

March 2008

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 with "SUBSCRIBE NEWS SCAN" in the subject line. To stop receiving this publication electronically, send "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.

Note: The authors of these 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.

CMS Extends Deadlines for Retiree Drug Subsidy Payment Reconciliations

On March 24, 2008, the Centers for Medicare and Medicaid Services (CMS) announced extended deadlines for Retiree Drug Subsidy (RDS) program payment reconciliations. For all plan sponsors with RDS applications ending in 2006, the March 31, 2008, reconciliation deadline has been extended to June 30, 2008. This extension applies both to calendar year and non-calendar year plans.

In addition, CMS also extended the deadlines for plan sponsors with RDS applications ending in the first quarter of calendar year 2007, as follows:

For RDS Applications Ending	Old Deadline	New Deadline
January 2007	April 30, 2008	July 31, 2008
February 2007	May 31, 2008	August 31, 2008
March 2007	June 30, 2008	September 30, 2008

For plan sponsors with RDS applications for plan years ending on or after April 1, 2007, the deadline is unchanged, and remains the last day of the 15th month following the last day of the RDS plan year specified in the applications. The announcement also notes that CMS will not provide future extensions.

Additional information is available at: http://www.rds.cms.hhs.gov/recon_deadline.htm

GAO Reports on Funded Status of State and Local Government Pension and Health Benefits

On February 28, 2008, the U.S. Government Accountability Office (GAO) released its report *State and Local Government Retiree Benefits, Current Funded Status of Pension and Health Benefits* (GAO-08-223). The report was requested by the U.S. Senate Finance Committee to better understand: 1) the current funded status of state and local government retiree benefits and; 2) key measures of funded status. The report explains that understanding funded status is complicated and requires examining not only whether funding levels are improving over time but also whether governments are making the recommended contributions each year. It identifies three key measures that are useful in understanding funded status:

1. **The ratio of annual contributions to annually required contributions** – which indicates the extent that governmental payments to the fund benefits are keeping up with benefit costs.
2. **Funded ratio** - which indicates the extent that plan assets cover plan liabilities.
3. **Unfunded liabilities** - which indicate the excess, if any, of plan liabilities over assets.

Generally, the report found that state and local governmental pension plans are reasonably well-funded. In determining funded status, the GAO analyzed data from the Public Fund Survey (PFS) and Public Pension Coordinating Council (PPCC) surveys. According to the PFS, the aggregate funded ratio was about 86% in fiscal year 2006. Of 65 large public pension plans surveyed, 58% maintained funded ratios of at least 80% in 2006, which is considered sound funding for state and local governments. However, the percentage of plans with funded ratios of 80% or higher has decreased since 2000. These declines are often attributed to the stock market downturn in the early 2000s which reduced the value of plan assets.

However the report also cautions that some governments are not contributing the full annual required contribution (ARC) needed to maintain or improve their plans' funded ratios. In fiscal year 2006, 46% of the 70 plans analyzed contributed less than 100% of the ARC, with 39% contributing less than 90%. Reasons given for not contributing the full ARC include: fiscal pressure and the need to decide among competing priorities.

With regard to funding retiree health care liabilities, the report explains that governments have generally not prefunded retiree health benefits, but rather have paid the annual costs out of their general funds using a pay-as-you-go approach. However, as a result of recent changes to governmental accounting standards, state and local governments have begun to measure and disclose their retiree health care liabilities. After reviewing several earlier studies of state and local government retiree health care, the GAO estimates that the total retiree health care liability ranges between \$600 billion and \$1.6 trillion in present value terms. However, it also cautions that these estimates are not, for the most part, based on actuarial valuations.

While the report shows annual payments for retiree health benefits are currently low compared to pensions, it warns that the future growth of health costs will likely be more rapid and less predictable. It concluded that, "state and local governments need to find strategies for dealing with unfunded liabilities, and such strategies will take time, will require difficult choices, and could be affected by changes in national health policy."

In a February 28 statement, Senate Ranking Member Charles Grassley (R-Iowa) commented on the GAO report stating, "It's good news that state and local government pension plans appear to be healthy." He added that, "states should pre-fund retiree health liabilities, while Congress looks at ways to hold down health care costs."

The GAO report is available at: <http://www.gao.gov/new.items/d08223.pdf>

IRS Issues Private Letter Ruling on Permissive Service Credits for Governmental Pension Plans

On February 1, 2008, the IRS issued a private letter ruling (PLR 200805026) regarding application of Internal Revenue Code (IRC) § 415(n) to the purchase of permissive service credits in a governmental defined benefit plan. The primary issue was whether service credit purchased with after-tax contributions made prior to December 31, 1997, could be treated as permissive service credit.

Generally, IRC § 415(b) limits the annual benefits that can be paid from a qualified defined benefit (DB) plan and § 415(c) limits the annual additions that can be made to a defined contribution (DC) plan. IRC § 415(n) was added by the Taxpayer Relief Act of 1997 (TRA) and limits that amount of service credit that participants can purchase in governmental DB plans. Generally, under § 415(n), if the payment made to purchase service in a given year exceeds the 415(c) limit for that year, then the annual benefit resulting from the contributions must be included in the benefit tested under the 415(b) limit.

While IRC § 415(n) is generally effective for service credit purchases after December 31, 1997, certain TRA transition rules “grandfather” plan participants who were covered by the plan as of TRA’s effective date (August 5, 1997). For these grandfathered participants, the 415(c) limits are not applied to reduce the amount of purchasable service credit to less than what was allowed under the plan as of TRA’s effective date.

In the ruling, the IRS confirmed that grandfathered plan participants who purchased service credit by making after-tax contributions prior to December 31, 1997, are to be treated under the TRA transition rules. Consequently, the service credit purchased with the contributions is considered “permissive service credit” under § 415(n) regardless of the fact that the contributions were made before TRA’s general effective date.

Readers should note that private letter rulings are directed only to the taxpayers requesting them and may not be used or cited as precedent. The letter ruling can be downloaded at: <http://www.irs.gov/pub/irs-wd/0805026.pdf>

AICPA Seeks Reconsideration of Certain Cafeteria Plan Proposed Regulations

In February 2008, the American Institute of Certified Public Accountants (AICPA) filed comments with the U.S. Treasury Department and Internal Revenue Service seeking reconsideration of certain proposed cafeteria plan regulations (REG-142695-05) under Internal Revenue Code (IRC) § 125. Issued in August 2007, the new proposed regulations update existing proposed regulations but also narrow certain rules in ways the AICPA found problematic. Specifically, the AICPA’s comments address two provisions of the proposed regulations:

- 1) the effect of § 125 plan failures; and
- 2) the assertion that § 125 is the exclusive means by which an employer can offer employees an election between taxable and nontaxable benefits without the election resulting in gross income.

In commenting, the AICPA noted the proposed regulations have adopted a standard of “zero tolerance” for any failure regardless of size or scope. Consequently, any small error in plan provisions or operations, even if it affected only one participant, could potentially disqualify the plan. In order to prevent such errors from needlessly harming plan participants, the AICPA urged the creation of a plan corrections program, similar to the Employee Plans Compliance Resolution System (EPCRS) currently available for qualified pension plans. Alternatively, if a corrections program is not possible, the AICPA suggested the regulations be applied on an individual-by-individual basis, in order to limit the impact of the failure on plan participants.

Additionally, the proposed regulations assert that cafeteria plans are the exclusive means for employers to offer employees an election between taxable and nontaxable benefits without the benefits resulting in gross income. The AICPA cautioned that such an assertion is overly broad and requested that it be removed from the final regulations. Since § 125 is an exception to the general constructive receipt rules and applies to elections between cash and qualified benefits, the AICPA argued that it does not apply to elections between cash and nonqualified benefits. Therefore, the regulations should provide that the general constructive receipt rules apply to elections that do not involve qualified benefits.

A copy of AICPA’s comment letter is available at: http://tax.aicpa.org/NR/rdonlyres/BAE6FE46-6920-4518-8028-52782B64D010/0/AICPA_Electronic_LH_125_Comments_final_1_28_07.doc

For a detailed summary of the proposed § 125 regulations, see the Groom Law Group’s analysis at: <http://www.groom.com/CafeteriaPlanProposedRegulationSummary.html>

NCPERS Releases Results of Survey on Implementation of GASB Statement No. 45

In January 2008, the National Conference on Public Employee Retirement Systems (NCPERS) published a new Research Series report, *GASB 45 Survey of NCPERS Members*. The report summarizes the results of an online survey conducted by NCPERS and Gallagher Benefit Services on how plan sponsors are responding to the requirements of GASB 45. In June 2004, the Governmental Accounting Standards Board (GASB) issued Statement No. 45 establishing financial reporting and accounting standards for state and local governments related to post-employment benefits other than pensions (OPEB).

The majority of respondents were large governmental employers, with 62% having annual revenues of \$100 million or more. Nearly 67% have completed their initial GASB OPEB valuations while about 24% were in process. Only about 10% had yet to begin their valuations. NCPERS noted that only a limited number of plans responded to the voluntary survey (74 out of about 500) and, therefore, the results could not be considered a representative sample.

As discussed in the report, the respondents' OPEB liabilities varied extensively depending on plan design, retiree contribution levels, and employer demographics. About 29% had OPEB liabilities exceeding \$500 million, 26% had liabilities between \$50 million and \$500 million, 15% had liabilities of less than \$50 million, and the remaining 30% had not yet completed their valuations.

With regard to OPEB funding, 11% of the respondents plan to fully fund their annual required contributions (ARC), 26% plan to at least partially fund the ARC, and 22% plan to continue funding on a "pay-as-you-go" basis, while the remaining respondents have not yet determined their funding approach. Because the GASB 45 requirements relate to the measurement and disclosure of OPEB costs and liabilities, rather than their funding, employers may choose from a range of funding options. They can continue pay-as-you-go financing, or partially or fully prefund the benefit by paying most or all of the ARC. They might also issue OPEB bonds in an effort to reduce the employer's costs through the higher investment returns that may be available. These choices involve complicated trade-offs that should only be made after careful deliberation.

The survey is accessible on NCPERS's website at:

<http://www.ncpers.org/News/PageText/documents/ResearchSeriesII.pdf>

Morningstar Issues Report on Public Sector DB Plan Investment Performance and Asset Allocation

On December 17, 2007, Morningstar, Inc., in conjunction with the National Conference on Public Employee Retirement Systems (NCPERS), published a report on the investment performance of public sector defined benefit pension plans. The report is based on Morningstar's survey of 62 participating public sector defined benefit plans who are members of NCPERS (consisting of 4 states, 8 counties, 32 cities and 18 police/fire/teacher retirement plans) that voluntarily provided data for the project. The analysis focuses on public plans' investment performance from a risk-adjusted return and diversification perspective relative to mutual funds (the predominant vehicle used in defined contribution retirement plans). The findings indicate:

- Public plans are broadly diversified. As of year-end 2006, the participating public sector plans had 41% of assets allocated to U.S. equity, 25% to fixed income, 20% to international equity, 8% to real estate and Real Estate Investment Trusts (REITs), 3% to private equity, 1% to hedge funds and 2% to cash.
- Annualized public plan investment returns were 8.72% over the 1997-2006 period, based on the 10-year time-weighted return. This was 170 basis points higher than the 7.02% return earned by mutual funds over the same period.

The report notes that, due to the small sample size, the data are incomplete and the study should only be considered a starting point. In order to provide more comprehensive information on investment performance,

Morningstar has formed a “Pension, Endowment, and Foundation” (PEF) database and is asking public and private plans to participate.

A copy of the report is available at:

http://www.ncpers.org/News/PageText/documents/MorningstarReport_122007.pdf

Health Improvement Institute Introduces ‘Triple Aim’ Health Reform Based on Integrated Patient Care

On January 25, 2008, Dr. Donald Berwick, clinical professor of pediatrics at the Harvard Medical School, discussed the design and coordination of patient health care at the Families USA Health Action 2008 conference. Berwick, who is also president and CEO of the Institute for Healthcare Improvement (IHI), presented what he referred to as the “Triple Aim” concept for health care reform, which is based on:

- Improving the quality of patients’ care;
- Raising the general level of health in the population; and
- Containing the per capita cost of health care.

Ultimately, the goal of the Triple Aim is better care at lower costs. According to Berwick, the necessary components of the Triple Aim are:

- Universal access to health care;
- Creation of a financial management system with capped budgets; and
- Implementation of quality measures across a continuum of care.

Additionally, he noted that improving patient’s experiences in the health care system requires an integrated care system. Berwick said, “In order to achieve such a system, hospitals would have to stop protecting their revenues; physicians would have to accept the primary care model; nurses would have to accept new roles as care guides; patients would have to ‘learn that more is worse’ and take control of health decisions; employers and other health insurance payers would have to accept the care integration model; and insurers would have to reduce transaction costs.”

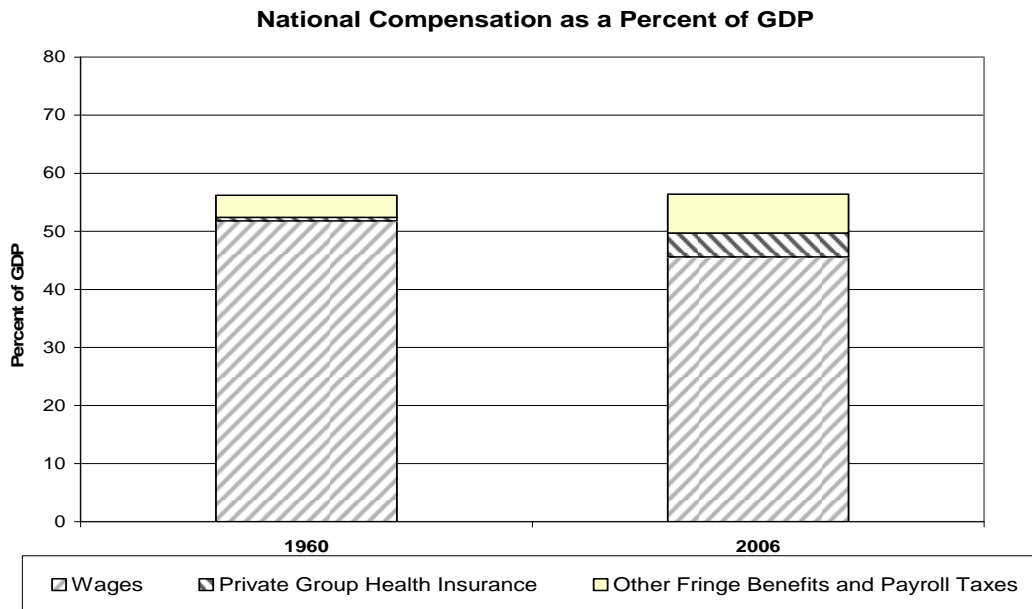
Further information on Triple Aim is available in the Technical Brief under Additional Resources at:

<http://www.ihl.org/IHI/Programs/ConferencesAndSeminars/AchievingtheTripleAimJune2008.htm>

Kaiser Foundation Reports on Impact of Health Care Costs on Wages

On February 12, 2008, the Kaiser Family Foundation released its report *Wages and Benefits: A Long-Term View*. The report is part of Kaiser’s “snapshot” series and focuses on the growth in employer costs for private group health insurance compared with wages, other benefits and national gross domestic product (GDP). According to the report, between 2001 and 2007, health insurance premiums increased 78% while general inflation increased 17% and wages increased 19%. Overall, total employer costs for group health insurance have grown from \$23 billion in 1960 to \$537 billion in 2006.

The report also examines total employer costs as a share of GDP for employee compensation, separated into wages, private group health benefits, and other benefits (including payroll tax contributions). Interestingly, as shown in the following graph, while total compensation (i.e., wages plus benefits) has remained a fairly steady percent of GDP between 1960 and 2005 (56% to 59%), wages have fallen from 52% of GDP in 1960 to 46% in 2006. Consequently, the share of compensation representing benefits has increased from about 4% of GDP in 1960 to 11% in 2005.



It is also interesting to note that much of this change is attributable to growing employer costs for private group health insurance. In another section, the report examines employer costs for health and other benefits as percentages of total compensation. Employer payments for health benefits have increased as a share of total compensation from 1.4% in 1960 to 7.2% in 2006. Non-health benefits have also increased as a share of total compensation from 7.7% in the 1960s to a high of 12.9% in the 1980s, but have declined somewhat to 11.7% in the 2000s.

The report is available at: <http://www.kff.org/insurance/snapshot/chcm012808oth.cfm>

Department of Labor Publishes Article on Older Americans Working Longer

In the January 2008 issue of *Monthly Labor Review*, the U.S. Bureau of Labor Statistics (BLS) published an article titled “Older workers: increasing their labor force participation and hours of work.” Written by Murray Gendell, Georgetown University professor emeritus of demography, the article updates his 2001 study based on BLS and Social Security data.

The study examines changes in the number of older Americans working full-time after retirement age. Gendell found that, since at least 1994, the labor force participation rates of older workers have increased considerably. Between 1994 and 2005, the share of workers employed full time between ages 65-69 rose from 44.0% to 54.2% for men and from 27.0% to 42.5% for women.

In addition, the average hours worked by older Americans has increased. From 1994 to 2006, the average workweek for working Americans ages 65-69 increased from 31.8 to 35.9 hours (12.9%) for men. For women it increased from 26.6 to 30.1 hours (13.2%). For working people ages 70-74, the average workweek grew from 29.5 to 32.7 hours (10.8%) for men and from 24.7 to 27.6 hours (11.7%) for women.

The study indicates that the share of the workforce ages 50 and older has grown from about one-fifth in 1995 to one-fourth in 2005 and is projected to reach about one-third by 2015. However, by 2015, the number of older

Americans leaving the labor force will also increase to record levels resulting in an increase in the dependency rate. Other significant trends over the last 30-years include:

- Due to changes in the economy, Social Security laws, and other factors, the trend toward earlier retirement has weakened and incentives to delay retirement have strengthened.
- Due to increasing competition from foreign and new domestic companies, private employers are shifting from defined benefit (DB) plans to defined contribution (DC) plans. As a result, the share of workers with DB plan coverage declined from 80% in 1985 to 33% in 2003.
- Rapid growth in health care costs has caused older workers to continue working full time, at least until they become eligible for Medicare coverage.

According to Gendell, increases in labor force participation and full-time employment by older Americans result from changes in the workplace and in Social Security. He expects the trends will likely continue through 2020 as the baby boom generation reaches retirement age.

The article is accessible at: <http://www.bls.gov/opub/mlr/2008/01/art3full.pdf>

Ohio Court of Appeals Rules on Nonprofit Employee's Eligibility to Purchase Service in Ohio PERS

On February 19, 2008, the Ohio Court of Appeals ruled that Susan Stiles, director of a county domestic violence program (DVP), remained a public employee after the DVP program transferred to a nonprofit organization. Consequently, she was entitled to purchase credit for this service from the Ohio Public Employees Retirement System (PERS) (*Greene County Department of Job & Family Services v. Ohio Public Employees Retirement System*, Ohio Ct. App., No. 07AP-421, 2/19/08).

From 1976 until 1984, Stiles worked as a public employee for the Greene County Welfare Department (currently the Department of Job and Family Services). During the period from 1979 to 1984, Stiles was eligible for membership in PERS and her employer made regular contributions on her behalf. In 1984, due to budget cuts, the welfare department converted the county's DVP to a newly formed nonprofit organization. Stiles served as director of the nonprofit DVP and entered into an agreement with the welfare department's executive director, who promised to continue funding the nonprofit organization to cover Stiles' salary "as much as possible."

In 2003, Stiles requested permission from Ohio PERS to purchase credit for her years of service from July 1, 1984, through November 30, 1988. Initially, her request was denied when a hearing officer found insufficient evidence of a contract between the county welfare department and the nonprofit DVP to consider her a public employee. However, in 2005, the PERS Board reversed the decision finding existence of a contract. The Board also found her duties under the nonprofit DVP were sufficiently similar to those performed under the county welfare department for her to be eligible for PERS coverage while working for the nonprofit DVP.

In December 2005, the county filed for declaratory judgment and a writ of mandamus to overturn the Board's decision. In March 2007, the trial court denied the county's request. The county appealed, contending that the welfare department's executive director lacked authority to contract with the nonprofit. Additionally, the county argued that Stiles' resignation from county employment to become director of the DVP constituted a break in service.

This February, the Ohio Court of Appeals ruled that the trial court did not err in finding evidence of a contract between the welfare department and the nonprofit DVP. Additionally, it found that the executive director's authority to contract with the DVP was a factual issue that should have been addressed in earlier proceedings. Since it was not addressed, the court found that the county forfeited the right to raise the issue upon appeal.

The court also noted that, under Ohio Revised Code 145.01(A)(2), a “public employee” is someone who belongs to PERS and “who continues to perform the same or similar duties under the direction of a contractor who has contracted to take over what before the date of the contract was a publicly operated function.” In this case, Stiles continued to perform the same duties for the nonprofit DVP as under the county. Therefore, the court ruled she was eligible for PERS coverage.

The case can be found at: <http://www.sconet.state.oh.us/rod/docs/pdf/10/2008/2008-ohio-642.pdf>