (S&P) released its report, *Improved U.S. State Pension Funding Levels Could Be On The Horizon*. The report surveys the financial status of the major state public employee and teachers' retirement systems in all 50 states as of fiscal year (FY) 2005.

S&P considers the financial status of an employer's pension plan to be a key factor in the employer's credit rating. One measure of a plan's status is its funded ratio (the actuarial value of assets divided by actuarial accrued liabilities). Although state pension funded ratios have decreased since FY 2000, when average ratios exceeded 100%, S&P reported that above average investment returns for the past three fiscal years and higher employer contribution rates in 2003 and 2004 may help to stabilize and improve the states' funded levels. Even though the mean funded ratio dropped slightly from 83.5% in 2004 to 81.8% in 2005, the report's authors were optimistic. According to S&P's Primary Credit Analyst, Parry Young, "There is reason to believe that funded ratios could stabilize and improve over the medium term if investment returns and liability growth meet expectations."

The S&P report also discussed funding other postemployment benefits (OPEBs) and the implementation of GASB accounting rules which treat OPEBs on an accrual basis, similar to pension benefits. According to the report, "Standard & Poor's believes that, with or without the prefunding of OPEB liabilities, most employers will be able to continue to meet their ongoing OPEB cost requirements without any near-term effect on credit quality."

A copy of the report is available on NASRA's website at:

<http://www.nasra.org/resources/S&Pstatefundinglevels0702.pdf>

### **Senators Ask GAO to Study Pension Plans' Hedge Fund Investments**

On March 1, 2007, Senator Max Baucus (D-Mont.), chairman of the U.S. Senate Finance Committee, and Senator Charles E. Grassley (R-Iowa) requested that the Government Accountability Office (GAO) study the scope of public and private pension plans' investments in hedge funds and evaluate the potential related risks and returns. In their letter to U.S. Comptroller General David M. Walker, the senators described hedge funds as private investment funds that invest in a wide range of asset classes and engage in a wide variety of investment strategies, such as "taking both long and short positions, using arbitrage, buying and selling undervalued securities, trading options or bonds, and investing in almost any opportunity in any market where it foresees impressive gains at reduced risk."

The senators expressed their concern that such complex investments could expose the pension plans, their participants, and ultimately the taxpayers to greater financial risk. Until recently, hedge funds were limited in how much pension plan equity they could receive, but the Pension Protection Act effectively eliminated such restrictions with regard to certain pension plan assets. The senators indicated that, as a result, more pension

assets could be invested in hedge funds which have generally been subject to less regulatory oversight than traditional investments.

Specifically, the senators requested that the GAO investigate:

- The extent that public and private pension plans invest in hedge funds;
- How pension plan sponsors evaluate the hedge funds in which they invest;
- The mechanisms that exist to monitor pension fund asset allocation;
- How the pension plans' hedge fund investment returns (net of fees) compare to other investments;
- The benefits and risks caused by hedge fund investments; and
- The roles of the Labor Department and other federal agencies in regulating and monitoring pension plans' use of hedge fund investments.

A copy of the letter is available at: <http://www.senate.gov/~finance/press/Bpress/2007press/prb030107c.pdf>

### **U.S. Health Care Spending Projected to Double by 2016**

On February 21, 2006, *Health Affairs* journal published a web article titled *Health Spending Projections Through 2016: Modest Changes Obscure Part D's Impact*. Authored by researchers at the Centers for Medicare & Medicaid Services (CMS), the report predicts that the annual rate of growth in U.S. health spending will decrease slightly from 6.9% in 2005 to 6.8% in 2006, and then stabilize at 6.9% from 2007 through 2016 (about 2.1 percentage points higher than the projected growth rate for gross domestic product (GDP)). However, despite this moderation in health spending trends, overall health expenditures are projected to double from \$2.1 trillion in 2006 (16% of GDP) to \$4.1 trillion in 2016 (20% of GDP).

Between 2005 and 2006, total Medicare spending is expected to increase 22.1% from \$342.0 billion to \$417.6 billion, largely as a result of Medicare Part D drug coverage. In 2007, Medicare spending growth is expected to slow to 6.5%, partly due to legislated Medicare cuts in managed care payments and slowing growth in physician payments. In 2016, annual Medicare spending is projected to reach \$862.7 billion.

Other CMS projections include:

- Prescription drug spending is expected to increase 6.5% in 2006 and 8.6% (on average) between 2007 and 2016, reaching \$498 billion in 2016.
- Hospital spending is expected to increase 6.6% in 2006 (down from 7.9% in 2005), due to slower increases in Medicare and Medicaid spending. Between 2007 and 2016, hospital spending is expected to grow at an average annual rate of 7.0%, reaching \$1.3 trillion in 2016.
- Private health insurance premiums are projected to increase 4.7% in 2006.
- Nursing home spending is expected to increase 3.4% in 2006 (down from 6.0% in 2005).
- Home health care spending is expected to increase 12.5% in 2006, placing it among the fastest growing health care areas.

The article is available on the Health Affairs website (with a Health Affairs subscription) at:

<http://content.healthaffairs.org/cgi/reprint/hlthaff.26.2.w242v1.pdf>

### **Massachusetts Governor Proposes Using Tobacco Settlement Payments to Fund Retiree Health Benefits**

On February 28, 2007, Massachusetts Governor Deval L. Patrick proposed using revenues from a multi-state tobacco litigation settlement to fund the state's retiree health benefits and other postemployment benefits (collectively referred to as "OPEB"). Currently, the state pays about \$380 million annually for these benefits under "pay-as-you-go" accounting rules. Under the GASB's new OPEB accounting rules, the state's annual OPEB contribution is estimated to be \$703 million (assuming the benefits are prefunded and the monies held in

an irrevocable trust). Overall, the State's unfunded OPEB liability is estimated to be about \$7.6 billion (assuming pre-funding) or \$13.3 billion (assuming no pre-funding).

In his fiscal 2008 budget presentation, Governor Patrick proposed eliminating the Health Care Security Trust Fund (which holds the tobacco settlement payments) and transferring \$400 million to help finance the State's unfunded OPEB liability. Over the past few years, annual tobacco settlement payments averaged about \$250 million, dropping somewhat to \$236 million in 2006. Under the Governor's plan, the transfers would be phased-in over three years, after which the state would use 90% of the annual tobacco settlement payments to help fund the OPEB liability.

Source: BNA *Pension & Benefits Reporter*, March 6, 2007.

### **Massachusetts Health Authority Selects Plans to Provide Required Health Coverage**

On March 8, 2007, the Commonwealth Health Insurance Connector Authority (CHICA) announced its endorsement of plans from seven insurance carriers offering health insurance to uninsured residents. The CHICA is Massachusetts' new independent public authority established to implement significant provisions of the state's 2006 health care reform law. Under the law, all state residents are required to have health coverage by July 1, 2007, or face tax penalties.

The CHICA administers two separate programs: i) Commonwealth Care providing subsidized insurance for residents with annual incomes below 300% of the federal poverty level, and ii) Commonwealth Choice providing commercial health products to uninsured residents and small businesses. Under Commonwealth Choice, all plans will offer comprehensive coverage including inpatient and outpatient medical care, mental health and substance abuse services, rehabilitation services, hospice, and vision care. Individuals will be able to choose among a variety of basic health plans that offer different levels of cost-sharing and premiums. The three major categories of coverage include a basic plan, a value plan, and a more expensive "premier" plan. The estimated premium for the least expensive plan for the average 37-year-old uninsured individual is \$175 per month. However, costs will vary depending on age, geographic location, and prescription drug coverage.

On March 20, 2007, the executive board of the CHICA approved draft standards for minimum coverage under the plans. The board also voted to delay the date for required coverage until January 2009, in order to give employers and individuals more time to evaluate the new plans.

More information is available at: [http://www.mass.gov/Qhic/docs/seal\\_of\\_approval\\_pr.doc](http://www.mass.gov/Qhic/docs/seal_of_approval_pr.doc)

### **Circuit Court Nullifies Law Merging West Virginia Teachers' DC Plan with the DB Plan**

On January 26, 2007, the Circuit Court of Kanawha County, West Virginia, declared null and void legislation requiring participants in the Teachers' Defined Contribution Retirement System (TDC) to transfer to the State Teachers' Retirement System (TRS) (*Anthony J. Barbario v. West Virginia Consolidated Public Retirement Board*, Civil Action 06-C-687, 1/26/07).

TRS was created in 1941 as a defined benefit (DB) plan for state teachers and other school employees. Under the plan, employees contribute 6% of pay with equivalent benefits provided by their employers. In 1990, the TDC was created as a mandatory defined contribution (DC) plan for all teachers and school employees hired after July 1, 1991. TDC participants contributed 4.5% of pay with an additional 7.5% contributed by employers.

In 2005, the West Virginia Legislature passed the Teachers Retirement Equity Act (TREA) requiring teachers in TDC to transfer to TRS upon approval by the majority of voting TDC participants (provided those voting were a majority of total TDC participants). Upon transfer, the individual accounts of each TDC member would be merged into TRS. Moreover, in order for a member to receive full credit in TRS for service in TDC, the

member had to contribute an additional 1.5% of their TDC account by June 30, 2007; otherwise, their TDC service credit transferred to TRS would be reduced by 25%.

TREA was intended to improve the retirement security of TDC participants while helping to reduce overall costs. According to the West Virginia Consolidated Public Retirement Board's actuary, the change could save \$1.9 billion over 30 years because lower employer contributions were required for TRS (4.3% of pay) than for TDC (7.5% of pay). State teacher representatives also indicated the change might encourage teachers to remain in their jobs longer.

In 2006, the TDC participants voted to merge with TRS. After the vote, however, over 1,000 of the TDC's approximately 23,000 participants brought suit, alleging the transfer deprived them of private property without just compensation. After hearing the case, the circuit court found that each TDC account constituted the private property of individual members. Therefore, absent express consent of the member, depriving the member of such property would constitute a "taking" in violation of the West Virginia Constitution. Moreover, the court found that the changes made by the TREA to the terms and conditions of the TDC violated the Contracts Clause of both the U.S and West Virginia Constitutions, prohibiting "arbitrary and unilateral changes in terms and conditions." Consequently, the court declared the TREA to be unconstitutional and, therefore, null and void.

The circuit court's final order is available at: <http://www.wvretirement.com/TDCFinalOrder.pdf>

### **Missouri Appellate Court Rules Disability Benefits Are Not Marital Assets**

On February 27, 2007, the Missouri Western District Court of Appeals overturned a trial court's decision and ruled that benefits received for permanent and total disability were not marital property and, therefore, not subject to division (*Coffman v. Coffman*, Mo. Ct. App. No. WD66204, 2/27/07).

The case involves a former employee of the General Motors Corporation who participated in the company's pension plan. Under the plan, after 10 years of service, an employee who becomes permanently and totally disabled is eligible to receive disability benefits until age 65. Upon reaching age 65, the disability benefit is reclassified as a normal retirement benefit.

After attaining age 45 with more than 20 years of service, the husband became permanently and totally disabled. Several years after, the couple divorced. When the dissolution was tried, the trial court ruled that the husband's disability benefits were a marital asset to the extent accumulated during the marriage, and awarded a proportionate amount to the wife. The husband appealed the trial court's award.

As explained by the appeals court, under Missouri law, retirement plan benefits are ordinarily deemed to be marital property to the extent they accumulate during the marriage and are subject to division in a dissolution of marriage proceeding. However, disability benefits are not marital property to the extent they substitute for earnings lost due to the recipient's inability to work as a result of permanent and total disability. Moreover, some pension benefits are "hybrid" to the extent they contain both a disability and deferred compensation component.

According to the court, clear evidence showed that that the husband could not receive the benefits absent permanent and total disability. Consequently, the benefits received by the husband up to the age of 65 were non-marital assets. However, after the husband turns age 65, the benefits received would serve as deferred compensation and, therefore, would be marital assets subject to division.

The case can be found at:

<http://www.courts.mo.gov/courts/pubopinions.nsf/e53581bdd14e64858625661f004bc8fd/34fbace4bde842ee8625728e006256f5?OpenDocument>