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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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IRS Releases Final Regulations for Deemed IRAs in Governmental Plans

On June 18, 2007, the IRS released the final regulations (TD9331) for deemed IRAs sponsored by governmental units seeking to qualify as nonbank trustees. The final regulations provide special rules for a governmental unit that maintains a deemed IRA as part of a retirement plan qualified under §§ 401(a), 403(a), 403(b) or 457 of the Internal Revenue Code (IRC). For this purpose, the regulations define a governmental unit as "a state, political subdivision of a state, and any agency or instrumentality of a state or political subdivision of a state."

On July 20, 2004, the U.S. Treasury and IRS released final regulations for deemed IRAs. Created when the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) added IRC § 408(q), deemed IRAs allow employees to make contributions to separate ("deemed") IRA accounts within a qualified employer plan. The final regulations replace earlier temporary regulations and help state and local governments establish deemed IRAs by allowing a governmental unit that sponsors a qualified retirement plan to serve as a deemed IRA trustee – provided it demonstrates that it can administer the deemed IRAs in a manner consistent with the requirements under IRC § 408.

The final regulations allow governmental units some flexibility in fulfilling the § 408 requirements. For example, under the final regulations, a governmental unit "need not demonstrate that it satisfies the net worth requirements ... if it demonstrates instead that it possesses taxing authority under applicable law." Moreover, the final regulations give the IRS Commissioner discretion to exempt governmental units from other requirements as well. The final regulations apply to written applications made on or after June 18, 2007, but may also be applied to applications submitted on or after August 1, 2003, and before June 18, 2007.

The final regulations for deemed IRAs are available at: <http://benefitslink.com/IRS/td9331.pdf>

IRS Revises Determination Letter Program for Qualifying Plan Amendments

On June 13, 2007, the IRS issued Rev. Proc. 2007-44, revising the determination letter (and advisory letter) program for qualified pension plan amendments. The new revenue procedure updates and supersedes Rev. Proc. 2005-66 in which the IRS established remedial amendment periods that correspond with the determination

letter periods for plans qualified under IRC § 401(a). Rev. Proc. 2007-44 includes a special extended deadline for governmental employers with respect to adopting certain remedial amendments.

Remedial amendment periods (RAPs) are typically provided when Congress changes retirement plan qualification provisions and when the U.S. Treasury and IRS change regulations related to qualification provisions. RAPs give plans time to retroactively amend their plans to conform to the new requirements, provided the plan is operated in conformance with the requirements. Because governmental plans are usually amended by state legislatures (or other legislative bodies) who may not meet annually, the IRS often extends the remedial amendment period for governmental plans until after the legislative body has had a chance to meet.

Issued in 2005, Rev. Proc. 2005-66 established new procedures for plan determination letters and remedial amendment periods based on a system of 5-year cycles. Under the new system, sponsors of individually designed plans (including governmental plans) who want to apply for determination letters would submit their application once every 5 years. The determination letter would rule on all plan amendments adopted and made effective during the applicable remedial amendment cycle, including all applicable federal legislative and regulatory changes made through September of the preceding year. Governmental plans (including multiple-employer governmental plans) are included in Cycle C. Consequently, the next determination letter period for governmental plans begins January 31, 2008, and ends January 31, 2009 (and every 5 years thereafter).

This created a potential problem for some governmental plans. For state retirement plans, it would require the state legislature to act during the 2008 legislative session to amend the state plan to conform to any qualification requirements enacted by Congress in late 2007. However, six state legislatures only meet on a biennial basis in odd-numbered years (and typically only for the first half of the year). Consequently, these states would not be able to act until 2009 and, therefore, would be precluded from obtaining a favorable qualification letter for changes made to qualification provisions during the last half of 2007.

The IRS recognized the potential problem and established the special deadline. For governmental plans, Section 5.06 of Rev. Proc. 2007-44 extends the adoption deadline for interim or discretionary remedial plan amendments to the **later** of (a) the deadline that would apply under the regular applicable rules, or (b) the “last day of the next regular legislative session beginning after the amendment’s effective date in which the governing body with authority to amend the plan can consider a plan amendment under the laws and procedures applicable to the governing body’s deliberations.”

Revenue Procedure 2007-44 is available at: <http://www.irs.gov/pub/irs-drop/rp-07-44.pdf>

GASB Reconciles Disclosure Requirements for Governmental Pension and OPEB Reporting

On May 31, 2007, the Governmental Accounting Standards Board (GASB) issued Statement No. 50, *Pension Disclosures*, intended to more closely align the financial reporting requirements for governmental pension plans with those for retiree health care and other postemployment benefits (OPEB). Statement No. 50 amends GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers* in order to conform their required note disclosures and required supplementary information (RSI) to those of the GASB’s OPEB standards in Statements No. 43 and No. 45. Most notably, Statement No. 50 requires:

- Disclosure of the pension plan’s current funded status in the notes to the financial statements of the pension plans and sponsoring governmental employers as of the plan’s most recent actuarial valuation date. Previously, this information was reported as required supplementary information.
- Governments that use the aggregate actuarial cost method for determining plan contributions are required to disclose the plan’s funded status in the schedule of funding progress using the entry age actuarial cost method for reporting purposes. Previously, such governments were not required to provide this information.

- Governments participating in multiple-employer cost-sharing pension plans are required to disclose the method used to determine the contractually required contributions to the plan.

Generally, the provisions of Statement No. 50 are effective for financial reporting periods beginning after June 15, 2007, with early implementation encouraged. The requirements related to plans using the aggregate actuarial cost method are effective for financial statements and required supplementary information resulting from actuarial valuations **as of** June 15, 2007, or later.

Additionally, the GASB has initiated a comprehensive research project to evaluate the effectiveness of its pension accounting and reporting standards. Based on constituent feedback received during the research, the Board will determine whether further changes to the current pension standards are necessary. Statement No. 50 (Product Code GS50) can be ordered online at www.gasb.org or through GASB's order department at 800-748-0659.

American Academy of Actuaries Publishes Report on Medicare Reform Options

In June 2007, the American Academy of Actuaries published a public policy monograph, *Medicare Reform Options*. The report was prepared by the Academy's Medicare Steering Committee and provides an overview of 16 proposed Medicare reform options to improve Medicare's financial condition. According to the Medicare Trustees' 2007 report, the financial status of the Hospital Insurance (HI) Trust Fund continues to deteriorate and is projected to be insolvent in 2019. After the HI Trust Fund is exhausted, payroll tax revenues would cover only 79% of projected HI expenses in 2019, and decline thereafter. While the Medicare Supplementary Medical Insurance (SMI) program is in better financial condition due to its reliance on general federal revenues, it too is facing financial problems. Additionally, since health care costs are projected to increase faster than gross domestic product, Medicare spending will place a greater strain on the federal budget and U.S. economy.

Without endorsing any specific policy, the report recommends that policymakers implement changes to improve Medicare's long-term financial condition and presents various potential approaches for addressing Medicare's financial problems. Generally, the reform options would include, but are not limited to:

Options to improve Medicare's trust fund solvency by:

- **Increasing the Medicare payroll tax rate** – an immediate increase in combined employee and employer Medicare payroll taxes from the current rate of 2.92% to 6.41% would eliminate the HI fund deficit over 75 years;
- **Increasing general revenue funding** – to shore up both the HI and SMI programs over the next 75 years, general federal revenues dedicated to Medicare funding would have to increase from 3.1% of GDP in 2006 to 8.1% of GDP in 2080; and,
- **Investing trust fund assets in stocks** – additional returns on Medicare trust fund assets could likely be earned if the funds were invested in stocks or other potentially higher-earning securities.

Options to reduce Medicare program spending by:

- **Managing provider payments** – hospital and physician costs could be better managed through the use of provider payments that encourage efficient services while minimizing inappropriate claims;
- **Increasing beneficiary cost sharing requirements** – progressive cost sharing could shift a greater proportion of the burden to those who can afford it, without reducing necessary care for those who cannot; and,
- **Increasing the Medicare eligibility age** – gradually increasing the eligibility age to 67 by 2022 would reduce Medicare costs by about 4%, but would also increase the number of uninsured.

The monograph concludes that a combination of reform options will be necessary to solve Medicare's funding problems. The report can be found on the American Academy of Actuaries' website at: http://www.actuary.org/pdf/medicare/options_june07.pdf

NCPERS Publishes Research Paper on Advantages of Maintaining Defined Benefit Plans

In May 2007, the National Conference on Public Employee Retirement Systems (NCPERS) published a research report titled, *The Top Ten Advantages of Maintaining Defined Benefit Pensions*. The paper was prepared with assistance from Gabriel, Roeder, Smith & Company (GRS) and addresses the question, "Should state and local government defined benefit (DB) plans be replaced with defined contribution (DC) plans?" It concludes that switching from a DB plan to a DC plan would likely result in significant, long-term, detrimental effects on state and local governments, their employees, economies, and ultimately the taxpayers.

After discussing how DB and DC plans work, the report examines the major advantages of DB plans compared with DC plans. It argues that, for a given level of retirement benefit, DB plans are likely to cost taxpayers less than DC plans, provide more stable retirement benefits, improve a government's ability to attract and retain qualified employees, and help sustain state and local economies. Its findings are concisely stated and extensively documented.

The report is at: http://64.78.62.104/Media/PageText/documents/NCPERS_ResearchSeries_TopTen.pdf

Third Circuit Court Upholds EEOC Exemption to Allow Employer Plans to Coordinate with Medicare

On June 4, 2007, a unanimous three-judge panel of the U.S. Third Circuit Court of Appeals upheld an Equal Employment Opportunity Commission (EEOC) proposed regulation to permit employers to reduce or eliminate employer-sponsored retiree health benefits without violating the Age Discrimination in Employment Act (ADEA) when participants become eligible for Medicare (*AARP v. EEOC*, No. 05-4594, 6/4/07). At issue is the proposed ADEA exemption, which the EEOC issued in 2003, in response to the Third Circuit's decision in the case of *Erie County Retirees Ass'n v. County of Erie*.

In 2000, the Third Circuit had ruled in *Erie County* that an employer violated the ADEA if it reduced or eliminated retiree health benefits upon Medicare eligibility, unless the employer could show either (1) that the benefits for Medicare-eligible retirees were equivalent to the benefits provided to younger retirees or (2) that employer spending on health care was equivalent for both groups of retirees.

In July 2003, the EEOC offered its proposed ADEA exemption for public comment, arguing it would make employers better able to offer retiree health care. Although the exemption was supported by groups representing employers and unions, AARP opposed the exemption on the grounds that it violated the ADEA. In its March 2005 decision, the U.S. District Court agreed with the AARP and found the exemption contrary to Congress's clear intent to protect retiree health care benefits under the ADEA. Consequently, the district court ruled that the EEOC did not have the authority to issue the exemption and blocked the regulation through an injunction.

The EEOC appealed. In June 2005, while the appeal was pending, the U.S. Supreme Court issued its ruling in *National Cable and Telecommunications Association v. Brand X Internet Service*, which significantly changed the legal standards for determining a federal agency's authority to issue regulations. The ruling held that a court's interpretation of a statute only bars an agency from interpreting that statute differently from the court "if the court has determined the only permissible meaning of the statute."

The district court then reexamined *AARP v. EEOC* using the *Brand X* standard and found that the Third Circuit's decision in *Erie County* did not determine the only possible interpretation of the ADEA for the situation at hand. Consequently, the district court ruled that the EEOC was not prohibited from issuing the

regulations. However, the district court also ruled that the injunction against issuing the regulations would remain in effect pending the AARP's appeal to the Third Circuit.

In the Third Circuit's June 2007 ruling, the three-judge appellate court unanimously agreed with the district court. It concluded that the proposed exemption was narrowly drawn in a manner consistent with the EEOC's authority under the ADEA and valid under the laws governing the issuance of the agency's regulations. The Third Circuit also lifted the injunction that prevented the EEOC from taking final action, giving the Commission authority to issue the regulation in final form. At this writing, the AARP has not announced whether it will seek the U.S. Supreme Court's review of the Third Circuit's decision.

It is important to note that the exemption applies only to health benefits. It does not permit other benefit distinctions based on age, which under current law, are only permissible if the age-based distinction meets the "equal benefit/equal cost" standard in the law.

The case is in the "Opinions" section of the Third Circuit's web site at: <http://www.ca3.uscourts.gov/>

Seventh Circuit Rules Mandatory Retirement at Age 63 Did Not Deprive Firefighters of Due Process

On May 14, 2007, the U.S. Seventh Circuit Court of Appeals found that City of Chicago firefighters, who were compelled to retire at age 63 under the city's mandatory retirement ordinance (MRO), lacked due process claims under the 14th Amendment to the U.S. Constitution (*Minch v. Chicago*, 7th Cir., No. 05-2702). The lawsuit was filed by two firefighters who were required to retire under the MRO, and who contended that mandatory retirement at age 63 violated the Age Discrimination in Employment Act (ADEA) as well as deprived them of their right to due process based on a collective bargaining agreement (CBA).

In 1974, when Congress extended the ADEA to state and local governments, age limits were permitted only to the extent that employers could establish that age was a *bona fide* occupational job qualification. However, after litigation in 1986 (*EEOC v. Wyoming*, 460 U.S. 226, 103 S. Ct. 1054 (1983)), Congress amended the ADEA to exempt from the statutory ban on age discrimination any state or local age limits on public safety employees in place as of March 3, 1983. The exemption expired on December 31, 1993, causing any existing age limits for such employees to violate the ADEA. Later in 1996, Congress reinstated the exemption retroactive to December 31, 1993, with no expiration date.

The City of Chicago enacted an ordinance requiring police officers and firefighters to retire at age 63 in 1938. After the ADEA was extended to state and local governments in 1974, Chicago raised the mandatory retirement age for such employees to age 70. Then, in 1988, after the 1986 exemption was adopted, Chicago reinstated a mandatory retirement age of 63. In 1993, after the expiration of the age limit to comply with the ADEA, the City again raised the age limit. Subsequently, in May 2000, the City reinstated the mandatory retirement age of 63.

In writing for the Seventh Circuit, Judge Ilana Diamond Rovner found that when the City reinstated the mandatory retirement age for its firefighters, it took action that was expressly authorized by the ADEA. The court remanded the case to the district court with instructions to dismiss the plaintiff's ADEA claim and conduct further proceedings consistent with the court's opinion. Additionally, the Court ruled that Chicago's mandatory retirement plan for firefighters did not deprive the plaintiffs of their due process rights because the CBA did not preclude the City from compelling its firefighters to retire at a particular age. Since the CBA did not give the plaintiffs a protected party interest in continued employment regardless of age, the plaintiffs could not show they were deprived of due process when the City adopted the MRO and enforced it by compelling retirement age at 63.

The case is in the "Opinions" section of the Seventh Circuit's web site at: <http://www.ca7.uscourts.gov/>