

June/July 2010

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 website 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.

GASB Issues Plain-Language Supplement to Preliminary Views on Pension Accounting and Financial Reporting Standards

On June 16, 2010, the Governmental Accounting Standards Board (GASB) issued a Plain-Language Supplement to its Preliminary Views on Pension Accounting and Financial Reporting by Employers. The supplement discusses the issues addressed in the Preliminary Views (PV) using non-technical language, and requests feedback from readers related to the effect of the GASB's proposed changes on improving the usefulness of the financial information related to pension benefits.

In the PV, the GASB proposes a number of significant changes to the current accounting and financial reporting standards that could, if ultimately approved, eventually apply to governmental employers that sponsor defined benefit pension plans. Several of the key proposals include (but are not limited to):

- Recognizing the employer's unfunded actuarial pension obligation as a "net pension liability" in the employer's basic financial statements (essentially on its balance sheet). Currently, the employer recognizes a "net pension obligation," which is defined as the difference between an employer's actuarially determined contributions and actual contributions accumulated (with interest) over time.
- Determining the net pension liability using the fair (market) value of plan assets. Currently, the unfunded actuarial liability is typically determined using a "smoothed" value of assets, which averages investment gains and losses over time, often over 5 years.
- Requiring the entry age normal actuarial cost method to be used to determine the net pension liability and the actuarial cost of service. Currently, one of six approved actuarial cost methods may be used to determine the actuarial accrued liability and cost of service.
- Determining the net pension liability using a blended discount rate based on the long-term expected investment return (to the extent expected future assets are sufficient to pay expected future benefits) and the yield on a municipal bond index (to the extent expected future assets are not sufficient). Currently, the discount rate is the long-term expected investment return.

With regard to the blended discount rate, the proposed changes would continue allowing the long-term expected investment return to be used for valuing benefit payments to the extent that current and expected future plan

assets (including expected future investment earnings and future employer and employee contributions) will cover projected future benefit payments. However, to the extent that current and expected future assets would not cover projected future benefit payments, the yield on a high-quality municipal bond index would be used to determine the related liabilities.

The 16-page summary is available on the GASB's website at: <http://www.gasb.org>

The GRS summary of the GASB's Preliminary Views is available in the July 2010 issue of *GRS Insight* at: http://www.gabrielroeder.com/news/pdf_insight/Insight2010_07.pdf

NASRA Research Director Keith Brainard Discusses the Potential Effects of the GASB's Preliminary Views

On June 29, 2010, BNA's *Pension & Benefits Reporter* published an article by Keith Brainard, research director for the National Association of State Retirement Administrators (NASRA), titled "GASB's Proposed Accounting Changes Could Exacerbate States' Fiscal Challenges." The article discusses the potential effects of the GASB's Preliminary Views related to proposed changes in pension accounting standards for state and local governmental employers.

The article indicates that public pension sponsors would welcome accounting changes that increase transparency and provide useful information for decision makers. It also states that the public pension community supports accounting changes that would help plan sponsors finance promised benefits by setting appropriate benefit and contribution levels. However, it cautions that some of the GASB's proposed changes may actually add confusion and increase the volatility of funding levels and required costs. As a result, the proposed changes may worsen the states' current fiscal challenges.

The article goes on to say that a large segment of the public pension community is concerned that the GASB's proposal to move away from the current funding orientation of governmental accounting "may not only fail to improve financial reporting but could also make reporting worse." Moreover, the GASB's "delinking" of accounting measures from the measures used to fund the benefits "would dangerously diminish the 'decision-usefulness' of current reporting."

Source: BNA *Pension & Benefits Reporter*, June 29, 2010, Vol. 37, No. 25, p. 1493.

Federal Reserve Reports Public Pension Assets Increased for Fourth Consecutive Quarter

On June 10, 2010, the Board of Governors of the Federal Reserve released its *Flow of Funds* statistical report for the first quarter of 2010. On page 78, the report shows that state and local government employee retirement fund assets totaled \$2.79 trillion on March 31, 2010, up from \$2.17 trillion on March 31, 2009, an increase of \$626 billion (29%). In 2010, the funds' holdings of corporate equities totaled \$1.66 trillion (59% of total assets) up from \$1.11 trillion (51% of total assets) a year earlier.

The statistical report is available on the Federal Reserve's website at: <http://www.federalreserve.gov/releases/z1/current/z1.pdf>

NGA/NASBO Survey Finds States Continue to Reduce Spending in Fiscal Year 2010

In June 2010, the National Governors Association (NGA) and the National Association of State Budget Officers (NASBO) released their semiannual report: *The Fiscal Survey of States*. The survey presents aggregate and individual data on the states' general fund receipts, expenditures, and balances. The survey was conducted by

NASBO and completed by the governors' state budget officers in all 50 states from March 2010 through May 2010.

Due to the recession, state general fund spending declined in both fiscal years 2009 and 2010. In fiscal 2010 general fund expenditures are estimated to be \$612.9 billion down from \$657.9 billion in fiscal 2009, a 6.8% decline. In fiscal 2011, the governors' expect general fund expenditures to be \$635.3 billion, a 3.6% increase over fiscal 2010, but still lower than the fiscal 2009 levels. Forty states lowered general fund expenditures in fiscal 2010, while 13 states propose lowering general fund expenditures in fiscal 2011.

According to the report, the reduction in general fund spending is due to significant decreases in sales, personal income, and corporate income tax collections, which comprise about 80% of state general fund revenues. The governors estimate that tax revenues will decline from \$541.4 billion in fiscal 2008 to \$477.4 billion in fiscal 2010, down 11.8%. (Fiscal 2008 is used as a benchmark because it was the last year in which the states were not affected by the recession.) In fiscal 2011, the governors project an 8.4% decrease in revenues from about \$541.3 billion in fiscal 2008 to \$495.8 billion. As a result of declining revenues, 40 states made mid-year budget cuts totaling \$22.0 billion in fiscal 2010. In fiscal 2009, 43 states made mid-year budget cuts totaling \$31.3 billion.

In fiscal 2009, Medicaid spending accounted for approximately 21% of total state spending (about \$138 billion). In 2010, Medicaid spending from state funds is estimated to decrease by 2.7%, while Medicaid spending from federal funds is estimated to increase by 17.2%. The additional federal monies are the result of emergency funding provided through the American Recovery and Reinvestment Act of 2009 (ARRA). However, by the end of fiscal 2011, nearly all of the emergency ARRA funding will be depleted. Consequently, the governors have recommended state budgets anticipate that Medicaid spending from state funds will increase by 7.0% in fiscal 2011, and that federal spending on Medicaid will decline by 1.7%.

In fiscal 2010, 29 states enacted net revenue increases while 9 states enacted net decreases. As a result, tax and fee revenues increased about \$23.9 billion, and other revenues increased an additional \$7.5 billion. In fiscal 2011, 18 states recommended net increases while nine states recommended net decreases, resulting in a projected net increase of \$3.1 billion in taxes and fees and an additional \$2.0 billion in other revenues.

The survey also reported on "total balances" which include year-end balances and any budget stabilization funds that the states have set aside for use during a financial downturn. In fiscal 2010, total balance levels are estimated to be 6.2% of general fund expenditures and are expected to decrease to 5.8% in fiscal 2011. The report notes: "Because states recognize that this economic downturn may last at least into 2012 they are reluctant to deplete balances."

The report is available at: <http://www.nga.org/Files/pdf/FSS1006.PDF>

Federal Agencies Issue Interim Final Rules on Grandfather Provisions Under Health Reform Law

On June 14, 2010, the U.S. Departments of Labor, Health and Human Services, and the Treasury jointly issued Interim Final Rules relating to "grandfathered" group health plans under the Patient Protection and Affordable Care Act (PPACA). The PPACA was enacted on March 23, 2010, and requires group health plans (and insurers) to modify their coverage to comply with the new health insurance reforms. However, the PPACA exempts grandfathered group health plans from many (but not all) of the PPACA's coverage requirements. Consequently, maintaining a plan's grandfathered status may have significant plan design and cost implications. The Interim Final Rules (IFR) provide guidance regarding how grandfathered plans are defined and what conditions would cause a plan to lose its grandfathered status.

Definition of Grandfathered Group Health Plan. The IFR clarifies that a grandfathered health plan is defined as a group health plan or health insurance coverage in which: (1) at least one person was enrolled on March 23,

2010; and (2) at least one person was covered continuously since March 23, 2010. The IFR also clarifies that a plan may add new employees (including newly hired employees or current employees newly enrolled) after March 23, 2010, without losing its grandfathered status. A grandfathered plan may be an insured or self-insured arrangement in a single employer, multiemployer, or multiple-employer plans.

Disqualifying Changes. In addition, the IFR clarifies that a group health plan will lose its grandfathered status if:

- It eliminates all or substantially all benefits to diagnose or treat a particular condition (even if relatively few participants are affected by the condition);
- It increases its percentage cost-sharing requirement from its March 23, 2010 level;
- It increases its fixed-amount copayment (over the March 23, 2010 level) by an amount exceeding the greater of: (i) a percentage equal to the sum of medical inflation plus 15%, or (ii) \$5 increased by medical inflation;¹
- It increases its other fixed-amount cost-sharing requirements (e.g., its deductible or out-of-pocket maximum) by a total percentage that is more than the sum of medical inflation plus 15%, measured from March 23, 2010; or
- An employer or employee organization decreases its contribution rate for any tier of coverage for any class of similarly situated individuals by more than 5 percentage points below the contribution rate in effect on March 23, 2010.

In addition, a group health plan will lose its grandfathered status if it changes its annual limits, as described below:

- If the plan did not impose an overall annual or lifetime limit as of March 23, 2010, it will lose its grandfathered status if it later imposes an overall annual limit on the dollar value of benefits;
- If the plan imposed an overall lifetime limit, but no overall annual limit, as of March 23, 2010, it will lose its grandfathered status if it later adopts an overall annual limit that is lower than the dollar value of the lifetime limit as of March 23, 2010; or
- If the plan imposed an overall annual limit on the dollar value of all benefits as of March 23, 2010, and later decreases the dollar value of the annual limit, it will lose its grandfathered status.

Transitional Relief. A transition rule is provided to preserve the grandfathered status for plans that adopted plan changes that became effective after March 23, 2010, but prior to June 14, 2010. For changes adopted before March 23, 2010, the IFR provides that a plan will not lose its grandfathered status so long as the changes were adopted pursuant to a legally binding contract, insurance filing, or written plan amendment. For changes adopted after March 23, 2010, and which “only modestly exceed” the IFR requirements, the agencies will take into account good-faith efforts to comply with the PPACA. However, if the changes otherwise exceed the IFR requirements, the plan must revoke the changes or else lose its grandfathered status.

Collectively Bargained Plans. A special rule applies to insured group health plans that are maintained pursuant to one or more collective bargaining agreements (CBAs) ratified prior to March 23, 2010. For these plans, coverage is deemed to be grandfathered until the last termination date of the last CBA in effect on March 23, 2010. After which time, the general grandfather rules apply. Self-funded collectively bargained plans are not subject to the special rules, but are subject to the general grandfather rules.

Retiree-Only Plans. The IFR clarifies that “retiree-only” plans are not subject to the insurance reform provisions of the PPACA. It explains that the portability provisions of the Health Insurance Portability and Accountability Act of 1996 (HIPPA) contain an exception for plans with less than two participants who are current employees.

¹ Medical inflation is measured by the increase since March 2010 in the overall medical care component of the Consumer Price Index for all Urban Consumers (unadjusted) published by the Department of Labor.

Moreover, this exception applies to “retiree-only” plans that cover less than two participants who are covered employees. As a result, the IFR indicates that the U.S. Department of Health and Human Services (HHS) will not enforce the requirements of the PPACA or HIPPA with respect to non-federal governmental retiree-only plans, and will encourage states not to enforce them as well.

Administrative Responsibilities. A grandfathered health plan must include a statement in any plan materials provided to a participant or beneficiary describing that it believes it is a grandfathered plan. The statement must also provide contact information for questions and complaints. The regulations contain model language that may be used to satisfy the disclosure requirement.

The interim final rules are available at: <http://edocket.access.gpo.gov/2010/pdf/2010-14488.pdf>. Comments on the guidance must be submitted by August 16, 2010.

The law firms of Ice Miller, LLP and the Groom Law Group have published summaries of the IFR, available respectively at:

http://www.icemiller.com/enewsletter/Benefits/Grandfathered_Plan_Status_Interim_Final_Rule.htm and
http://www.groom.com/media/publication/728_GLG%20Grandfather%20Rule%20-%206-15-10%20final.pdf

Commonwealth Fund Reports Health Care Reforms May Reduce National Health Spending by \$560 Billion from 2010 to 2019

On May 21, 2010, the Commonwealth Fund and the Center for American Progress released an issue brief titled: *The Impact of Health Reform on Health System Spending*. The analysis estimates that the newly enacted national health care reforms will reduce health care spending by a total of \$590 billion over the period from 2010 to 2019. The report also projects that the reforms will lower premiums by about \$2,000 per family in 2019, from \$21,458 to \$19,490, down by 9.2%. Moreover, the annual growth rate in national health expenditures may be slowed from 6.3% to 5.7%.

The report also indicates that the health care reforms will reduce the federal deficit by nearly \$400 billion over the next 10 years. By comparison, the Congressional Budget Office (CBO) projects that the reforms will reduce the federal deficit by \$143 billion over the same period. Additionally, the Centers for Medicare & Medicaid Services (CMS) Office of the Actuary estimated the new law will increase national health spending by \$311 billion over the same time period.

The authors of the issue brief attribute most of the differences between their projections and those of the CBO and CMS to the fact that they include potential savings from health care system modernization in their analysis. They argue that current inefficiencies and misaligned incentives within the health care system provide an opportunity to significantly improve productivity through modernization. While the related estimated cost savings are included in their issue brief, they are not included in the CBO and CMS studies.

The issue brief is available at: <http://tinyurl.com/24qdl6x>

American Academy of Actuaries Publishes Issue Brief on Social Security Reform Proposals

In June 2010, the American Academy of Actuaries published its issue brief, *Social Security Reform: Possible Changes in the Benefit Formulas and Taxation*. According to the brief, the Social Security Program’s long-term solvency is threatened by the growing number of retirees which has outpaced the number of workers supporting the program. As stated in the 2009 Social Security Trustee Report, annual benefit payments and administrative expenses are expected to exceed Social Security tax revenues beginning in 2016. Furthermore, the report projects that the trust fund reserves will be exhausted by 2037.

Currently, Congress is considering Social Security reforms which include increasing the Social Security normal retirement age, reducing benefit payments, and increasing tax income. The Academy's brief focuses on two possible options for Social Security reform: (1) changing the benefit formulas for workers or spouses; and (2) changing the federal income tax treatment of Social Security benefits. The brief provides an overview of the current Social Security benefit calculation formulas for both workers and spouses, and the tax structure for Social Security benefits. Additionally, it discusses various reform options and their possible effects on benefit adequacy, individual equity, and the program's solvency. Some of the findings include:

- An individual's primary Social Security benefit is currently based on earnings averaged over 35 years. Increasing the averaging period to 38 years would reduce the 75-year deficit by 14.5%;
- Social Security cost-of-living adjustments are currently based on the full Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). Reducing annual cost-of-living adjustments by 0.5% would reduce Social Security's 75-year deficit by about 40%; and
- Social Security benefits are currently taxed using a complicated formula that excludes some or all of the Social Security benefits, based on certain thresholds. Taxing Social Security benefits in the same manner as other pension benefits (i.e., as taxable income, excluding after-tax employee contributions) would reduce the 75-year deficit by 14%.

While these reform options may improve Social Security's solvency, they would also reduce benefits. The brief concludes by cautioning policymakers to consider several underlying questions before changing benefits. These questions include:

- Does the proposed change make sense on its own, or is it solely revenue-driven?
- To what extent is Social Security responsible for ensuring that the elderly population is not faced with high poverty rates?
- How would a change in cost-of-living adjustment affect existing beneficiaries; particularly the very elderly who currently have the highest poverty rates in the United States?

The Brief can be found on the American Academy of Actuaries' website at:

http://www.actuary.org/pdf/socialsecurity/Social_Security_Reform_Issue_Brief_6-15-10.pdf