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NASRA Supports Amending the Pension Protection Act's Cap on Interest Credits for Public Plans

As reported by BNA's *Pension & Benefits Reporter*, on May 20, 2008, Jeannine Markoe Raymond, Director of Federal Regulations for the National Association of State Retirement Administrators (NASRA), spoke at a Washington Legislative Update session sponsored by the International Foundation of Employee Benefit Plans (IFEBP) in Washington, D.C. As part of her presentation, Ms. Raymond reported on NASRA's support for amending the 2006 Pension Protection Act (PPA) to permit state and local governments to set their own interest rate credits without violating the Age Discrimination in Employment Act (ADEA).

In 2006, § 701 of the PPA amended the ADEA by adding new rules that determine how benefits may accrue in ways that are not age discriminatory for cash balance plans and other similar hybrid plans. The rules were further interpreted by the IRS to include plans where the accumulated benefit of the participant is "expressed as the balance of a hypothetical account maintained for the participant...." Representatives of the IRS have stated their belief that such plans include certain governmental Deferred Retirement Option Plans (DROPs), as well as defined benefit plans that credit interest on refunds of "picked-up" employee contributions, among others. PPA § 701 also provided special rules for crediting interest on such accounts, under which a plan would be considered age discriminatory unless the plan limited the interest credited to no more than the "market rate of return." In this context, "market rate of return" is essentially defined as the interest rate on investment grade corporate bonds with maturities of 20 years or more, as determined by the IRS.

As explained by Ms. Raymond, this interest rate cap was intended to deal with age discrimination issues stemming from the conversion of traditional private-sector pension plans to hybrid cash balance plans. However, benefit protections and designs in public-sector plans are quite different from private-sector plans, and such discrimination issues generally do not arise. The application of the interest rate cap to public-sector plans may cause harm to public employees by reducing benefits, conflicting with state and local benefit guarantees, undermining efforts to preserve significant elements of defined benefit plans, and exposing public plans to liability if they are unable to fulfill their collective bargaining obligations. Consequently, NASRA supports legislation that would allow public plans to set their own interest crediting rates. This provision was recently included in H.R. 6382. Although bill was dropped on June 26, there is hope that it will be brought up again when Congress returns from its July recess.

Source: BNA *Pension & Benefits Reporter*, June 3, 2008.

GASB Begins Project Examining Possible Changes to Benefit Accounting and Reporting Standards

On April 24, 2008, the Governmental Accounting Standards Board (GASB) revised its 2008 Technical Plan, adding a new “Postemployment Benefit Accounting and Financial Reporting” project. The overall goal of the project is to consider improvements to accounting and financial reporting standards for state and local government pension and other postemployment benefits (OPEB), including:

- 1) Improving accountability with regard to the financial effects of employers’ actions and commitments related to pension benefits and OPEB;
- 2) Improving information about whether benefit costs are being paid by taxpayers as they accrue (i.e., maintaining interperiod equity); and
- 3) Improving the usefulness of pension and OPEB related information provided to users of governmental general purpose financial reports.

The GASB expects to finalize any changes by the end of 2013. The project’s timeline includes:

- Through 2008: Continue discussions related to potential accounting approaches.
- March 2009: Issue an Invitation to Comment (ITC) on potential approaches.
- July 2009: Hold public hearings and forums.
- December 2009: Discuss ITC responses and decide on further activities (e.g., issue a Preliminary Views statement or go directly to an Exposure Draft of the standards).

This project is particularly relevant to state and local governments due to recent efforts by proponents of financial economics to require public pension plans to disclose their “market value of liabilities” (MVL). The MVL is essentially a pension liability measure based on benefits accrued to date (excluding projected future salary and service) and using a discount rate based on risk-free bond returns. As such, it measures liabilities as if the plan had terminated on the valuation date. This contrasts with the current actuarial methods typically used for public plans which measure the liabilities on an ongoing basis and attempt to establish contribution rates as a level percentage of covered payroll.

Oponents of the MVL approach for public pension plans argue that: 1) state and local governments are long-term entities that are unlikely to go out of business or be sold; 2) public pension plan participants are generally entitled to the continued accrual of benefits until they retire; and 3) the MVL would needlessly inflate a plan’s current and projected costs. Additional information about the MVL issue is available on NASRA’s website at: <http://www.nasra.org/resources/MVL.htm>

Further information on the GASB’s project is available by selecting “Postemployment Benefit Accounting and Financial Reporting” on GASB’s website at: http://www.gasb.org/project_pages/index.html

BLS Publishes Survey of State and Local Government Retirement Benefits in 2007

In May 2008, the U.S. Labor Department’s Bureau of Labor Statistics (BLS) published its report: “National Compensation Survey: Retirement Benefits in State and Local Governments in the United States, 2007.” The survey represents 18.9 million full-time and part-time state and local government employees based on a sample of approximately 2,000 public-sector establishments. This study follows on an earlier National Compensation Survey “Employee Benefits in State and Local Governments” published in September 2007, which provided information about access to and participation in state and local government defined benefit (DB) and defined contribution (DC) plans. According to the earlier study, retirement benefits are provided to 99% of full-time employees of state and local governments, with 91% of full-time public-sector employees having access to DB plans and 33% having access to DC plans.

In this new report, the BLS focused on the detailed provisions of state and local governments' defined benefit and defined contribution plans. As reported by the BLS, some of the major findings include:

Defined Benefit Plans

- Nearly all participants in DB plans had their retirement benefits calculated on the basis of preretirement earnings.
- 95% of DB plan participants were covered by disability provisions and 82% were covered by early retirement provisions.
- More than 80% of employees were eligible to participate immediately after employment.
- 79% of participants were in plans that use a flat percentage of preretirement earnings per year of service, with most plans not being integrated with Social Security.
- One out of four participants could receive full benefits at any age after a service requirement was met with 56% of participants having a normal retirement age requirement.
- 83% of participants in state-sponsored plans were allowed to purchase credits for prior government service.
- About 93% of participants were in plans allowing new hires to participate while the remaining 7% were closed to new hires.

Defined Contribution Plans

- 70% of DC plan participants were in money purchase plans with fixed employer contributions.
- 76% of participants were allowed to contribute to the plan on a pre-tax basis.
- 65% of participants were allowed to transfer contributions from previous employer plans.

The report is available at: <http://www.bls.gov/ncs/ebs/sp/ebsm0008.pdf>

Pension Research Council Sponsors Conference on Future of Public Employee Retirement Systems

On May 1-2, 2008, the Wharton School's Pension Research Council and Boettner Center for Pensions and Retirement Research sponsored a symposium on the Future of Public Employee Retirement Systems. The conference focused on the challenges facing both national and international public retirement systems including: management and accounting issues, methods for measuring plan liabilities, and the defined benefit vs. defined contribution debate. The presentations covered the following broad topics:

- 1) Evolution of Public-Sector Pension Plans and Redefining Traditional Plan Design
- 2) New Developments in Public Plan Management
- 3) International Perspectives on Public Retirement Systems in Germany, Japan and Canada
- 4) Reform Paths for Public Sector Retirement Plans
- 5) Costs and Benefits of Public Retirement Systems

The presentations can be downloaded at: <http://www.pensionresearchcouncil.org/conferences/conf-2008.php>. While downloads are free, registration on the site is required before downloading.

State and Local Government Pension Plan Funding Considered Reasonably Sound

On April 17, 2008, the Center for Retirement Research at Boston College (CRR) released an issue brief titled: *The Miracle of Funding by State and Local Pension Plans*. The report is part of a series of studies that CRR is conducting for the Center for State and Local Government Excellence to provide research on state and local pension plans.

The study's key findings include:

- Overall, state and local pension plans are as well funded as private plans with assets covering about 90% of liabilities. Over the period 2003-2006, funding levels for public-sector retirement plans averaged 88% compared to 86% for private-sector retirement plans.
- Typically, public plans pay larger benefits than private plans and are not covered by national legislation that mandates funding standards.
- As of 2006, the unfunded liability for public plans was about \$380 billion. State and local governments could pay off this liability over 30 years through increasing their contribution rates by about 0.7% of covered pay.

According to the authors, the “Miracle” of funding by state and local pension plans is that it occurred without national legislation. In 1978, the U.S. House Education and Labor Committee's *Pension Task Force Report on Public Employee Retirement Systems* noted a “high degree of pension cost blindness” among state and local governments. However, largely for constitutional reasons, public plans were not made subject to ERISA-like legislation. Instead, the GASB's refinement of governmental accounting standards combined with state and local governments' recognition of the importance of sound pension funding resulted in steady growth in public pension assets through the 1990s. While funding levels declined between 2000 – 2002 due to a “perfect storm” of low domestic equity returns and interest rates, public plans gained back enough of these losses between 2003 – 2006 to reach an average funded level of 88%.

The report also includes an interesting discussion of the funding methods used to determine the actuarial liabilities and costs of public plans. The report is available at: http://crr.bc.edu/images/stories/Briefs/slp_5.pdf

IRS Releases 2009 Health Savings Account Inflation Adjustments

On May 13, 2008, the U.S. Treasury Department and IRS released Revenue Procedure 2008-29 establishing the 2009 inflation-adjusted amounts for health savings accounts (HSAs) as determined under Internal Revenue Code (IRC) § 223(g). Effective for calendar 2009, the annual HSA contribution limitations and High Deductible Health Care (HDHC) plan limitations are as follows:

2009 Annual HSA Contribution Limitations

HSA contribution limits are applicable to all contributions made to the HSA of an eligible individual, whether made directly by or on behalf of the eligible individual. For 2009, the annual HSA contribution limitations under a High Deductible Health Care (HDHC) plan as provided by IRC § 223(b)(2)(A) are:

- Individual coverage: \$3,000
- Family coverage: \$5,950

2009 Annual Qualified HDHC Plan Limitations

In order to qualify as a HDHC plan for HSA purposes, a health care plan must satisfy the following requirements as defined under § 223(c)(2)(A):

The minimum annual HDHC plan deductible limitations are:

- Individual coverage: \$1,150
- Family coverage: \$2,300

The maximum annual HDHC plan out-of-pocket expenses limitations (including deductibles, copayments, and other amounts, but not premiums) are:

- Individual coverage: \$ 5,800
- Family coverage: \$11,600

While not addressed in Revenue Procedure 2008-29, the Treasury recently issued a press release stating that the annual catch-up contribution permitted for HSA-eligible individuals age 55 and over will increase by statute in 2009 to \$1,000 (and remain at that amount in future years). Individuals who are eligible on the first day of the last month of the taxable year (typically December for most taxpayers) are allowed the full annual contribution plus catch-up contribution, if age 55 or older by year end, regardless of the number of months the individual was considered an eligible individual. For those who are no longer eligible individuals, both the HSA and catch-up contributions apply pro rata based on the number of months of the year a taxpayer is an eligible individual.

Revenue Procedure 2008-29 is available at: <http://www.ustreas.gov/press/releases/reports/rp13970407.pdf>

IRS Issues Private Letter Ruling on Minimum Required Distributions for Governmental Plans

On February 15, 2008, the Internal Revenue Service issued a private letter ruling (PLR 200807023) regarding compliance with the minimum distribution rules under Internal Revenue Code (IRC) § 401(a)(9) for a governmental plan. The ruling addresses the consequences of certain plan amendments related to the minimum distribution provisions under IRC § 401(a)(9) and related regulations. The governmental plan is qualified under IRC § 401(a).

In 2006, the state legislature adopted statutory amendments that changed several rules related to joint and survivor annuities. Previously, the plan permitted members unlimited elections to “pop-up” from a joint and survivor annuity to a single life annuity or “pop-down” to their original benefit following a pop-up. The 2006 plan amendments changed the rules for members who retire after the amendments’ effective date by disallowing all pop-downs and only allowing a one-time pop-up if the joint beneficiary dies or ceases to be a beneficiary pursuant to a qualified domestic relations order. The legislation provided that the amendments would only be effective upon receipt of an IRS ruling to the effect:

1. The amendments comply with the rules contained in Treas. Reg. § 1.401(a)(9)-6 (Q&A-14) specifying the conditions under which annuity payments are permitted to increase; and
2. The amendments would not cause the plan to lose the grandfathering provisions for governmental plans contained in the Treas. Reg. § 1.401(a)(9)-6 (Q&A-16).

In responding to the request, the IRS noted that under the IRC § 401(a)(9) distribution rules for defined benefit plans, an employee's entire interest must be paid over the employee's life (or the joint lives of the employee and beneficiary) or over a period certain that does not exceed a certain maximum length. Under Treas. Reg § 1.401(a)(9)-6, Q&A-14, annuity payments may increase to the extent there has been a reduction in the employee's payments to provide for a survivor benefit, but only if there is no longer a survivor benefit because the beneficiary has died or is no longer the employee's beneficiary pursuant to a qualified domestic relations order.

The IRS also noted that, under Treas. Reg § 1.401(a)(9)-6, Q&A-16, an annuity distribution option provided under the terms of a governmental plan in effect on April 17, 2002, will not fail to satisfy the statutory requirements of IRC § 401(a)(9) merely because the annuity payments do not satisfy the regulations under § 1.401(a)(9)-6, provided the distribution option satisfies IRC § 401(a)(9) based on a reasonable and good faith interpretation of the statutory provisions.

As a result, the IRS ruled that the 2006 amendments for a one-time pop-up comply with the rules in Reg § 1.401(a)(9)-6, Q&A-14 related to conditions under which annuity payments are permitted to increase. Additionally, the limits on the pop-up imposed by the legislation will not affect the grandfather rules applicable to governmental plans.

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/0807023.pdf>

IRS Issues Private Letter Ruling on Retiree Health Insurance Trust Under IRC § 115

On May 9, 2008, the Internal Revenue Service (IRS) issued a private letter ruling (PLR 200819005) regarding the tax exclusion of income earned by and benefits paid from a retiree health benefit trust established under IRC § 115(1). The trust was established through a trust agreement, entered into by a County and Board of Education, to irrevocably hold and invest contributions made by the County and Board of Education to exclusively fund health care benefits for eligible retired employees. The trust is overseen by a Board of Trustees, made up of nine members representing the County, Board of Education, and general public.

In its ruling, the IRS concluded that the income of the trust is excludable from gross income as provided by § 115(1). Under § 115(1), gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision of a state. The IRS found that providing health benefits to eligible retired County and Board of Education employees and their dependents constitutes the performance of an essential government function. Therefore, the trust's income is excludable from gross income.

The IRS also concluded that the contributions paid to the trust and payments made from the trust, which are used exclusively to pay for accident or health coverage of employees (or former employees), their spouses and dependents, are excludable from the gross income of retired employees and their spouses and dependents under §§ 106 and 105(b). Specifically, § 106 provides that gross income of an employee does not include employer-provided coverage under an accident or health plan. Additionally, under § 105(b), gross income does not include amounts received by an employee (or former employee) through accident or health insurance if such amounts are paid, directly or indirectly, to the taxpayer as reimbursement for medical care expenses incurred by the taxpayer and his or her spouse or dependents.

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/0819005.pdf>

Former GAO Chief Outlines Strategy to Address Financial Crisis in Health Care

On April 8, 2008, former U.S. Comptroller, General David M. Walker, discussed his strategy to address the financial crisis in health care at an annual meeting of the American Hospital Association (AHA). As reported in BNA's *Pension & Benefits Reporter*, Walker's strategy focuses on:

- Providing universal coverage for affordable "basic and essential" health care services which would include inoculations against infectious disease, certain wellness and preventive care services, and protection against financial ruin due to an unexpected catastrophic accident or illness.
- Achieving comprehensive health care reform by establishing a national health care spending budget, national evidenced-based practice standards, and personal accountability for health.

According to Walker, the current system through which government pays for health care is unsustainable. From 1960 to 2005, the average annual growth rate of health care spending per capita was 4.9% while the gross

domestic product grew at an annual per capita rate of 2.3%. He recommended that the federal government adhere to a health care spending budget.

Additionally, he noted that although U.S. health care spending is higher per capita than other industrialized nations, the quality of U.S. health care needs to be improved. He suggested that this could be attained through national evidence-based practice standards that help improve consistency, reduce costs, improve quality, and extensively reduce litigation risk. Walker also favored incentives to encourage personal responsibility and accountability for health and wellness.

Source: BNA *Pension & Benefits Reporter*, April 15, 2008.

EBRI Finds Workers' Retirement Confidence Dropped Sharply Due to Health Care and Economic Issues

On April 9, 2008, the Employee Benefit Research Institute (EBRI) released an issue brief titled: *2008 Retirement Confidence Survey: Americans Much More Worried About Retirement, Health Costs a Big Concern*. The survey found that American workers' confidence in affording a comfortable retirement decreased sharply over the past year, mainly due to concerns about health care costs and the economy. The percent of active workers who were very confident about having enough money for a comfortable retirement dropped from 27% in 2007 to 18% in 2008, the largest one-year decrease in the survey's 18-year history. Furthermore, the percent of retirees who were very confident about having a financially secure retirement dropped sharply from 41% to 29%.

The survey also found that health care costs are a major concern for retirees. Of the respondents, almost half have been faced with larger health care expenditures than they anticipated when they retired. As a result, 54% of retirees are more concerned about their financial future now than they were at retirement, up from 40% in 2007. Moreover, since many employers are considering eliminating health care coverage for future retirees, only 34% of current workers expect to have access to employer-paid retiree health care when they retire, down from 42% in 2007.

Additionally, the survey found that workers' efforts to calculate what they will need to live comfortably in retirement can be effective in changing behavior. In 2008, 47% of workers and/or their spouses performed a retirement savings calculation, up considerably from about 30% in 1996. As a result of the calculation, approximately 45% changed their retirement planning, and of those workers, almost 60% either started saving or investing more. Currently, over 70% of workers have some retirement savings. However, most savings levels are modest with nearly 50% reporting total savings and investments (not including the value of their primary residence or any defined benefit plans) of less than \$50,000. Moreover, 22% of active workers and 28% of retirees reported having no savings at all.

The Retirement Confidence Survey is available at: http://www.ebri.org/pdf/briefspdf/EBRI_IB_04-2008.pdf

Health Insurance Premiums Increase Faster Than Incomes

On April 29, 2008, the Robert Wood Johnson Foundation released its report: *Squeezed: How Costs for Insuring Families are Outpacing Income*. The report reveals that the cost to U.S. workers for family health insurance is increasing dramatically without an equivalent increase in family income. Therefore, if this trend continues, more workers are likely to become uninsured due to the growing expense.

Currently, about 76% of insured Americans receive health insurance through employer-sponsored plans. During the period from 2001 to 2005, premiums for employer-provided family health insurance coverage have risen 30% while incomes have only risen 3%. Nationally, the average cost of family health care coverage increased from \$8,281 in 2001 to \$10,728 in 2005, an increase of about \$2,500. Over this period, the

percentage of family premiums paid by workers remained at about 24%. On average, the amount employees paid for premiums increased from \$1,921 in 2001 to \$2,585 in 2005, an increase of \$664. However, the median income for those with family health insurance coverage increased from \$40,818 in 2001 to \$42,068 in 2005, an increase of \$1,250. Consequently, half of these workers' gains in income have been offset by increases in health care premiums. Additionally, the average employer cost for family coverage increased from \$6,360 in 2001 to \$8,143 in 2005, an increase of 28%. The survey also found:

- **Fewer employees are working in private-sector jobs that offer insurance.** In 2005, 4.1 million fewer individuals worked in private-sector jobs offering health insurance than did in 2001.
- **Fewer private-sector businesses offer coverage.** In 2005, about 30,000 fewer private-sector employers offered health insurance benefits to their employees than did in 2001.
- **Fewer individuals have private health insurance coverage.** In 2005, 2.4 million (or 6%) fewer individuals had private health insurance compared to 2001.
- **More individuals are uninsured.** According to the U.S. Census 2006-2007, about 47 million Americans lacked health insurance.

The Foundation commissioned the University of Minnesota's State Health Access Data Assistance Center to prepare the report, based on a state-by-state analysis of family health insurance premium costs compared to income. The report is available at: <http://www.rwjf.org/files/research/042508ctuwfinalembargoed.pdf>