News Scan

GRS
Gabriel Roeder Smith & Company
Consultants & Actuaries

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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.

Note: The authors of these news 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.

GRS in the News: *PLANSPONSOR* Magazine Publishes Article on Public Pension Myths

The November 2006 issue of *PLANSPONSOR* magazine features an article titled "Three Myths About State and Local Government Pension Plans," written by Keith Brainard, research director at the National Association of State Retirement Administrators (NASRA), and Paul Zorn, governmental research director at Gabriel, Roeder, Smith & Company. The article is intended to dispel misinformation about state and local government pension plans that has been circulating in recent media reports. These reports claim that public pension plans are in a financial crisis, lack oversight and accounting standards, and should be replaced with defined contribution plans to reduce costs. The article presents evidence refuting these claims, and goes on to discuss the potential impact of current pension trends on the future economy and describes methods to improve public plan sustainability.

The article is available on the *PLANSPONSOR* website at:
http://www.plansponsor.com/magazine_type3/?RECORD_ID=35588

Certain Pension Protection Act Provisions Become Effective Beginning in 2007

Although many of the Pension Protection Act provisions affecting governmental plans were effective upon enactment (i.e., August 17, 2006), certain provisions will become effective beginning in 2007. These include:

In-Service Distributions: For plan years beginning after December 31, 2006, a qualified pension plan may (but is not required to) begin paying distributions to an employee who reaches age 62 even though the employee has not separated from employment at the time of the distribution. Prior to the Act, an employee had to be eligible for unreduced benefits before receiving in-service distributions.

Rollovers of After-Tax Amounts: For tax years beginning after December 31, 2006, a qualified defined benefit, defined contribution, or 403(b) plan may (but is not required to) accept rollovers of after-tax amounts from qualified plans, provided the after-tax amounts are accounted for separately by the receiving plan. Prior to the Act, after-tax amounts could only be accepted by defined contribution plans.

Rollovers to Non-spouse Beneficiaries: For distributions after December 31, 2006, a non-spouse beneficiary may roll an eligible rollover distribution from a qualified retirement plan to an "inherited" individual retirement

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account or individual retirement annuity specifically established to receive the distribution. Qualified retirement plans include governmental defined benefit and defined contribution plans, as well as 403(b) annuities and governmental 457 plans. Prior to the Act, non-spouse beneficiaries were not allowed to rollover distributions. Qualified plans are required to allow for such distributions, and should make the changes in plan forms and procedures necessary to comply with the change.

A helpful summary of these and other Pension Protection Act provisions affecting governmental plans is available from the law firm of Ice Miller at http://www.icemiller.com/enewsletter/bulletins/ppa_govt.pdf

Senate Finance Committee Chairman Asks Federal Agencies to Report on Hedge Fund Transparency

On October 16, 2006, Senator Charles Grassley (R-IA), chairman of the U.S. Senate Finance Committee, requested federal agencies with jurisdiction over hedge funds to provide information about current hedge fund transparency rules and make recommendations for ways to improve such transparency. In letters to the Treasury Department, Labor Department, and Securities and Exchange Commission (among others), Senator Grassley expressed concern about pension plan exposure to hedge fund investment losses and the potential impact of such losses on the retirement security of American workers. Observing that hedge funds are a major presence in financial markets and the economy, with more than 9,000 hedge funds managing assets of over $1.1 trillion, the Senator expressed alarm that the funds are not subject to the same government oversight and regulation as other alternative investments. As he states in his letter: “I am particularly concerned that tens of millions of Americans may be unwittingly exposed to hedge fund investments through their participation in public and private pension plans, and yet have no way of knowing it.”

A copy of Senator Grassley’s letter is available at: http://www.grassley.senate.gov/

IRS Issues Private Letter Ruling on Trustee-to-Trustee Transfers

On August 2, 2006, the Internal Revenue Service issued a private letter ruling (PLR 200643005), detailing the tax rules related to “trustee-to-trustee” transfers of assets between § 401(a) plans. The ruling pertains to a state-maintained money purchase plan (Plan X) and a multiple-employer retirement system (System Y) for police officers and firefighters throughout the state. System Y, in turn, is comprised of two plans: Tier 1 is a standard defined benefit plan; and Tier 2 combines both a defined benefit plan component and money purchase plan component. In addition, some local governments maintain separate money purchase plans (“Local MP Plans”). All are designated as qualified governmental plans under the Internal Revenue Code (IRC).

In 2003, the state amended its statutes to permit governments that participate in Plan X (or have a Local MP Plan) to elect to cover their fire and police employees under either Tier 1 or Tier 2 of System Y. Provided the employer complies with the applicable requirements and 65% of the membership approves, the employer may, through a trustee-to-trustee transfer, move assets from Plan X (or the Local MP Plan) to the money purchase component of Tier 2 or purchase service credit in the defined benefit portion of Tier 1 or Tier 2. Moreover, under certain circumstances, individual members may make similar elections.

In ruling, the IRS found that such transfers would not constitute an actual distribution to the employee and, consequently, would not be subject to income tax at the time of transfer. Under Revenue Ruling 67-213, if an employee’s interest in a tax-qualified plan is transferred from that plan’s trust to the trust of another tax-qualified plan without being made available to the employee, no taxable income will be recognized at the time of the transfer. However, the amount would be taxed later when distributed as retirement income.

The IRS also found such transfers would not be subject to the IRC § 415(c) defined contribution limits or the § 415(b) defined benefit limits. Under Treasury Regulation § 1.415-3(b)(1)(iv), for the purposes of defined benefit limitations, when assets are transferred from one qualified plan to another, the annual benefit attributable to such transfers does not have to be taken into account by the receiving plan in applying the 415

defined benefit limitations. Treasury Regulation § 1.415-6(b)(2)(iv) offers similar relief for transfers to qualified defined contribution plans.

It should be noted that private letter rulings are directed only to the taxpayers requesting them and may not be used or cited as precedent. The letter ruling is posted to the IRS Written Determinations page of the IRS web site (http://www.irs.gov). The page can be found by entering "Written Determinations" in the site's search box and then clicking on the resulting IRS Written Determinations link or directly downloaded at: http://www.irs.gov/pub/irs-wd/0643005.pdf

IRS Issues Fringe Benefit Inflation Adjustments for 2007

On November 9, 2006, the Internal Revenue Service (IRS) issued Revenue Procedure 2006-53 which adjusts various income tax rates, credits, and deductions for inflation in calendar year 2007. Among other items, the document adjusts the standard deduction, earned income credit, income limits applicable to retirement savings contributions credits, Roth IRA contributions, and traditional IRA deductible contributions when a taxpayer or spouse is covered by an employer-sponsored retirement plan. With regard to Health Savings Accounts (HSAs) and Medical Savings Accounts (MSAs), Revenue Procedure 2006-53:

- **Increases the HSA monthly contribution limit on deductions.** HSAs are tax-advantaged savings plans created by the Medicare Modernization Act in which money can be deposited into a tax-deferred health savings account and then withdrawn on a pre-tax basis for qualified medical care and expenses. In 2007, the HSA monthly contribution limit on deductions will be 1/12 of the lesser of the annual deductible or $2,850 for single coverage ($5,650 for family coverage). In order to contribute to an HSA, an individual must also have coverage under an HSA-qualified "high deductible health plan" (HDHP). In 2007, the HDHP minimum annual deductible must be at least $1,100 for single coverage or $2,200 for family coverage and annual out-of-pocket expenses (i.e., deductibles, co-payments, and other amounts excluding premiums) cannot exceed $5,500 for single coverage or $11,000 for family coverage.

- **Increases the MSA annual deductible.** MSAs are tax-deferred accounts that allow individuals to save money for medical expenses. For MSAs in 2007, a high deductible health plan must have an annual deductible between $1,900 and $2,850 for single coverage or between $3,750 and $5,650 for family coverage. Annual out-of-pocket expenses (other than premiums) cannot exceed $3,750 for single coverage or $6,900 for family coverage.

Revenue Procedure 2006-53 can be found at: http://www.irs.gov/pub/irs-drop/rp-06-53.pdf

GASB Publishes Comprehensive Implementation Guide

On November 3, 2006, the Governmental Accounting Standards Board (GASB) announced publication of the 2006-2007 edition of the *Comprehensive Implementation Guide.* The guide consolidates and updates previously issued implementation guides through June 30, 2006. Additionally, it provides current guidance on standards for which no stand-alone guides have been published. The guide also includes a freestanding Implementation Guide to Statement No. 44 on the Statistical Section and the Implementation Guide to Statements Nos. 43 and 45 on Other Postemployment Benefits (OPEB).

The implementation guide (product code GSIG07) can be ordered from the GASB by calling 800-748-0659 or via its website at: http://www.gasb.org/

FASAB Releases Preliminary Views on Accounting for Federal Social Insurance Programs

On October 23, 2006, the Federal Accounting Standards Advisory Board (FASAB) released a "preliminary views" document entitled: *Accounting for Social Insurance, Revised.* In the document, the FASAB presents two differing views on how liabilities should be reported in the financial statements compiled by the U.S. Treasury Department for social insurance programs, including Social Security, Medicare, and other federal programs.

As explained in the document, the main difference between the "primary view" and the "alternate view" is the point in time that a liability is recognized for social insurance benefits and related expenses. The "primary view," supported by six of the 10 board members, would require the federal government's annual financial report to recognize social insurance expenses and liabilities when participants meet the benefit eligibility requirements (e.g., after working 40 quarters for Social Security and Medicare). This change would move the U.S. government closer to the accrual accounting approach required for private-sector companies. Under the "alternate view," supported by three board members, liabilities would be recognized when a participant has met all eligibility requirements and the benefit amount is "due and payable." This approach is consistent with current federal accounting requirements.

The FASAB's preliminary views document is intended to gauge public reaction regarding possible improvements in financial information about federal social insurance programs. It may also provide guidance for a future exposure draft followed by a new accounting standard. Comments are due by April 18, 2007, and a public meeting is scheduled for May 23, 2007.

The document is available at: http://www.fasab.gov/pdffiles/socialinsurance_pv.pdf

IPSASB Releases Proposed International Public Sector Accounting Standard

On October 26, 2006, the International Public Sector Accounting Standards Board (IPSASB) published Exposure Draft (ED) Number 31, *Employee Benefits*. The ED proposes financial accounting and reporting requirements for international public sector employers related to short-term employee benefits, post-retirement benefits, other long-term benefits, and termination benefits. IPSASB is an independent, standard-setting body within the International Federation of Accountants (IFAC), and the ED is drawn largely from International Accounting Standards Board (IASB) Standard Number 19, also titled *Employee Benefits*. While the IPSASB's standards are not currently applicable to state and local governments in the U.S., the ED illustrates the international perspective on governmental benefit accounting. For defined benefit pension and health care plans, the ED would generally require a governmental entity to:

- Account for both legal benefit obligations and "constructive obligations," i.e., benefit promises that the entity has no legal obligation to pay but also no realistic way to reduce or avoid;
- Use the Projected Unit Credit actuarial method to measure obligations and costs;
- Determine the valuation discount rate as the risk-free rate based on market yields of government bonds in a currency consistent with the benefit obligations (or high quality corporate bonds where there is no deep market for the government bonds);
- Disclose the defined benefit liability on the entity's Statement of Financial Position, minus the fair market value of assets and unrecognized past service costs;
- Treat post-employment benefits provided through composite Social Security programs in the same manner as governmental defined benefit plans, to the extent they are not defined contribution plans; and,
- Establish orderly mechanisms for implementing the proposed standard.

Currently, the IASB is collaborating with the U.S. Financial Accounting Standards Board (FASB) on a broad basis regarding many aspects of pension and other postretirement plan accounting. Public comments on the exposure draft are requested by February 28, 2007.

Exposure Draft Number 31 is available on the International Federation of Accountants' website at: http://www.ifac.org/Guidance/EXD-Details.php?EDID=0060

Sixth Circuit Court Rules EEOC May Proceed With ADEA Lawsuit

On October 31, 2006, the U.S. Sixth Circuit Court of Appeals reversed a district court's summary judgment for the Kentucky Retirement Systems (KRS) on an Equal Employment Opportunity Commission (EEOC) age discrimination claim (EEOC v. Jefferson County Sheriff's Dept., 6th Circuit (en banc), No. 03-6437). In a 10-4 "en blanc" rehearing (made before the full court of 14 appellate judges), the majority found that the EEOC had provided sufficient evidence to establish a "prima facie" (meaning "at first view" or "self-evident") violation of the Age Discrimination in Employment Act (ADEA).

The case stems from an EEOC claim filed by a deputy sheriff in Jefferson County. Upon applying for disability benefits from the Kentucky Retirement Systems, the deputy was informed he was ineligible for disability benefits because he was older than the plan's normal retirement age. Under the plan's disability provisions, employees who become disabled after normal retirement eligibility (i.e., age 55 for workers in hazardous positions and age 65 for other workers) receive normal retirement benefits based on actual years of service. However, those who are disabled before normal retirement eligibility receive additional years of service credit up to normal retirement age or (20 years of service), but not more than the number of years already worked. As a result, younger workers who are disabled before becoming eligible for normal retirement can receive higher benefits than older workers who are eligible for normal retirement, even with the same final earnings and actual years of service.

Writing for the majority, Judge Karen Nelson Moore found that the KRS Plan "is facially discriminatory on the basis of age" in two ways. First, the plan disqualifies employees from receiving disability retirement benefits if they have reached normal retirement age at the time they become disabled. Second, the plan calculates disability retirement benefits using a method that results in an older employee receiving lower monthly benefit payments than a younger employee who is similar in every applicable factor other than age. Furthermore, because the plan was found to be facially discriminatory, it was not necessary for the EEOC to show discriminatory intent in order to establish an age-discrimination claim.

Writing for the minority, Chief Judge Danny Boggs held that the disability plan was not discriminatory, since it only considered age in combination with years of service and service to retirement age. "The plan simply provides that a worker who is disabled before reaching eligibility for normal retirement benefits has a way of receiving a retirement benefit equal to (or closer to) what he would have received had he not become disable." The case was remanded to the district court for further proceedings.

The court opinion is available at: http://www.ca6.uscourts.gov/opinions.pdf/06a0405p-06.pdf

Federal Appeals Court Rules Oregon Legislature Did Not Violate Contract Rights of PERS Members

On October 24, 2006, the U.S. Ninth Circuit Court of Appeals ruled that the Oregon legislature did not impair a term of the Oregon Public Employees' Retirement System (PERS) contract and, therefore, did not violate the Contract Clause of the U.S. Constitution (*Robertson v. Kulongoski*, 9th Circuit, No. 04-35898). The plaintiffs were current and retired employees of Oregon PERS who challenged legislation that amended the retirement plan in 2003.

Prior to the 2003 legislation, PERS members contributed 6% of pay into either a regular or variable account, with minimum annual earnings credited to the account at PERS' existing assumed earnings rate. At retirement, a member's benefit was calculated under three different formulas with the highest result paid as the retirement benefit. One of the formulas was the "Money Match" formula, under which the retirement benefit was calculated as the actuarial equivalent of the member's account balance in the form of an annuity, plus an equal amount paid by the employer.

In 2003, the Oregon legislature amended the law and, after January 1, 2004, all member contributions were deposited into a new Individual Account Program (IAP). The balances in the IAP accounts were no longer annually credited with a minimum of the assumed earnings rate and, at retirement, were not subject to employer matching under the Money Match or enhanced by annual COLAs. In response, certain active and retired members of Oregon PERS sued on the grounds that the legislative change impaired rights established under contract.

The appellate court affirmed the decision of the district court, finding that the Oregon legislature did not promise a perpetual or "immutable" right for employees to contribute to the regular or variable accounts. Moreover, it held the state legislature did not promise that the money match formula would remain the primary calculator of retirement benefits. Consequently, the appellate court ruled that the legislative change did not impair the employees' PERS contract; therefore, it did not violate the Contract Clause of the U.S. Constitution.

The court opinion is available at:
www.ca9.uscourts.gov/coa/newopinions.nsf/52A81D1A1DA45AE888257210007B403A/$file/0435898.pdf

Kaiser Study Compares Medicare Part D Plans in 2006 and 2007

On November 17, 2006, the Kaiser Family Foundation released a report, *Benefit Design and Formularies of Medicare Drug Plans: A Comparison of 2006 and 2007 Offerings, A First Look.* The report provides a summary of the Medicare stand-alone drug programs being offered to 43 million Medicare beneficiaries in 2007 with a comparison of plan changes from 2006 to 2007. According to the report, the number of nationwide prescription drug plans will increase by 30% from 1,429 in 2006 to 1,875 in 2007.

The report analyzes key plan features affecting out-of-pocket costs and drug access for Medicare beneficiaries, including: premiums, deductibles, coverage gaps, prescription drug costs, and other factors. According to the report, 77% of Medicare beneficiaries are currently enrolled in plans that are expected to increase monthly premiums in 2007, and 28% are in plans where premiums will increase by at least 25%. However, if enrollees remain in the same plan, many of the monthly premium increases will be less than $5. With regard to the Part D "donut hole" gap, the majority of plans (71%) will not have gap coverage in 2007, 27% will have only generic drug gap coverage, and 1% will have gap coverage for both generic and brand-name drugs.

The report also provides an in-depth study of the 10 nationwide plans with the largest enrollment in 2006. In 2007, according to the report, seven of the 10 plans will increase monthly premiums (with four increasing by a minimum of 15%), and three will decrease premiums. Most of these plans will continue using tiered cost-sharing with seven of the plans using specialty tiers and almost 1/3 increasing coinsurance to 33%. In 2007, monthly cost sharing will range from $0 to $7 for generic drugs, $20 to $57 for preferred brand-name drugs, and $45.75 to $85 for non-preferred drugs. In these plans, the costs for 79 brand-name drugs compared in the study are expected to rise from 2006 to 2007, while costs for 73 generic drugs are expected to decline.

The report advises Medicare beneficiaries to assess their 2006 Part D plan in light of any anticipated 2007 changes before the close of the six-week open enrollment period ending December 31, 2006.

The report is available at: http://www.kff.org/medicare/7589.cfm