



March 2006*

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

Wisconsin Legislative Council Publishes Public Retirement Systems Study

In December 2005, the Wisconsin Legislative Council published its "2004 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 2004, the systems covered more than 17.0 million active and retired participants. The number of active participants grew 2 percent from 2002 to 2004, while the number of retirees increased 8 percent for the same period. The ratio of active members to retirees declined from 2.38 in 2002 to 2.24 in 2004. In 2004, the average funded ratio was 84.8 percent. Funded ratios were distributed as follows:

- 11 percent of the plans had funded ratios of 100 percent or more;
- 55 percent had funded ratios of 80 to 99 percent;
- 26 percent had funded ratios of 60 to 79 percent;
- 6 percent had funded ratios of less than 60 percent; and
- 2 percent had funded ratios that were not determined.

The study is available on the Wisconsin State Legislature website at: http://www.legis.state.wi.us/lc/2_PUBLICATIONS/Other%20Publications/Reports%20By%20Subject/Employment%20and%20Occupations/04comparstudy.pdf

Iowa House Approves Bill to Phase Out Taxes on Social Security and Pensions

On January 31, 2006, the Iowa House passed legislation (H.F. 2045) to gradually phase out state income taxes on Social Security and retirement income over five years. The bill's sponsor, Rep. Jamie Van Fossen (R), introduced the legislation to address concerns that elderly residents were being driven out of the state due to income tax on retirement benefits. He introduced similar legislation last year.

* The authors of these news summaries are not attorneys and the statements made are not intended as legal advice or opinion. Qualified legal counsel should be consulted to ensure plan provisions and documents comply with applicable laws and regulations.

Currently, Iowa residents have a limited tax exemption on pension and retirement income for the first \$6,000 for single filers and first \$12,000 for married filers. Additionally, 50 percent of Social Security income is exempt for all taxpayers. Under H.F. 2045, these exemptions would remain and, beginning in 2007, an additional 20 percent of pension or retirement income would be exempt from tax. Over the next four years, income exempt from tax would increase 20 percentage points per year until 2011 when the state tax would be completely eliminated on pension and retirement income.

The bill also provides for a broader exemption from income tax for elderly residents. Taxpayers age 65 and older would be exempt from state income tax if they have a net income of \$36,000 or less for single filers and \$48,000 or less for married filers. In calculating net income, all otherwise tax-exempt pension and Social Security income would be included.

According to a fiscal note by the Legislative Fiscal Services Division, the estimated cost for the state would be \$18 million in the first year of implementation, increasing to about \$210 million in lost revenue each year after the phase-out was complete.

H.F. 2045 is available at: <http://www.legis.state.ia.us/asp/Cool-ICE/DisplayBills.htm> by searching for "HF2045."

U.S. Cities Report Fiscal Conditions Improving

On January 25, 2006, the National League of Cities released the results of its survey, *City Fiscal Conditions in 2005*. The study found that, for the majority of cities, fiscal conditions improved in 2005 for the first time since 2001. In 2005, 63 percent of surveyed city finance officers reported their cities' fiscal conditions improved from the previous year. This is up dramatically from the 2003 survey, when only 19 percent reported similar improvements. During the past year, almost 50 percent of U.S. cities raised new revenues, including increased fees and charges for city services (48 percent) and increased property taxes (26 percent).

Looking to fiscal year 2006, 59 percent of the surveyed officials predicted their cities will be "better able" to meet their financial needs. However, city officials were cautious due to revenue constraints and concerns about possible property tax revenue declines resulting from slowing real estate markets. Officials also identified several factors that could negatively affect city budgets, including upward pressure on employee wages, rising health care costs, increasing public safety needs, necessary infrastructure improvements, and increased pension and benefit costs.

The League's annual survey has been conducted since 1985. In 2005, the survey data was based on a sampling of 276 cities with populations of 10,000 or more. The League advised that the data should be considered in light of variations in tax authority, functional responsibility, accounting systems and state laws which influence city revenues and expenditures.

The survey findings are available on the National League of Cities' website at: <http://www.nlc.org/content/Files/RMPetyfiscalcondbrf05.pdf>

Health Insurance Survey of Older Americans

On January 20, 2006, the Commonwealth Fund released its report *Health Coverage for Aging Baby Boomers*. The analysis examined health insurance coverage for working older adults ages 50 to 64 (i.e., the "boomers"), and focused on those with low and moderate incomes. The survey found that the health care expenditures of aging boomers are more than double those of younger adults.

Among the key findings for working older adults:

- 62 percent have been diagnosed with at least one of six chronic medical conditions (such as high blood pressure, high cholesterol or arthritis).
- 20 percent are uninsured or have had trouble obtaining medical coverage. Those with low or moderate incomes are significantly less likely to have employer-based coverage. About 54 percent of those surveyed with incomes under \$25,000 reported a time when they were uninsured. This was also the case for 33 percent of those with incomes between \$25,000 and \$39,999.
- 55 percent of those with individual coverage spent more than \$3,600 per year compared to only 16 percent of those with employer-provided health care coverage.
- 66 percent are concerned that they will not be able to afford needed medical care in the future.

Older adults without adequate health insurance have a higher risk of experiencing adverse health conditions. Unstable health coverage and high out-of-pocket health care costs may result in neglecting health care needs, increasing medical debt, and jeopardizing the ability of workers to save for retirement. To address these issues, the survey also examined support for several public policy solutions:

- Establishing new Medicare savings accounts for long-term care and other non-covered health care expenses;
- Allowing individuals to enroll in Medicare before age 65, plus a tax credit for health care costs; and,
- Eliminating the two year waiting period for those on Social Security Disability Insurance to become eligible for Medicare.

Over 70 percent of those surveyed said they would be interested in investing one percent of their income in a Medicare savings account. The same percentage said they would like to enroll in Medicare before age 65.

The study is available at: http://www.cmwf.org/usr_doc/884_Collins_hlt_coverage_aging_baby_boomers.pdf

EBSA Reviews SEC Documents Regarding Conflicts of Interest for Pension Consultants

On February 3, 2006, Assistant Secretary of Labor Ann L. Combs released a letter written to Representatives George Miller (D-CA) and Edward Markey (D-MA) confirming the Department of Labor's (DOL) Employee Benefit Security Administration (EBSA) review of Securities and Exchange Commission (SEC) regulations regarding the fiduciary duties of pension consultants. Combs' letter responded to the issues raised by Miller and Markey on conflicts of interest for pension consultants.

The DOL and SEC regulate pension consultants' activities in accordance with statutes that contain different definitions, authorities and sanctions. EBSA is the DOL agency responsible for administering and enforcing Title I of the Employee Retirement Income Security Act (ERISA) in conjunction with the IRS and PBGC. The SEC is responsible for administering and enforcing security laws such as the Investment Advisers Act of 1940 (Advisers Act).

In the letter, Combs explained the different fiduciary definitions under the Advisers Act and ERISA. She clarified that under the Advisers Act, a pension consultant who is a registered investment adviser is considered a fiduciary, but may not be a fiduciary under ERISA.

Among other provisions, Title I of ERISA specifies that benefit plan fiduciaries must act prudently and solely in the interest of the plan's participants and beneficiaries. Generally, ERISA considers a person to be a fiduciary to the extent he or she engages in certain "fiduciary" activities, such as exercising discretionary authority or control over the management of a plan or its assets, without regard to title or position. Generally, ERISA does not consider registered investment advisers who do not have sufficient authority or control over plan assets to be fiduciaries unless they render investment advice with respect to plan assets for a fee or other

compensation. She stated that a consultant's status as a fiduciary depends on the particular facts and circumstance of the case.

However, she added that an investment adviser is a "party in interest" and that transactions between a plan and a party in interest are prohibited under ERISA except under certain specified circumstances. A plan fiduciary who hires or retains a service provider must ensure that the relationship between the plan and its service providers meet ERISA's requirements for necessary and appropriate services with reasonable compensation.

Assistant Secretary Combs' letter includes a fact sheet with tips to help plan fiduciaries select and monitor investment advisors and other investment consultants. It is available at:

<http://markey.house.gov/docs/finance/DOL%20Response%20Letter%202.1.06.pdf>

Deficit Reduction Act Increases PBGC Premiums

On February 8, 2006, President Bush signed the Deficit Reduction Act of 2005 (DRA). According to the Congressional Budget Office, the Act will reduce direct federal spending by \$39 billion over the 2006-2010 period, with over half of the reductions coming from changes to the Medicare and Medicaid programs (\$11.2 billion), federal student loan programs (\$8.3 billion), and the Pension Benefit Guaranty Corporation (PBGC) (\$3.6 billion).

In an effort to ensure the long-term solvency of the PBGC, the Act increases PBGC premiums for private-sector pension plans. Effective for plan years beginning on or after January 1, 2007:

- The annual flat-rate premium will increase from \$19 to \$30 per participant for single employer plans and from \$2.60 to \$8.00 per participant for multiemployer plans;
- The additional variable rate premium for underfunded pension plans will remain at \$9 for every \$1,000 of unfunded vested benefits; and,
- When a company transfers its underfunded pension plan to the PBGC, a new termination premium of \$1,250 per participant will be payable annually for three years after plan termination.

Several professionals specializing in private-sector pension plans have expressed concern about the new law's effect on private pension plans. BNA's *Pension & Benefits Reporter* quotes Dallas Salisbury, president of the Employee Benefit Research Institute, as saying "these increases, combined with changes in the variable rate included in the new Bush budget, will be weighed in decisions on plan freezes in the months and years ahead." James Klein, president of the American Benefits Council, said he expected Congress to pass a more comprehensive bill that would supersede the PBGC provisions in the DRA.

Source: BNA *Pension & Benefits Reporter*, February 14, 2006.

CRS Updates Social Security Reform Issue Brief

On January 23, 2006, the Congressional Research Service updated its *Social Security Reform* issue brief for Congress. According to the report, over the past several months Congress and the Bush Administration have been focusing on budget reconciliation, federal relief for hurricane victims, and other matters rather than Social Security reform. The most recent legislative proposal was S. 1302, the Stop the Raid on Social Security Act. This legislation would establish voluntary personal accounts funded by surplus Social Security tax revenues – with reductions in traditional Social Security benefits based on the assets accumulated in the personal accounts. Other Social Security reform proposals included in the report were:

- Bipartisan Retirement Security Act - creating mandatory individual accounts funded by payroll taxes and modifying traditional Social Security benefits.

- Individual Social Security Investment Program - creating voluntary personal investment accounts financed by redirecting payroll taxes and modifying traditional Social Security benefits.
- Social Security Forever Act - requiring workers and employers to contribute 3 percent of earnings above the taxable wage base and extending the pay-as-you-go requirement under the Balanced Budget and Emergency Deficit Control Act.
- Growing Real Ownership for Workers Act - to create voluntary “GROW” accounts for workers born after 1949 and applying surplus Social Security revenue to the accounts.

Source: BNA *Pension & Benefits Reporter*, February 14, 2006.

Seventh Circuit Rejects Retirees’ Claim to Trial on Lifetime Health Benefits

On February 8, 2006, the U.S. Court of Appeals for the Seventh Circuit ruled that retirees of the Ameren Corporation were unable to show that a “patent or latent ambiguity” existed in prior collective bargaining agreements that would entitle them to lifetime health benefits. In so doing, the appeals court affirmed the district court’s summary judgment and found that the retirees were not entitled to a trial on their claim. (*Barnett v. Ameren Corp.*, 7th Cir., No. 05-1496, 2/8/06).

Ameren was created in 1997 through the merger of two companies, both of which had a longstanding practice of providing health benefits to retirees. For at least a decade, an ongoing dispute existed at both companies, with management claiming the right to change or terminate health care benefits and retirees claiming them as lifetime benefits. While some changes were made to retiree health benefits before 2003, the changes did not provoke a lawsuit.

In 2003, however, retirees sued when Ameren announced they would have to pay 25 percent of their health insurance premiums and 50 percent of their dependent’s premiums by 2009. While the retirees acknowledged the governing bargaining agreement did not unambiguously create a lifetime benefit, they claimed the agreement had “patent and latent ambiguities” that would entitle them to a trial on their claim. The retirees argued that a patent ambiguity existed in a 1993 Stipulation of Agreement because it required 10 years of “vested service” to be eligible for retiree health care and that for 1995 and “all subsequent years” retirees would be required to pay 20% of the monthly major medical premium for dependents. The retirees also argued that a latent ambiguity existed because the agreement provided other benefits that had not been changed by Ameren. After hearing the arguments, the District Court for the Southern District of Illinois found no ambiguities and granted summary judgment to Ameren.

In reviewing the case, the appeals court noted that the 1993 Stipulation was followed two months later by a Supplementary Agreement (SA) providing that the company would “take such action as may be necessary to modify and to continue for the life of the Labor Agreement” health benefits for employees who retire. Moreover, the SA rephrased the benefit provision, removing references to “the year 1995 and all subsequent years.” Given that the SA allowed the company to change or terminate the benefits, the appeals court ruled that the benefits were not vested. The appeals court also rejected the retirees’ claim of latent ambiguity, holding that health benefits do not vest simply because a company had not reduced them in the past.

The decision is available at: <http://caselaw.lp.findlaw.com/data2/circs/7th/051496p.pdf>

Colorado Senator Introduces PERA Reform Legislation

On January 31, 2006, Colorado Senator David Owen introduced Senate Bill 06-162 to reform the Colorado Public Employees’ Retirement Association (PERA). Senator Owen reported that his bill was supported by the governor and state treasurer and would reduce PERA’s \$11 billion shortfall more rapidly than the other proposed legislation. Under SB 06-162, the legislative changes would:

- Increase the retirement eligibility age and service requirements for new hires to 35 years of service regardless of age, 30 years of service at age 60, or 5 years of service at age 65. This change would also apply to current members under age 40 who are not vested as of January 1, 2007.
- Prevent annual cost-of-living increases in monthly benefits for new hires unless PERA is overfunded and the increase is approved by at least two-thirds of the board.
- Allow new hires to join a defined contribution plan rather than the defined benefit plan.
- Replace the 16-member board of trustees with an 11-member board. The new board would consist of the state auditor, the state treasurer, five members elected by PERA members and retirees; and four members appointed by the governor.
- Require PERA to hire an internal auditor.
- Require the state attorney general, rather than in-house counsel, to provide legal advice to the board.

SB 06-162 has been assigned to the Senate State Veterans and Military Affairs committee and is available by selecting "Senate Bill 06-162" at: <http://www.copera.org/pera/about/legislation/2006legislation.stm>

Colorado PERA Proposes Pension Reform Package

In late 2005, the Colorado Public Employees' Retirement Association (PERA) proposed a package of legislative reforms intended to protect the benefits of current plan participants while improving the actuarial soundness of the fund. The proposal would limit "spiking" for current ("Tier 1") members and create a second tier ("Tier 2") defined benefit plan for employees hired on or after January 1, 2007.

For current participants, retirement benefits are calculated as 2.5 percent of Highest Average Salary (HAS) times years of service, with HAS based on three years of salary. The proposal would limit "spiking" by tightening the limit on salary increases included in HAS. This change would be effective for benefits on or after January 1, 2009.

For new participants hired after December 31, 2006, Tier 2 retirement benefits would be calculated as 2.1 percent of HAS, with HAS based on five years of salary. In addition, there would be no guaranteed cost-of-living increases after retirement, unlike Tier 1 where most participants receive a guaranteed 3.5 percent COLA. Moreover, employee contributions for Tier 2 would be 7 percent of pay, compared with 8 percent for Tier 1. Also, for current PERA members under age 45 and for new members, the proposal would limit PERA's subsidy for retiree health premiums.

On February 6, 2006, Colorado Senator Paula Sandoval introduced pension reform legislation (SB 06-174) containing many of PERA's provisions. The bill has been assigned to the Senate State Veterans and Military Affairs Committee and can be found at: <http://www.copera.org/pera/about/legislation/2006legislation.stm> by selecting "Senate Bill 06-174."

Bush Administration Proposes HSA Policy Initiative in Fiscal Year 2007 Budget

On February 6, 2006, in his budget proposal for fiscal year 2007, President Bush introduced a policy initiative to expand health savings accounts (HSAs) as a way to constrain health care costs and reduce the number of uninsured. HSAs are designed to help individuals save for health care expenses using contributions to health savings accounts combined with high-deductible health plans (HDHPs). The estimated cost of the new HSA incentive would be \$156.1 billion over 10 years. The proposal would:

- Raise the maximum annual HSA contribution to equal the out-of-pocket limit for the participants' HDHP. If implemented in 2006, this would increase the maximum amount contributed to a health savings account from \$2,700 to \$5,250 for individual coverage and from \$5,450 to \$10,500 for family coverage;
- Prorate the maximum HSA contribution based on the number of months the individual is eligible for HDHP coverage;

- Allow a refundable tax credit for a portion of after-tax contributions made to an HSA. The tax credit would be the lesser of 15.3 percent of a taxpayer's after-tax contribution to the HSA or 15.3 percent of wages subject to employment taxes. The purpose of the tax credit would be to offset employment taxes on the HSA contributions;
- Provide a tax deduction applicable to the premium costs for the HDHP.

The proposal also includes a modified tax credit for low- and moderate-income taxpayers. While a previously proposed low-income tax credit would have applied to a broader range of health insurance products, the current proposal would only apply to HSA-eligible HDHPs. The proposed maximum credit would be \$1,000 for individual coverage and \$3,000 for family coverage, up to 90 percent of the HDHP's premium (and further limited based on the individual's annual income). One-third of the credit could be used to fund the HSA and the rest to pay the insurance premiums.

Currently, the insurance industry estimates about 3 million people are enrolled in HSA-compatible HDHPs. According to the Administration, nearly 37 percent of those were purchased by people who were previously uninsured. The Administration predicts that with the proposed policy changes, 21 million HSAs will exist by 2010, compared with 14 million HSAs otherwise.

Source: BNA *Pension & Benefits Reporter*, February 14, 2006.

GASB Announces New Pension Research Project

In January 2006, the Governmental Accounting Standards Board (GASB) added a new project to its research agenda. Responding to concerns about the funded status of state and local pension plans, the project is intended to open up a broad discussion regarding accounting and financial reporting for governmental retirement benefits. Specifically, the project is designed to review GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, regarding its usefulness for:

- Assessing the financial implications of governmental pension benefits and of managerial decisions regarding those benefits; and
- Making decisions about the value of benefits, proposed changes in benefits, and funding of benefits.

Although not discussed in the project description, the project will likely examine pension accounting issues currently under review by the Financial Accounting Standards Board (FASB), including: the appropriateness of asset smoothing methods, selection of actuarial assumptions, and inclusion of the unfunded actuarial liability on the face of the financial statements. In conducting the study, the GASB will request comments from government officials, retirement system boards and staff, plan members, actuaries, auditors, bond analysts, investors, and taxpayers. The GASB expects that conclusions drawn from this project would also be applicable to other postemployment benefits.

The project is described in the GASB's First-Third 2006 Technical Plan and is scheduled to continue through December 2007. The Technical Plan is available at: <http://www.gasb.org/tech/techplan.pdf>