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Gabriel Roeder Smith & Company
Consultants & Actuaries

September/October 2009

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.

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IRS Issues Final Regulations on Good Faith Interpretation of Minimum Distribution Rules by Governmental Plans

On September 4, 2009, the IRS and Treasury Department issued final regulations (TD 9459) allowing governmental plans to comply with the required minimum distribution rules by using a reasonable and good faith interpretation of Internal Revenue Code (IRC) § 401(a)(9). The regulations affect all tax-qualified governmental retirement plans established by federal, state and local government agencies, including plans qualified under IRC § 401(a), 403(b) contracts that are part of governmental plans, and eligible governmental 457(b) deferred compensation plans.

The final regulations are identical to the proposed rules issued on July 9, 2008, (IRS Reg-142040-07) pursuant to § 823 of the Pension Protection Act of 2006 (PPA). When enacted, PPA § 823 required the Secretary of the Treasury to issue regulations implementing a permanent reasonable good faith standard for governmental plans to comply with IRC § 401(a)(9).

IRC § 401(a)(9) establishes the required minimum distribution (RMD) rules for a qualified trust. Generally, the RMD rules require retirement plans to begin distributing each participant's plan assets by April 1 of the calendar year following the later of: (1) the calendar year in which the plan participant reaches age 70-1/2 or (2) the calendar year following the year in which the participant retires. Furthermore, the entire interest of the participant must be distributed over the life of the participant or over the lives of the participant and designated beneficiary (or over a period not extending beyond the life expectancy of the participant or life expectancies of the participant and designated beneficiary). IRC § 401(a)(9) also establishes rules for distributions after a member's death and for incidental death benefits.

The final rules became effective on September 8, 2009, and apply to all plan years to which § 401(a)(9) applies. Given the complexity of the rules, it may be useful for plan administrators to review plan provisions with legal counsel to ensure the provisions comply with the reasonable good faith standard.

The regulations are available at: http://edocket.access.gpo.gov/2009/E9-21453.htm

IRS Updates Safe Harbor Explanations for Eligible Rollover Distributions

In September 2009, the IRS issued Notice 2009-68, updating its safe harbor explanations for eligible rollover distributions. Under IRC § 402(f), administrators of qualified plans are required to provide rollover recipients with a clearly written explanation of the rules related to eligible rollover distributions. Qualified plans include defined benefit and defined contribution plans under IRC §§ 401(a), 401(k), 403(a), and governmental 457(b) deferred compensation plans. (For plans qualified under § 403(b), the payor is required to provide the written explanation.)

To satisfy § 402(f), the written explanation should include descriptions of (1) the direct rollover rules; (2) the mandatory income tax withholding rules; (3) the tax treatment of distributions that are not rolled over; (4) when distributions may be subject to different restrictions; and (5) the tax consequences of the rollover. Under IRC § 402(f), the written explanation is to be provided to the recipient not more than 180 days and not less than 30 days before the date on which the distribution is to be made. (However, the recipient may waive the 30-day requirement.)

Notice 2009-68 provides two safe harbor explanations that satisfy § 402(f): one for rollovers from designated Roth accounts and the other for all other rollovers. The new explanations update those issued in 2002, and include tax law changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the Pension Protection Act of 2006 (PPA), and the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA), among others. The changes include, but are not limited to:

- The ability of participants to roll over amounts from an eligible employer plan to a Roth IRA (subject to certain income and other limitations);
- The ability of non-spouse beneficiaries to roll over distributions to IRAs (required for all plan years beginning after January 1, 2010); and
- Relief from the 10% early withdrawal penalty for distributions from government plans to qualified public safety employees who separate from service after attainment of age 50.

The notice allows plan administrators to customize the safe harbor explanations by omitting information that does not apply to the plan, provided the resulting document is consistent with the safe harbor explanations. The new explanations may be used immediately; however, the 2002 explanations will continue to serve as safe harbor explanations though the end of 2009.

Notice 2009-68 is available at: http://www.irs.gov/pub/irs-drop/n-09-68.pdf

IRS Modifies Remedial Amendment Rules for Governmental Pension Plans

On August 12, 2009, the Internal Revenue Service released Revenue Procedure 2009-36 regarding remedial amendments for governmental plans qualified under IRC § 401(a). Rev. Proc. 2009-36 modifies Rev. Proc. 2007-44, relating to the IRS's determination letter program for qualified plan amendments.

Plan qualification under IRC § 401(a) offers significant tax advantages. To maintain these advantages, a plan's written provisions need to conform to the rules under § 401(a) and the plan needs to be operated accordingly. To assist plan sponsors determine whether plan provisions meet the § 401(a) requirements, the IRS will review the plan documents and issue either a favorable or unfavorable determination letter. While IRS determination letters are not required for a plan to be qualified, a favorable determination letter provides evidence of a plan's qualification under § 401(a).

IRC § 401(b) provides a remedial amendment period during which plans may be amended retroactively to comply with the qualification rules under § 401(a). Previously, Rev. Proc. 2007-44 and Treas. Reg. § 1.401(b)-1(e)(3) provided generally that if a governmental plan's determination letter request had been rejected by the IRS due to a "disqualifying provision," the plan sponsor had 91 days after the IRS issued its finding to make the necessary retroactive remedial amendments.

Rev. Proc. 2009-36 extends the remedial amendment period, recognizing that 91 days may not be sufficient time for a governmental plan to adopt the necessary amendments. For example, the governing body may not be in session, or may be prevented from immediately considering the amendments for procedural reasons. Under Rev. Proc. 2009-36, the remedial amendment period will not end before the expiration of the 91st day after the close of the first legislative session beginning more than 120 days after a determination letter is issued for the plan, provided the plan's determination letter application was submitted to the IRS in a timely manner (i.e., before the end of the plan's remedial amendment cycle).

Additionally, Rev. Proc. 2009-36 also formalizes a change in the remedial amendment cycle for governmental plans. Beginning in 2006, the IRS established a series of standardized 5-year remedial amendment cycles (coincident with the cycles for submitting determination letters), labeled Cycles A through E. Initially, all governmental plans were placed in Cycle C, which began February 1, 2008, and ended January 31, 2009. However, in November 2008, the IRS announced it would modify the remedial amendment (and determination letter) cycle for governmental plans and allow a one-time option to file under Cycle E, beginning February 1, 2010 and ending January 31, 2011. This was done to allow governmental plans more time to prepare applications for determination letters. Under Rev. Proc. 2009-36, a sponsor of an individually designed governmental plan may make a one-time election to file for a determination letter under Cycle E rather than Cycle C. Because this modification is only applicable for the initial cycle, a plan's subsequent remedial amendment/determination letter cycle will revert to the next Cycle C (ending January 31, 2014).

Rev. Proc. 2009-36 is effective as of August 31, 2009; however, the IRS has clarified that plan sponsors may rely on the option to elect Cycle C or Cycle E as of November 5, 2008.

Rev. Proc. 2009-36 is available at: http://www.irs.gov/pub/irs-drop/rp-09-36.pdf

Issue Brief Examines Governmental Options for Prefunding OPEB Liabilities

In September 2009, the Center for State and Local Government Excellence released its issue brief, *Prefunding Other Post Employment Benefits (OPEB) in State and Local Governments: Options and Early Evidence.* The brief examines various options that state and local governments are considering to reduce health care costs and prefund OPEB liabilities.

In the past, most state and local governments financed their retiree health care and other OPEB costs on an annual "pay-as-you-go" basis. However, after the Governmental Accounting Standards Board (GASB) issued new standards for calculating and reporting OPEB liabilities under GASB Statement No. 45, some governments have begun pursuing options for prefunding OPEB liabilities. While prefunding may initially increase an employer's OPEB contributions, the brief explains that such increases may help reduce the employer's long-term OPEB contributions through investment earnings. The report discusses three prefunding mechanisms:

- **Governmental Trusts.** Established under IRC § 115, governmental trusts may be used to carry out essential governmental functions, including prefunding retiree health care;
- **Medical Subaccounts.** Established within a pension trust under IRC § 401(h), medical subaccounts may be used to pay health care benefits for retirees covered by the pension plan; and
- **VEBAs.** Established under IRC § 501(c)(9), Voluntary Employees' Beneficiary Associations provide a separate, non-profit trust that may be used for a variety of purposes, including funding health care.

When these trusts are adopted as irrevocable trusts and annual contributions are made to fully prefund the OPEB costs, governments sponsoring OPEB plans are allowed to use a discount rate that reflects the expected return of the trust's diversified portfolio. This return is usually higher than the expected return of the government's short-term investments, which would otherwise be used. The use of the higher discount rate lowers the present value of the OPEB liabilities.

Although all three options for prefunding retiree health care obligations are currently available, the issue brief suggests it is unlikely that many governments will adopt the prefunding mechanisms in the near future, as shown in the following table, adapted from the brief:

Table 1: Adoption of OPEB Prefunding Mechanisms by State and Local Governments

How likely is your state or municipality to adopt the following options in the next five years?	Municipal Governments (based on 2,136 responses)			State Governments (based on 50 responses)		
	Already Adopted	Likely to Adopt	Unlikely to Adopt	Already Adopted	Likely to Adopt	Unlikely to Adopt
Governmental Trust (IRC § 115)	3% (54)	9% (196)	32% (674)	10% (5)	30% (15)	52% (26)
Medical Subaccount (IRC § 401(h))	1% (22)	4% (83)	36% (773)	4% (2)	8% (4)	80% (40)
VEBA (IRC § 501(c)(9))	3% (56)	5% (111)	34% (722)	6% (3)	2% (1)	84% (42)

Note: Numbers in parentheses indicate number of responses. Remaining percentages reflect missing values.

According to the survey results, only five states (Alabama, Alaska, Colorado, Maine, and Massachusetts) reported having adopted a Governmental Trust under IRC § 115; although 15 additional states indicated they were likely to do so within the next five years. Only two states reported using a 401(h) Medical Subaccount (Alaska and Ohio), while four other states indicated they are likely to adopt them. Three states reported having adopted a VEBA, including Montana which received a favorable VEBA determination letter in June 2003.

The study also found that when a prefunding trust is established, changes may also be made to retiree health care benefits. For example, when the State of West Virginia created a Governmental Trust under IRC § 115, it also changed retiree health care benefits by increasing copayments and coinsurance rates. In addition, the West Virginia Public Employees Insurance Agency (PEIA) voted to eliminate retiree health care subsidies for all employees hired after July 1, 2010. It should be noted that the West Virginia Education Association recently initiated legal action to challenge the PEIA's decision.

The report concludes that state and local governments will likely utilize a multi-faceted approach to controlling health care costs and prefunding OPEB liabilities in the future.

The brief is available at:
http://www.slge.org/vertical/Sites/%7BA260E1DF-5AEE-459D-84C4-876EFE1E4032%7D/uploads/%7BF7CBC101-1E69-4DE7-AEEC-ECFE6F41CAF5%7D.PDF

SEC Proposes New Rules Curbing "Pay-to-Play" Activities for Investment Advisors

On July 22, 2009, the U.S. Securities and Exchange Commission (SEC) voted unanimously to issue proposed new "pay-to-play" rules under the Investment Advisors Act of 1940. "Pay-to-play" refers to political contributions (or related activities) by investment advisors to key government officials in order to obtain, or compete for, contracts to manage public pension plans or other government accounts. The new rules would:

- Prohibit an investment advisor from providing compensated advisory services to a governmental entity for two years after the advisor (or certain of its executives or employees) made a contribution to elected officials or candidates who are in a position to influence the selection of the advisor;
- Prohibit an advisor from providing or agreeing to provide (directly or indirectly) payment to any third party for soliciting advisory business from a governmental entity on behalf of the advisor;
- Prevent an advisor from soliciting (or coordinating) contributions to certain elected officials, candidates, or political parties where the advisor is providing or seeking government business; and
- Require registered advisors to maintain records of the political contributions made by the advisor or certain of its executives or employees.

The proposed rule would apply to any investment advisors who are registered (or required to be registered) with the SEC, as well as unregistered investment advisors who are exempt from registration. Governmental entities include all state and local governments, pension plans, 403(b) and 457(b) plans, and 529 college investment plans. According to SEC Chairman, Mary Schapiro, even though the SEC has brought cases related to kickbacks in pay-to-play schemes, it is concerned that there may be broader efforts to influence the selection of public fund advisors. Consequently, the proposed rules are intended to address specific circumstances where monetary payments may inappropriately be used to influence the selection of investment managers.

The proposed rules are available at: http://www.sec.gov/rules/proposed/2009/ia-2910.pdf

IRS Clarifies Rules for Rollovers from Qualified Plans to Roth IRAs

On September 8, 2009, the IRS issued Notice 2009-75, clarifying certain federal tax rules related to rollovers from qualified retirement plans to Roth IRAs. In this context, qualified retirement plans include defined benefit and defined contribution plans under IRC § 401(a), including governmental plans. Qualified plans also include plans established under IRC §§ 401(k), 403(a), 403(b), and eligible governmental deferred compensation plans under § 457(b).

Roth IRAs are IRAs to which individuals make after-tax contributions. In return, distributions from Roth IRAs (including investment earnings) are not subject to federal income tax, provided certain conditions are met. Generally, distributions from Roth IRAs are excluded from federal income tax if the distributions are made after the participant attains age 59½ and the amount distributed has been held in the Roth account for at least 5 years (or certain other conditions are met). If the necessary conditions are not met, the Roth distribution is subject to federal income tax. However, any after-tax contributions included in the Roth distribution are excluded from federal tax, since taxes have already been paid on these amounts.

Generally, an eligible rollover distribution from a qualified retirement plan may be rolled over to another qualified retirement plan or to a traditional (non-Roth) IRA. In these cases, the rollover distribution is not included in the participant's income when rolled over, but rather is taxed when ultimately distributed to the participant. Before enactment of the 2006 Pension Protection Act (PPA), an eligible rollover distribution from a qualified plan could be rolled over to a traditional IRA and then converted to a Roth IRA, but could not be directly rolled over to the Roth IRA. PPA § 824 amended the IRC to allow participants in qualified retirement plans to directly rollover eligible rollover distributions to Roth IRAs. IRS Notice 2009-75 clarifies certain aspects of rollovers from qualified plans to Roth IRAs, including:

- Amounts rolled over from a qualified plan to a Roth IRA are subject to federal income tax in the year of the rollover. However, if after-tax contributions are included in the rollover, the after-tax contributions are not subject to federal income tax.
- The 10% early distribution penalty does not apply to amounts rolled over from a qualified plan to a Roth IRA, provided the 5-year rule is satisfied. In addition, if the rollover is a direct rollover, the mandatory 20% withholding requirement does not apply.

- For distributions before January 1, 2010, a rollover to a Roth IRA is available only to taxpayers with modified adjusted gross income (MAGI) of $100,000 or less in the year of the distribution. In addition, if the individual is married, the tax return must be filed jointly.
- For distributions on or after January 1, 2010, a rollover to a Roth IRA is not limited by the MAGI and joint filing restrictions.
- For rollovers from a designated Roth account to a Roth IRA, the amount rolled over is not included in the member's gross income. Also, the MAGI and joint filing requirements do not apply.

Notice 2009-75 is available at: http://www.irs.gov/pub/irs-drop/notice_2009-75.pdf