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Monthly Newsletter – Volume 3, No. 1 – January 5, 2007

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Highlights of the Month

- 1. Internal Revenue Service Sets Its Semi-Annual Regulatory Agenda**
- 2. Employee Benefits Security Administration Sets Its Semi-Annual Regulatory Agenda**
- 3. EBSA Issues Field Assistance Bulletin with Guidance on Periodic Benefit Statement Issuance to Plan Participants**
- 4. New Tax Law Expands Provisions for Health Savings Accounts and Extends the Mental Health Parity Act**
- 5. Final Regulations Issued on Health Plan Nondiscrimination and Wellness Programs**

Internal Revenue Service Sets Its Semi-Annual Regulatory Agenda

The Internal Revenue Service (IRS) has issued its semi-annual regulatory agenda, which lists regulatory priorities for the next twelve months, including projects involving pension and benefit plans. The IRS identified pension regulations that were in the "proposed rule" stage including:

- ❖ defining "highly compensated employee";
- ❖ updating and clarifying general rules for deductibility of employer contributions to qualified retirement plans and other deferred compensation arrangements;
- ❖ regulations governing the performance of actuarial service under ERISA. (These regulations will cover the qualifications required for enrollment, continuing education requirements for enrolled actuaries, professional standards for the performance of actuarial services under ERISA, the grounds for disciplinary action against an enrolled actuary, and the procedures to be followed in taking disciplinary actions.);
- ❖ providing additional guidance on satisfying Code § 401(a)(4) nondiscrimination requirements with respect to benefits or contributions;
- ❖ regulations covering cafeteria plans;
- ❖ amendments to the fringe benefit regulations [Reg. § 1.61-21(k)(6)(B) will be amended by removing a reference to Code § 414(q)(1)(C) that no longer exists, and replacing it with a reference to Reg. § 1.61-21(f)(5)(i)];



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- ❖ providing additional guidance on the measurement of income inclusion and calculation of applicable taxes under Code § 409A, relating to deferred compensation;
- ❖ providing guidance with respect to determining the annual benefit under a defined benefit plan for the purpose of applying the limitations of Code § 415 where there has been more than one annuity starting date.

The IRS also reported that it has several pension and benefit regulations in the "final rule" stage that are expected to be the subject of final regulations in the next twelve months, including:

- ❖ regulations that will revise and update Reg. § 1.403(b)-1 to reflect the many statutory revisions to Code § 403(b) since the existing regulations were first promulgated in 1964;
- ❖ regulations that will be amended under Code § 415, relating to limitations on benefits and contributions under qualified plans. [Code § 415 provides a series of limits on benefits under defined benefit plans, and contributions and other additions under defined contribution plans. Comprehensive regulations regarding Code § 415 were last issued in 1980.]

Employee Benefits Security Administration Sets Its Semi-Annual Regulatory Agenda

The Department of Labor's (DOL) Employee Benefits Security Administration (EBSA) has issued its semi-annual regulatory agenda, which lists regulatory priorities for the next twelve months.

EBSA is conducting reviews of the:

- ❖ guidelines applicable to determining when a qualified public accountant is independent for purposes of auditing and rendering an opinion on the financial information required to be included in the annual report of an employee benefit plan for purposes of ERISA § 103(a)(3)(A); and
- ❖ regulations governing plan assets/participant contributions (Labor Reg. 2510.3-102). This review will cover the continued need for the rules, the nature of complaints or comments received from the public concerning the rules, the rules' complexity, the extent to which the rules overlap, duplicate, or conflict with other federal or state and local rules, and the degree to which technology, economic conditions, or other factors have changed in industries affected by the rule.



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In addition, three regulations are in the proposed rule stage (the EBSA intends to publish a notice of proposed rulemaking):

- ❖ an amendment of Labor Reg. 2510.3-102, which defines when participant monies paid to or withheld by an employer for contribution to an employee benefit plan constitute “plan assets” for purposes of Title I of ERISA, and the related prohibited transaction provisions of the Code. The regulation would establish a safe harbor period of a specified number of business days during which certain monies that a participant pays to, or has withheld by, an employer for contribution to a plan, would not constitute "plan assets";
- ❖ an amendment to the regulations governing ERISA § 404(c) plans (Labor Reg. 2550.404c-1) to ensure that the participants and beneficiaries in § 404(c) plans are provided the information they need to make informed investment decisions, including information about fees and expenses;
- ❖ an amendment of the regulation setting forth the standards applicable to the exemption under ERISA § 408(b)(2) for contracting or making reasonable arrangements with a party in interest for office space for services (Labor Reg. 2550.408b-2). This proposed regulation would be designed to ensure that plan fiduciaries are provided with, or have access to, the information required to determine whether an arrangement for services is "reasonable" within the meaning of the statutory exemption, as well as the prudence requirements of ERISA § 404(a)(1)(B).

Lastly, there are regulations in the "final rule" stage which are anticipated to be the subject of final regulations in the next twelve months:

- ❖ The DOL, IRS, and the Department of Health and Human Services are proceeding concurrently (due to shared interpretive jurisdiction) to provide final regulatory guidance to implement The Health Insurance Portability and Accountability Act of 1996 (HIPAA), with respect to its amendment of Title I of ERISA, the Code, and the Public Health Service Act (PHSA);
- ❖ The DOL and the Department of Health and Human Services are proceeding concurrently (due to shared interpretive jurisdiction) to provide final regulatory guidance with regard to the provisions of The Newborns' and Mothers' Health Protection Act of 1996 (NMHPA) which amended ERISA and the PHSA;
- ❖ An amendment of Labor Reg. 2520.104a-2, setting forth the annual reporting requirements for employee benefit plans to require that such reports be filed electronically;
- ❖ Establishing a safe harbor under which a fiduciary of a participant-directed individual account pension plan will be deemed to have satisfied his fiduciary responsibilities with respect to investment and asset allocation decisions made on



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behalf of individual participants and beneficiaries who fail to give investment direction.

EBSA Issues Field Assistance Bulletin with Guidance on Periodic Benefit Statement Issuance to Plan Participants

In the absence of regulatory guidance on the obligation of pension plans to provide periodic benefit statements in accordance with the Pension Protection Act of 2006 (PPA), the EBSA has issued *Field Assistance Bulletin No. 2006-03 (FAB 2006-03)* outlining what will be considered good faith compliance with the PPA provisions.

PPA § 508(a) amended ERISA § 105 by, among other things, requiring pension plans to furnish pension benefit statements automatically. In the case of individual account plans that permit plan participants to direct their investments, these statements must be furnished at least once each quarter. For all other individual account plans, the statements must be furnished at least once a year, and for defined benefit plans, the statements must be distributed at least once every three years. The PPA changes generally apply to plan years beginning after December 31, 2006. EBSA will treat a plan administrator as satisfying the requirements of ERISA § 105 if the administrator has "acted in good faith with a reasonable interpretation of those requirements." EBSA has provided guidance on the requirement to provide benefit statements to plan participants:

1. Pending further guidance, multiple documents may be used to comply with the requirement to provide a benefit statement. However, if multiple documents are to be used to satisfy the benefit statement requirements, plan participants and beneficiaries must be provided, in advance, with a notification that makes it clear how and when they will receive the required information.
2. Until regulations are developed, plans may provide electronic delivery by using the safe harbor described in Labor Reg. 2520.104b-1(c) or by furnishing statements in accordance with the IRS provisions for electronic delivery of plan documents. EBSA will view the availability of benefit statement information through continuous website access as good faith compliance, provided that plan participants and beneficiaries are given, in advance, a written notification that explains the availability of the required information, how it can be accessed, and how they can request a free paper version of it.
3. Pending the issuance of further guidance, a benefit statement provided no later than 45 days following the appropriate period (quarter or year) will constitute good faith compliance. Thus, the earliest date on which a non-collectively bargained pension plan is required to provide an automatic benefit statement that complies with the PPA would be, for a calendar year plan, 45 days after March 31, 2007 (the end of the first quarter). For plans without quarterly reporting



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- obligations, the earliest date for providing a statement would be, for a calendar year plan, 45 days after December 31, 2007.
4. An individual account plan that does not otherwise have to provide quarterly statements will not need to do so merely because the plan permits participants to take plan loans.
 5. For an individual account plan, ERISA § 105(a)(2)(B)(ii)(I) requires a benefit statement to include an explanation of any limitations or restrictions on a participant's or beneficiary's right under the plan to direct an investment. Pending further guidance, a benefit statement need only explain limitations and restrictions under the plan, and does not need to address limitations and restrictions imposed by investment funds, other investment vehicles, or state and federal securities laws.
 6. For an individual account plan, ERISA § 105(a)(2)(B)(ii)(II) requires a benefit statement to include an explanation of the importance of diversifying investments and the risk of holding too much of one security (such as employer securities). Pending the development of a model statement for this explanation, EBSA says that using the following language in a benefit statement will be considered good faith compliance:

"To help achieve long-term retirement security, you should give careful consideration to the benefits of a well-balanced and diversified investment portfolio. Spreading your assets among different types of investments can help you achieve a favorable rate of return, while minimizing your overall risk of losing money. This is because market or other economic conditions that cause one category of assets, or one particular security, to perform very well often cause another asset category, or another particular security, to perform poorly. If you invest more than 20% of your retirement savings in any one company or industry, your savings may not be properly diversified. Although diversification is not a guarantee against loss, it is an effective strategy to help you manage investment risk. In deciding how to invest your retirement savings, you should take into account all of your assets, including any retirement savings outside of the plan. No single approach is right for everyone because, among other factors, individuals have different financial goals, different time horizons for meeting their goals, and different tolerances for risk. It is also important to periodically review your investment portfolio, your investment objectives, and the investment options under the plan to help ensure that your retirement savings will meet your retirement goals."

7. PPA provides new diversification rights to plan participants, effective January 1, 2007, and plans must provide an ERISA § 101(m) notice of these rights, as



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- described in IRS Notice 2006-107. EBSA has stated that participants and beneficiaries in plans conferring new rights as of January 1, 2007, should be furnished the requisite information as soon as possible after January 1, 2007. For plans that prior to January 1, 2007 have already provided diversification rights at least equal to those enacted by PPA, the EBSA has stated its recognition that issuing both the ERISA § 101(m) notice and the quarterly pension benefit statement may confuse participants and beneficiaries and be an unnecessary administrative cost. Therefore, for a plan with pre-2007 diversification rights at least at the PPA-required level, EBSA will treat a plan administrator's compliance with the benefit statement requirements as satisfying the ERISA § 101(m) notice requirement.
8. Under ERISA § 105(a)(2)(B)(ii)(III), an individual account plan that permits participants to direct their investments must include, in its benefit statements, a notice directing participants to the DOL website for sources of information on individual investing and diversification. To fulfill this requirement, plan administrators should direct participants to www.dol.gov/ebsa/investing.html.

New Tax Law Expands Provisions for Health Savings Accounts and Extends the Mental Health Parity Act

Tax bill H.R. 6111 was signed into law on December 20, 2006 and gives Health Savings Accounts (HSAs) expanded flexibility by removing some of the barriers that kept some employers from establishing and employees from participating in an HSA.

Participants in High Deductible Health Plans (HDHPs) are permitted to establish HSAs, which allow pre-tax contributions and tax-free earnings accumulation. Distributions from HSAs are tax-free if used for payment of qualified medical expenses. Prior to the enactment of H.R. 6111, contributions to HSAs were limited to the lesser of the deductible under the HDHP or a statutory amount (\$2,850 for single coverage and \$5,650 for family coverage in 2007) and these limits were reduced by 1/12th for every month an individual was not an eligible individual as of the first day of the month). In addition, restrictions were imposed on employees with Health Reimbursement Accounts (HRAs) or Flexible Spending Accounts (FSAs) who wanted to switch to an HDHP with an HSA. H.R. 6111 increases the contribution limit to the applicable inflation-adjusted statutory limit, without regard to the individual's HDHP deductible. (Therefore, in 2007, an eligible individual with self-only coverage under an HDHP with a \$2,000 deductible will be able to contribute \$2,850 to his HSA.) The bill also creates a special rule for calculating the annual HSA contribution limit. Specifically, anyone who is an eligible individual during the final month of a year can contribute the maximum annual amount to his HSA for that year even if he was not an eligible individual for the entire year. To take advantage of this special rule, the individual must maintain eligible individual status for



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all of the next taxable year. Otherwise, he will have to include the value of the HSA contributions that could not have been made but for this special rule in income, and pay a ten percent penalty tax on such contributions.

Employees generally may not fund HSAs while covered by HRAs or health FSAs because these arrangements are not high-deductible health plans (HDHPs). To remedy this problem, the bill creates a five-year window during which employers can permit their health FSAs or HRAs to make "qualified HSA distributions." A qualified HSA distribution is a one-time distribution from a health FSA or HRA that the employer contributes directly to the employee's HSA. The maximum amount of the distribution is the balance of the health FSA or HRA on September 21, 2006, or the date of distribution, whichever is less. Also, the employer must transfer the distribution to the employee's HSA before January 1, 2012. A qualified HSA distribution is not taxable to the employee. However, this favorable tax treatment is conditioned on the employee maintaining HDHP coverage, and otherwise satisfying the requirements to be an "eligible individual", for the twelve-month period beginning with the date of the distribution. Otherwise, the amount of the qualified HSA distribution will be included in the employee's gross income and subject to a ten percent penalty tax. There is an exception for employees who cease to be eligible individuals because they become disabled or die.

H.R. 6111 also extends the Mental Health Parity Act (MHPA) provisions of ERISA, the Code, and the PHSA to December 31, 2007, and extends the cut-off date for the Archer MSA pilot project to December 31, 2007. (The MHPA prohibits a group health plan from applying a lower annual or aggregate lifetime dollar limit to mental health benefits than the plan applies to medical/surgical benefits. Archer MSAs are tax-advantaged medical savings accounts that can be established by certain self-employed individuals and employees of small employers who have qualifying high-deductible health coverage.)

Final Regulations Issued on Health Plan Nondiscrimination and Wellness Programs

Final rules (*71 Fed. Reg. 75014*) have been issued jointly by the Departments of Treasury, Labor, and Health and Human Services that finalize and clarify the interim final regulations issued in 2001 regarding nondiscrimination based on health status and finalize the proposed rule on "wellness programs". These final regulations apply for plan years beginning on or after July 1, 2007.

HIPAA prohibits group health plans and insurers from discriminating against any individual based on any health factor, e.g., health status, medical claims history, genetic information, or disability. The prohibited types of discrimination include waiting



periods, denial of coverage, limits on coverage that are specific to a health factor, etc. The new regulations include the following clarifications:

- ❖ Source of Injury Exclusions – a plan may not restrict eligibility based on participation in a particular activity; however, a plan may restrict benefits for injuries based on the source of the injury, but must provide that the exclusion does not apply to injuries due to a medical condition or domestic violence, even if the condition is diagnosed after the injury.
- ❖ Nonconfinement Clauses – The final rules prohibit "nonconfinement clauses" that restrict coverage, eligibility, or benefits based upon hospital confinement. For example, when a hospitalized individual switches coverage during their hospital stay, the succeeding plan or carrier may not deny eligibility to that individual until the individual is released. (Some state insurance laws require the prior carrier in the above situation to continue coverage throughout the hospital stay.) Under the HIPAA rules, the successor carrier also is required to cover the individual. The final rules clarify that state law cannot change the legal obligation of the succeeding carrier under HIPAA, but any state law designed to prevent more than 100% reimbursement, such as state coordination of benefits laws, continue to apply.
- ❖ Carryforward of Unused Employer-provided Medical Care Reimbursement Amounts – an additional example related to HRAs is provided in the final regulations in which an employer contributes an equal amount to all employees' HRAs and allows employees to carryover HRA contributions. Thus, employees with less claims experience could carry over greater contributions to later years. The final rules clarify that the carryforward of unused employer-provided medical care reimbursement amounts to later years would not violate the nondiscrimination rules.
- ❖ Wellness Programs – To be permissible under HIPAA, any wellness program must limit any rewards/penalties under the wellness program, along with other wellness programs offered by the plan, to 20% of the cost of employee coverage; be reasonably designed to promote health or prevent disease; offer participants the opportunity to qualify for the reward at least once per year; provide a reasonable alternative to individuals who medically cannot meet the required standard; and disclose the availability of the alternative standard.