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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 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.

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President Signs Pension Protection Act of 2006

On August 17, 2006, President Bush signed the Pension Protection Act (H.R. 4) of 2006. The 907-page pension reform bill makes significant changes to a broad scope of rules that apply to employee benefit plans. The final provisions are complex, representing the first comprehensive pension legislation in more than 30 years. In brief, the Act:

- Changes the rules governing private-sector, single-employer defined benefit plan funding;
- Accelerates the funding obligations of private-sector employers for plans "at-risk" (e.g., less than 80% funded);
- Introduces new rules for defined contribution plans;
- Clarifies the rules for cash balance plans;
- Imposes new reporting and disclosure requirements; and
- Makes permanent the EGTRRA provisions that were scheduled to expire after 2010.

Although a majority of the changes are not applicable to governmental plans, the Act does include several provisions that affect state and local governmental plans and participants. These provisions clarify the rules related to service credit purchases and minimum distributions, and expand certain benefits for public safety employees. A summary of the key provisions applicable to governmental plans is provided in our research memo, available at: <http://www.gabrielroeder.com>.

The Pension Protection Act of 2006 is available at:

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:h4enr.txt.pdf

GASB Issues Technical Bulletin on Accounting for Medicare Part D Drug Subsidies

On June 30, 2006, the Governmental Accounting Standards Board (GASB) issued Technical Bulletin (TB) No. 2006-1, *Accounting and Financial Reporting by Employers for Payments from the Federal Government Pursuant to the Retiree Drug Subsidy Provisions of Medicare Part D*. The TB provides guidance to

governments and other postemployment benefit (OPEB) plans on reporting federal government payments received for Medicare Part D retiree drug subsidies.

The Technical Bulletin addresses:

- How an employer should account for and report Medicare Part D retiree drug subsidy payments from the federal government to the employer;
- How such payments to an employer affect the accounting and financial reporting for the transaction by a defined benefit OPEB plan;
- How an employer should account for and report such payments to the plan; and
- How a defined benefit OPEB plan should account for and report such benefits to the plan.

Generally, the TB provides that Medicare Part D drug subsidy payments made to a governmental employer be treated by the government as revenues (and accompanying assets) rather than as reductions in the annual OPEB cost. Subsidy payments made directly to an OPEB plan should be treated separately from the employer's contributions – i.e., as payments made by the federal government “on-behalf of” the state or local government(s) sponsoring the OPEB plan. Again, the payments would be treated as revenues (and assets) rather than as reductions in the annual OPEB cost.

The TB is effective immediately except for provisions applicable to the implementation of the OPEB standards under GASB Statements 43 and 45, which are effective as of the Statements' effective dates. The Technical Bulletin can be purchased online at: <http://gasbpubs.stores.yahoo.net> or by calling 800-748-0659.

Further information is available on GASB's website at:

http://www.gasb.org/plain-language_documents/tb2006-1_plain-language_article.pdf

GASB Posts Implementation Guidance for OPEB Plan Trusts and Fiduciary Responsibilities

In July 2006, the Governmental Accounting Standards Board (GASB) answered an additional question about the structure and functions of other postemployment benefit (OPEB) plan trusts and the fiduciary responsibilities of those who oversee or administer them. In its answer, the GASB recognized that an OPEB plan may be structured in different ways to fit specific circumstances. For example, some plans may be structured so that all plan functions are carried out by a single administrative entity, subject to trustee oversight. For other plans, responsibility for different functions (e.g., investments and benefit payments) may be assigned to different entities.

Regardless of these different structures, the GASB clarified that for an OPEB plan to be considered a qualified trust or equivalent arrangement in accordance with Statements 43 and 45, the plan's structure and activities must be “compatible with holding and managing plan assets, not as assets of the employer, but in a trust for the exclusive benefit of plan members.” This includes criteria regarding the (1) irrevocability of contributions, (2) the dedication of plan assets (including investment income) for payment of plan benefits, and (3) the legal protection of the plan assets from creditors. Actions by an entity or person that are inconsistent with these criteria would be evidence that the OPEB plan is not a trust or equivalent arrangement.

The guidance will be included in the 2006 Comprehensive Implementation Guide, but was posted to the GASB's web site prior to publication due to its immediate relevance. The guidance is available at: http://www.gasb.org/project_pages/opeb_staff_guidance.pdf

IRS Provides Guidance for Governmental Employers Regarding 414(h)(2) “Pick-Ups”

On August 9, 2006, the Internal Revenue Service (IRS) released Revenue Ruling 2006-43 which provides guidance for employing governmental units that “pick up” employee contributions to their qualified retirement plans. Under § 414(h)(2) of the Internal Revenue Code, governmental employers are permitted to pick up mandatory employee contributions to qualified plans established by state and local governments. As a result, the employee contributions are treated as employer contributions and are not subject to federal income tax when contributed (although they are subject to income tax when later distributed). Revenue Ruling 2006-43 clarifies that such a contribution will **not** be treated as having been picked up by the employer unless the employing unit:

- (1) “Specifies that the contributions, although designated as employee contributions, are being paid by the employer. For this purpose, the employing unit must take formal action to provide that the contributions on behalf of a specific class of employees of the employing unit, although designated as employee contributions, will be paid by the employing unit in lieu of employee contributions. A person duly authorized to take such action with respect to the employing unit must take such action. The action must apply only prospectively and be evidenced by a contemporaneous written document (e.g., minutes of a meeting, a resolution, or an ordinance).”
- (2) “Does not permit a participating employee from and after the date of the “pick-up” to have a cash or deferred election right (within the meaning of § 1.401(k)-1(a)(3)) with respect to designated employee contributions. Thus, for example, participating employees must not be permitted to opt out of the “pick-up”, or to receive the contributed amounts directly instead of having them paid by the employing unit to the plan.”

The requirement is effective August 28, 2006. However, under the ruling’s transition relief, governmental employers will have until January 1, 2009, to take formal action in writing to pick up the contributions, provided the employing unit took “contemporaneous action evidencing the intent to establish a pick-up plan” (i.e., by announcing the pick-up to employees and operating the plan accordingly). The ruling does not modify or revoke any private letter ruling issued prior to August 28, 2006.

Revenue Ruling 2006-43 is available at: <http://benefitslink.com/IRS/revrul2006-43.html>

State and Local Groups Respond to Request for GAO Study of Public Pension Funding

On July 10, 2006, Senator Charles Grassley (R-IA), chairman of the U.S. Senate Finance Committee, and ranking committee member Max Baucus (D-MT) requested that the U.S. Government Accountability Office (GAO) conduct a study of the current funded status of public pension plans, indicating their concern that such plans may be poorly funded. On August 2, 2006, representatives of 28 national organizations representing state and local governments, public retirement systems, employees and retirees responded to the Senators’ request, pointing out the strengths of public plans and volunteering to work with the GAO to ensure the study’s accuracy.

In their letter, the group noted that there are fundamental differences between governments and businesses that legitimately affect the manner in which their retirement plans should be accounted for and measured. Moreover, they added, “comprehensive state and local laws and significant public accountability and scrutiny provide rigorous and transparent regulation of public plans, and have resulted in strong funding rules and levels.” The group also emphasized that state and local retiree health benefits are handled separately from pension plans and should be distinguished from the pension plans in the GAO’s study. Finally, they urged the GAO to “keep in mind” the following facts as their work progresses:

1. **Public pension plans are in good financial condition.** As a group, public pension plans have funded 86% of their liabilities. This funded ratio is projected to grow in the near future as the investment losses that occurred earlier this decade are more fully offset by strong investment gains.
2. **The bulk of public pension funding is not shouldered by taxpayers.** When placed in context, required employer (taxpayer) contributions to public pension plans constitute a fraction of total revenues. In 2004, investment earnings accounted for 77% of all public pension revenue, while employer contributions were 15%.
3. **State and local retirement plan assets are professionally-managed and provide valuable long-term capital for the nation's financial markets.** The \$2.8 trillion held in plan portfolios are an important source of stability for the marketplace and are designed to withstand short-term fluctuations while still providing optimal growth potential.
4. **State and local pension plans fuel national, state and local economies.** Public plans distribute more than \$130 billion annually in benefits to over 6 million retirees and beneficiaries, with an average annual pension benefit of roughly \$19,500.
5. **Public plans are subject to comprehensive oversight.** State and local government plans are subject to state constitutional, statutory and case law and must comply with state and local requirements, as well as governmental accounting standards.
6. **Public retirement plans attract and retain the workforce that provides essential public services.** Active public employees comprise more than 10% of the nation's workforce, and two-thirds are employed in education, public safety, corrections, or the judiciary.

The text of the joint letter is available at: <http://www.nasra.org/news/article.asp?newsid=131>.

Seventh Circuit Rules IBM Cash Balance Plan Did Not Discriminate Against Older Workers

On August 7, 2006, the Seventh U.S. Circuit Court of Appeals overturned a federal district court's decision by ruling that IBM did not discriminate against older workers in violation of the Employee Retirement Income Security Act (ERISA) when it converted from a defined benefit plan to a cash balance plan (*Cooper v. IBM Personal Pension Plan*, 7th Cir., No. 05-3588). The three-judge appellate panel unanimously found that all terms of IBM's cash balance plan were age-neutral and, therefore, did not result in age discrimination.

On July 31, 2003, the U.S. District Court for the Southern District of Illinois ruled that IBM's cash balance plan violated ERISA by discriminating against older workers (*Cooper v. IBM Personal Pension Plan*, S.D. III, No. 99-829-GPM). In 1995, IBM changed its traditional pension plan to a hybrid pension equity plan and, in 1999, converted it to a cash balance plan. Under the terms of the cash balance plan, 5% of each employee's annual taxable income would be credited to their account and the account balance would earn interest at a rate of 100 basis points above the rate on one-year Treasury bills. In response, three former employees brought a class action lawsuit claiming the cash balance formula discriminated on the basis of age.

Under ERISA § 204(b)(1)(H)(i), a defined benefit plan is age-discriminatory if "an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced" on account of age. The plaintiffs argued that the cash balance formula was discriminatory because, when an individual's accrued benefit is valued as an annuity payable at age 65, the rate of growth in the accrued benefit would be lower for older employees than for younger employees. The district court agreed, stating: "The rate of a participant's benefit accrual diminishes as the participant closes on the age 65 target."

In overturning the district court, the appellate court argued that the district court had mistakenly interpreted "benefit accrual" to mean "accrued benefit." According to the appeals court, "benefit accrual" refers to the amount the plan sponsor puts into the plan for each employee and "accrued benefit" refers to the final amount which plan participants can withdraw when they retire. In the view of the appellate court, the district court erred by treating the "time value of money" as age discrimination. The fact that younger employees had more

time to accrue interest did not mean that the plan discriminated against older workers. The court noted that in accordance with ERISA, the plan did not stop making allocations or accruals to the plan, nor did it change the rate at which they accrue, based on age. According to the court, “every covered employee receives the same 5% pay credit and the same interest credit per annum.”

The appellate court also rejected the plaintiffs’ contention that the plan discriminated against older workers because they would have received more favorable benefits under the traditional defined benefit plan. “Removing a feature that gave extra benefits to the old differs from discriminating against them. Replacing a plan that discriminates against the young with one that is age-neutral does not discriminate against the old.”

Note: Recent changes under the Pension Protection Act are generally consistent with the appellate court’s findings. Under the Act, a cash balance plan does not engage in age discrimination if a participant’s accrued benefit is equal to or greater than that of any “similarly situated” younger participant. For this purpose, the term “similarly situated” means identical in every respect (e.g., period of service, salary, position, etc.) except for age. However, the Act does prohibit “wear away” when a pension plan is converted to a cash balance plan. Under the new law, a participant’s benefit may be no less than the sum of the participant’s accrued pension benefit at the time of conversion plus the benefit for service earned under the cash balance formula.

The case is available at: http://benefitslink.com/cases/ibm_v_cooper_7th_cir_decision.pdf

Michigan Senate Introduces Bill for Local Governments to Issue Bonds for Health Care Trust Funds

On July 26, 2006, Michigan Senator Nancy Cassis introduced legislation (S.B. 1360) to amend the Revised Municipal Finance Act (MCL 141.2103). The bill would allow a local Michigan government (county, city, village or township) to issue municipal bonds to pay the unfunded accrued liability of a health care trust fund created by a public employee retirement system for retiree health care benefits.

The local government would be required to publish a public notice of the intent to issue the bonds. In addition, the issuing government would have to develop a comprehensive financial plan that demonstrates: (1) the borrowed money plus future required annual contributions would be adequate to meet required benefits, (2) the actuarial assumptions and amortization schedule satisfy established criteria, (3) the issuance of municipal bonds would result in a projected present value savings, and (4) the retirement system has a plan to reduce health care costs. The new debt would be in the form of “general obligation limited tax” bonds backed by the local government with a maximum 30-year term. The bond total could not exceed 5% of the state equalized value of the local government’s total property assessment. Under S.B. 1360, the local government would not be authorized “to levy any tax not authorized by law at the time the securities are issued” to pay for the bonds. The bonds, interest, and income from the bonds would be exempt from state and local taxation.

S.B. 1360 is available at:

<http://www.legislature.mi.gov/documents/2005-2006/billintroduced/Senate/pdf/2006-sIB-1360.pdf>

U.S. House Subcommittee Holds Hearing on Reemployment of Federal Retirees

On July 25, 2006, the U.S. House Government Reform Subcommittee on Federal Workforce and Agency Organization held a hearing for several federal agencies to discuss reemploying federal retirees to meet workforce shortages and emergency preparedness. According to the Office of Personnel Management (OPM), about 60% of the government’s 1.6 million white-collar employees and 90% of its 6,000 federal executives will be eligible to retire within 10 years. Moreover, many younger federal employees with professional or technical experience are leaving for the private sector or retiring early. In response, the federal government is looking for ways to encourage continued employment and reemploy retirees.

Under current law, the salaries of most reemployed federal retirees (excluding military retirees) are reduced by the amount of their retirement annuities, although they continue to earn additional service credit during reemployment. Generally, these rules were established to prevent excessive compensation and “double-dipping.” OPM can waive the salary reduction if a governmental agency experiences exceptional difficulty in filling positions or if there is a need for temporary employment due to an emergency. (Retirees reemployed by the Department of Defense receive such waivers automatically.) Federal retirees who are reemployed under the waiver continue to receive their full annuity and full salary, but do not earn any additional retirement benefits other than Social Security.

On July 21, the OPM proposed a rule to authorize federal agencies to grant waivers for retired federal employees to be reemployed without penalty. The subcommittee examined this proposal as well as others that might encourage continuing employment, such as part-time employment and job sharing. Currently, federal employees who convert to part-time employment are not given credit for full-time equivalent salaries earned during that period for calculating retirement benefits. Since this could serve as a disincentive for employees to transition to retirement by working part-time, the panel called for changes in federal employment laws to meet the needs of the agencies and their employees.

Further information is available at: <http://reform.house.gov/FWAO> by clicking on “Hearings” and selecting “July 25, 2006 hearing.”

San Francisco Mayor Signs Universal Health Care Legislation

On August 7, 2006, San Francisco Mayor Gavin Newsom signed health access legislation, making San Francisco the first U.S. city to provide universal health care for its 82,000 uninsured residents. The Health Access Program (HAP) is expected to cost about \$200 million to \$229 million, or \$2,400 per person. The program is expected to be implemented by July 1, 2007, and funded through a combination of public funds and private employer contributions. Local uninsured residents would be eligible to join HAP if they are also willing to apply for state and federal health benefits. Health care will be available only within the city or county limits, through a network that includes public hospitals and health clinics, and community non-profit and private providers that meet participation requirements.

San Francisco employers with 20 to 99 employees that do not provide health coverage would have to pay about \$1.06 per hour per employee and those with more than 100 employees would have to pay \$1.60 per hour per employee. Employers who currently provide health coverage at a rate less than the rate set by the city would have to contribute the difference to the program. The city’s rate will be set at 75% of average contributions for full-time employees, based on a 10-county survey. Employers who do not provide health coverage would begin making phased-in contributions starting July 1, 2007.

The press release is available at: http://sfgov.org/site/mayor_page.asp?id=44645