News Scan

GRS
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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.

IRS Issues Proposed Regulations for Cash Balance and Other Hybrid Retirement Plans

On December 28, 2007, the U.S. Treasury Department and Internal Revenue Service (IRS) issued proposed regulations providing guidance on changes made by the Pension Protection Act (PPA) that affect the treatment of cash balance and other hybrid retirement plans. Generally, the proposed regulations incorporate the transitional guidance provided under Notice 2007-6, released on December 21, 2006, with some modifications.

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, Treasury Department officials indicated that many of the PPA § 701 rules would apply to governmental plans through parallel changes made to the ADEA. The proposed regulations generally apply to defined benefit plans under which all or a portion of the participant's benefit is based on the balance of a hypothetical account which is credited with contributions plus interest at a rate set by the plan (rather than a rate based on actual investment returns).

The regulations establish a safe harbor, under which such plans would not be considered age discriminatory if each individual's "accumulated benefits" can never be less than that of a "similarly situated" younger participant. 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. "Accumulated benefits" is a new term used in the regulations to mean benefits accumulated to date. This is distinguished from the term "accrued benefits" which is used to mean the actuarial equivalence of the participant's accumulated benefits paid as an annuity starting at normal retirement age.

In addition, the proposed regulations provide that the interest credited to the hypothetical accounts may not be greater than the "market rate of return." This rate can be determined using a number of different methods but, in general, may not be greater than the rate of return earned on long-term, investment grade corporate bonds.

The regulations would affect plan sponsors, administrators, participants, and beneficiaries of hybrid defined benefit plans. The regulations are proposed to be effective for plan years beginning on or after January 1, 2009. The IRS has requested comments on the regulations, including comments regarding their clarity, due by March 27, 2008.

The proposed regulations are available at: http://benefitslink.com/taxregs/E7-25025.pdf

EEOC Issues Final Rule on Retiree Health Benefits Under ADEA

On December 26, 2007, the Equal Employment Opportunity Commission (EEOC) published a final rule allowing coordination of employer-sponsored retiree health benefits with Medicare or comparable state health benefits programs. This narrow exemption from the Age Discrimination in Employment Act (ADEA) permits employers to alter, reduce, or eliminate retiree health benefits for Medicare-eligible retirees without affecting benefits for pre-Medicare retirees. The final rule is effective December 26, 2007.

The rule stems from the EEOC's concern that its earlier interpretation of the ADEA encouraged employers to terminate employer-sponsored retiree health benefits. Under the previous EEOC policy, an employer who provided retiree health benefits had to prove that either: 1) the benefits available to Medicare-eligible retirees were the same as those provided to pre-Medicare retirees, or 2) the employer was spending the same amount for both groups of retirees. However, such proof involves complicated comparisons that employers could avoid by ending their retiree health care coverage. The final rule eliminates this "equal benefits or equal cost" rule for retiree health care benefits. Under the final rule, employers may maintain or adopt Medicare bridge plans, Medicare wraparound plans, and other programs that reduce or eliminate health benefits for Medicare-eligible retirees without violating the ADEA.

As discussed in the rule's preamble, the final rule is similar to the Older Workers Benefit Protection Act of 1990, which provided that the practice of reducing or eliminating employer-sponsored retiree health benefits for Medicare-eligible employees was lawful under the ADEA. However, in 2000, the U.S. Third Circuit Court of Appeals ruled in *Erie County Retirees Association v. County of Erie* that an employer violated the ADEA in reducing or eliminating retiree health benefits for Medicare-eligible retirees unless the employer could show the benefits satisfied the equal benefits or equal cost rule. At first, the EEOC applied the Third Circuit's position to its enforcement policy, but later rescinded this position as concerns about employers dropping retiree health care came to light. In 2007, the Third Circuit reversed its prior ruling and held that the EEOC properly exercised its power in issuing the exemption to the ADEA. In November 2007, the AARP filed a petition for the U.S. Supreme Court's review of the Third Circuit's decision.

The EEOC's final rule is available at: http://edocket.access.gpo.gov/2007/pdf/E7-24867.pdf

Treasury Department Releases Issue Brief on Fairness and Benefit Adequacy in Social Security Reform

On January 9, 2008, the U.S. Treasury Department issued *Social Security Reform: Benchmarks for Assessing Fairness and Benefit Adequacy*, the third in a series of issue briefs on Social Security reform. As discussed in the brief, decisions about Social Security reform inherently involve value judgments regarding the level of benefits, degree of progressivity, and distribution of financial burden across generations to achieve a solvent system. The brief discusses three key issues in assessing the fairness and benefit adequacy of Social Security reform proposals:

- **How should the absolute burden of reform be allocated across birth cohorts?** Should reform be phased in so that people nearing retirement bear a smaller share of the burden than younger employees? According to the brief, this is the first decision that must be considered.

- **How should allocations of the burden across birth cohorts be distributed among income groups within the birth cohorts?** Should people with higher incomes be expected to bear a greater part of the burden? The brief cautions that shifting more of the burden to higher income groups could result in reduced work incentives.

- **How large should the benefits (and related supporting taxes) be?** Should Social Security benefits replace the same percentage of pre-retirement income for future retirees, even though future real wages may increase due to productivity growth? Also, given that additional revenues must be found to keep benefit replacement rates at current levels, can tax increases alone sustain Social Security without true pre-funding?

The brief emphasizes that without reforms, current and future generations will need to pay higher taxes or receive lower benefits (or both) in order to close Social Security's financing gap.

The brief is available at: http://www.treas.gov/press/releases/reports/ss_issuebrief_no.3.pdf

EBRI Releases Report on Retirement Annuity and Pension Income

On January 17, 2008, the Employee Benefit Research Institute (EBRI) published "Retirement Annuity and Employment-Based Pension Income, Among Individuals Age 50 and Over: 2006" in the January 2008 issue of *EBRI Notes*. In the article, EBRI analyzed recent U.S. population data regarding factors that affect employment-based pension and annuity income including age, gender, and education. It found that in 2006, 21.2% of the U.S. population age 50 and older received pension or annuity income, with mean annual income of $16,373. For people age 65 and older, 35.4% received pension or annuity income, with mean annual income of $14,442. The report notes that the higher benefit levels provided to those under age 65 may reflect people who were able to retire early or who had accumulated sizable annuities.

In addition to age, the report also found that gender, marital status, education, and other demographic variables have a significant impact on the likelihood that a worker will receive pension or annuity income in retirement. For example:

- **Education:** In 2006, 27.5% of males over age 50 with a graduate-level education received pension or annuity income, with mean annual income of $30,112, compared with 21.7% of males without a high school diploma who received pension or annual income with a mean of $10,555.

- **Gender:** In 2006, 44.6% of males age 65 and over received pensions and annuity income with a mean of $17,200, compared with 28.4% of females in the same age group who received pensions and annuities with a mean of $11,142. Therefore, a female age 65 and older was only two-thirds as likely to receive an annuity or pension payment as her male counterpart. Moreover, the mean benefit for a female age 65 and older was about 65% of the benefit for her male counterpart.

One reason cited for the differential between male and female benefits is that women age 50 and over have relatively lower labor-force participation rates than males. However, in recent years, women's participation in retirement plans has risen significantly. This is causing the gender gap to shrink and, as a result, aggregate pension and annuity benefits for women may increase over time.

However, according to the report, the majority of current retirees with annuity income receive benefits from defined benefit pension plans, which are declining in the private sector. As a result, many future private-sector retirees may only receive annuity income if they purchase it with their own savings.

The report is available at: http://www.ebri.org/pdf/notespdf/EBRI_Noptes_01-2008.pdf

EBRI Study Finds Employers Spent $2.33 Trillion to Finance Employee Benefits in 2006

On January 17, 2008, the Employee Benefit Research Institute (EBRI) published "Finances of Employee Benefits, 1950-2006" in E*BRI Notes* for January 2008. According to the article, public and private employers spent a total of $2.33 trillion for major employee benefit programs in 2006, up almost 50% from 2000. Currently, retirement benefits constitute the largest share of employer spending on benefits. However, health costs are growing rapidly and will likely constitute the largest share in the near future. The following table illustrates employer payments for employee benefits in selected years:

Benefits Paid ($ billion)	1990	2000	2006
Retirement Income	$481.9	$862.9	$1,166.6
Health Benefits	300.3	596.8	1,014.7
Other Benefits	87.8	112.5	149.6
Total Benefits	**$870.0**	**$1,572.2**	**$2,330.9**
Source: EBRI tabulations based on U.S. Bureau of Economic Analysis (BEA)			

Retirement benefits accounted for $1.17 trillion (50.1%) of the total benefit payments. Of that amount, $544.1 billion was paid by Social Security's Old Age, Survivors, and Disability Insurance program, $331.8 billion was paid by private pension and profit sharing plans, and $290.7 billion was paid by federal, state, and local government employer retirement plans.

Health benefit payments accounted for $1.01 trillion (43.5%) of total benefit payments in 2006. Of that amount, $609.9 billion was paid by private group health insurance programs while $402.3 billion was paid by Medicare. Additionally, payments for other voluntary and mandatory employee benefit programs (including unemployment insurance, workers' compensation, group life insurance, disability, and veterans' benefits) totaled $149.6 billion (6.4%) of total benefit payments in 2006.

Of the three major employee benefit categories, health benefits increased the most as a percentage of total benefit spending. In 1990, based on the EBRI tabulations, health benefits accounted for 34.5% of total benefit spending, retirement benefits accounted for 55.4%, and other benefits accounted for 10.1%. By comparison, in 2006, payments for health benefits increased to 43.5% of total benefit spending, retirement benefits decreased to 50.1%, and other benefits decreased to 6.4%.

The report is available at: http://www.ebri.org/pdf/notespdf/EBRI_Noptes_01-2008.pdf

Commonwealth Fund Estimates $1.5 Trillion in Health Care Savings Through Federal Policy Changes

On December 18, 2007, the Commonwealth Fund's Commission on a High Performance Health System released its report "Bending the Curve: Options for Achieving Savings and Improving Value in U.S. Health Spending." According to the report, U.S. health spending is projected to increase from 16% of gross domestic product (GDP) in 2006 to 20% in 2016, rising from $2 trillion to $4 trillion. Additionally, the number of uninsured individuals will continue to rise.

The report presents 15 federal policy options and estimates that, if implemented in conjunction with universal health coverage through a blend of private and public insurance, the options could result in a combined savings of $1.5 trillion in national health expenditures over 10 years. According to the study's authors, the implementation of these policies through a new national "insurance connector" entity could expand and improve health care access, quality, and outcomes. Specific federal policy options and their potential savings from 2008 to 2017 include:

- Using better information to incorporate cost-effective treatment options in health plan benefits and offering incentives for health providers and patients to use the alternative options could save $368 billion.

- Using educational tools to inform Medicare beneficiaries about medical treatment alternatives could save $9 billion.
- Promoting health information technology for sharing patient information could save about $88 billion.
- Promoting health and disease prevention, such as reducing obesity and tobacco use, could save $283 billion and $191 billion, respectively.
- Encouraging employers to offer wellness programs by investing $2 billion in federal funds could save $19 billion.
- Aligning payments to health providers based on coordination of health services and requiring medical homes for primary patient care could save $194 billion.
- Hospital pay-for-performance programs designed to decrease hospital readmissions could save $34 billion.
- Changing the current Medicare fee-for-service system to fixed prospective payments for hospital and ambulatory care could save $229 billion.
- Requiring all payers to use Medicare payment rates for hospitals and physicians could save $122 billion.
- Allowing the Secretary of the Department of Health and Human Services to negotiate or set limits for prescription drug plans could save $43 billion.

The study is available at:
http://www.commonwealthfund.org/usr_doc/Schoen_bendingthecurve_1080.pdf?section=4039

CMS Study Finds Per Capita Health Spending for Persons Age 85 and Older Growing More Slowly

On November 6, 2007, the Centers for Medicare and Medicaid Services (CMS) released *U.S. Health Spending By Age, Selected Years Through 2004.* The study examines health care spending for children (ages 0 to 18), working-age adults (ages 19-64), elderly (ages 65+) and the oldest elderly (ages 85+) for selected years from 1987 through 2004. Surprisingly, the current trends indicate that per capita spending for persons age 85 and over is growing more slowly than spending for all other age groups. The following table, based on data presented in the article, shows total PHC spending, per capita PHC spending, and the annual rate of growth in per capita spending by age groups.

Total Personal Health Care Spending ($ billions)			
	1999	**2002**	**2004**
Total Population	$ 1,069	$ 1,341	$ 1,551
Ages 0-18	143	184	206
Ages 19-64	546	692	814
Ages 65+	380	465	531
Ages 85+	88	109	125
Per Capita PHC Spending ($)			
Total Population	$ 3,818	$ 4,652	$ 5,276
Ages 0-18	1,872	2,385	2,650
Ages 19-64	3,230	3,934	4,511
Ages 65+	11,018	13,218	14,797
Ages 85+	20,992	23,985	25,691
Annual Rate of Growth in Per Capita Spending (%)			
Total Population	N/A	6.8%	6.5%
Ages 0-18	N/A	8.4%	5.4%
Ages 19-64	N/A	6.8%	7.1%
Ages 65+	N/A	6.3%	5.8%
Ages 85+	N/A	4.5%	3.5%

In 2004, PHC spending for persons age 65 and older amounted to $531 billion or about 34% of all PHC spending that year, and averaged $14,797 per capita (about 3 times the $5,276 per capita average for the total population). For persons age 85 and older, PHC spending amounted to $125 billion, and averaged $25,691 per capita (about 5 times the per capita average for the total population). However, the growth rate in per capita PHC spending for persons age 65 and older was less than that for the total population (i.e., 5.8% vs. 6.5%). Moreover, for persons age 85 and older the growth rate in per capita PHC spending was much less than the total population (i.e., 3.5% vs. 6.5%). Similar results were found for 2002.

The researchers largely attribute the lower growth rates for persons age 85 and older to a slowdown in nursing home spending due to an increase in alternative care, such as Medicaid's home and community-based waivers program. These alternatives include in-home care as well as adult day care and assisted living facilities.

A summary of the study and related data are available on the CMS website at:
http://www.cms.hhs.gov/NationalHealthExpendData/04_NationalHealthAccountsAgePHC.asp

Wisconsin Legislative Council Releases Public Retirement Systems Study

In December 2007, the Wisconsin Legislative Council published its "2006 Comparative Study of Major Public Employee Retirement Systems." The biennial survey covers retirement benefits for general employees and teachers in 85 large public retirement systems. Conducted since 1982, the study provides information about retirement benefits, employer and employee contributions, actuarial methods and assumptions, plan funding, and other relevant topics.

In 2006, the retirement systems surveyed covered more than 17.7 million active and retired participants. The number of active participants increased 2.6% from 2004 to 2006, while the number of retirees increased 7.5%. As a result, the ratio of active members to retirees declined from 2.24 in 2004 to 2.14 in 2006.

In 2006, the systems' funded ratios averaged 82%, and were distributed as follows:

- 8% of the plans had funded ratios of 100% or more;
- 48% had funded ratios of 80 to 99%;
- 33% had funded ratios of 60 to 79%;
- 7% had funded ratios of less than 60%; and
- 4% had funded ratios that were not determined.

The study is available at: http://www.legis.wisconsin.gov/lc/publications/crs/2006_retirement.pdf

Circuit Court Grants Stay of District Court Judgment to Preempt San Francisco Health Care Ordinance

On January 9, 2008, the U.S. Ninth Circuit Court of Appeals stayed an injunction against implementing the San Francisco Health Care Security Ordinance, which requires employers to make health care payments on behalf of their employees (*Golden Gate Restaurant Association v. City and County of San Francisco*, 9th Cir., No. 07-17370, 1/9/08). The injunction was originally imposed by the U.S. District Court for the Northern District of California, which granted summary judgment for the Golden Gate Restaurant Association (*Golden Gate Restaurant Association v. City and County of San Francisco,* N.D. Cal., No. C 06-06997 JSW, 12/26/07).

At issue is an ordinance enacted in July 2006 by the City and County of San Francisco to implement the "Healthy San Francisco" program providing comprehensive health benefits to the city's uninsured residents. The ordinance requires medium and large businesses to make minimum health care payments on behalf of covered employees, beginning January 1, 2008, either through contributions to health savings accounts, direct reimbursement to employees, payments to third parties, or payments to the city. In November 2006, the Golden Gate Restaurant Association (GGRA) sued the city claiming that ERISA preempted the ordinance.

On December 26, 2007, the district court ruled in favor of GGRA, and issued an injunction against implementing the program. Writing for the district court, Judge Jeffrey S. White found that "Congress has evinced its intent to preclude state or local governments from passing any legislation that relates to ERISA plans so as to avoid a patchwork of state and local health care programs across the nation." Moreover, the ordinance was "related to" an ERISA plan because its "requirements directly or indirectly affect the relationship between private employers and the provision of health care coverage, a relationship that has traditionally been governed by ERISA." Accordingly, the court granted GGRA's motion for summary judgment stating that "any state law that mandates employee benefit structures or their administration is preempted by ERISA."

On December 27, 2007, the city appealed and requested an emergency stay of the injunction in both the district courts and the Ninth Circuit pending a decision on the merits of their appeal. The district court denied the motion. However, the Ninth Circuit granted the stay and allowed the law to go into effect pending the appeal. The Ninth Circuit found that the ordinance did not have a "connection with" an ERISA plan because it did not require any employer to adopt an ERISA or other health benefit plan. Additionally, it did not require an employer to provide specific benefits through an existing plan.

Writing for the Ninth Circuit, Judge William A. Fletcher held that the city has "a probability, even a strong likelihood, of success in their argument that the Ordinance is not preempted by ERISA." He held that the balance of hardships favored the city since individuals without health care coverage likely would not seek health care and that "avoidable human suffering, illness, and possibly death will result if a stay is denied." Additionally, the city's financial burden may increase if uncovered employees were forced to seek emergency treatment at the city's public hospitals. Therefore, the appellate court ordered that the district court's judgment be stayed pending resolution of the appeal.

The district court case is accessible at:
http://www.sfgov.org/site/uploadedfiles/cityattorney/GGRA-USDC-ORDER.PDF

The Circuit Court case is available at:
http://www.ca9.uscourts.gov/ca9/Documents.nsf/54dbe3fb372dcb6c88256ce50065fcb8/aff372e2cbda965a882573cb0070d2ca/$FILE/0717370o.pdf