

Federal Legislative & Regulatory

Report

August 2006



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A quick-read version of this month's report. The full version begins on page 3.

EDITOR'S NOTE: This report was modified on September 18, 2006 to add clarifications to the Pension Protection Act table found on page 4.

I. Congress Passes Pension Reform with EGTRRA Permanency & More

The full article can be found on [page 3](#).

The Pension Protection Act of 2006 represents a sea change for the private sector defined benefit system but, for defined contribution plan sponsors and IRA accountholders, the Act also provides major improvement.

Most notably, the Act **makes permanent the retirement plan and IRA provisions in EGTRRA**, but there are other provisions that may affect plan sponsors and participants.

Beginning on page 4, we [provide a table](#) with the Description and Effective Dates of Key Provisions of the Act.

II. IRS issues Final Regulations for Employer HSA Contributions

The full article can be found on [page 12](#).

Employers trying to control health care costs are offering employees high deductible health plans (HDHPs) as an alternative to traditional health plan coverage. Often, HDHPs are paired with health savings accounts (HSA) into which employees and employers may deposit contributions to pay future medical costs not covered under the HDHP.

The IRS has issued final regulations for employer HSA contributions. The final regulations provide a number of clarifications including the sub categories of family HDHP coverage and the treatment of collectively bargained employees for comparability purposes.

Beginning on page 12, we [provide a table](#) with the major provisions of the final regulations for employer HSA contributions.

III. NAGDCA Promotes National Save for Retirement Week

The full article can be found on [page 20](#).

Senators Gordon Smith (R-OR) and Kent Conrad (D-ND) have introduced [Senate Resolution 550](#) which would declare the last week of October as National Save for Retirement Week. The resolution is backed by the National Association of Government Defined Contribution Administrators. NAGDCA says it expects the resolution will be placed on the Unanimous Consent Calendar following the Labor Day recess.

About this report

JOANN ALBRECHT, CPC, QPA, Plan Technical Consultant, our resident expert on legislative and regulatory issues, prepares this report. As a leading member of the Nationwide Legislative Task Force, She identifies how federal actions may affect your defined contribution plan and its participants.

Albrecht is a member of American Society of Pension Professionals and Actuaries (ASPPA), currently serving on its Government Affairs Committee and is chair of its Tax Exempt and Government Plans Subcommittee. She also is a member of the National Association of Governmental Defined Contribution Administrators.

BOB BEASLEY, CRC, CIC, Communications Consultant, edits it. Beasley brings 17 years of financial services communications to your plan. He helped prepare the *457 Guidebook* and *Fiduciary Fundamentals*, edited countless newsletters and plan sponsor communications, and in 2001 authored "What you should know about the Economic Growth and Tax Relief Reconciliation Act of 2001."

Beasley serves on the Education and Communication Committee for the Profit Sharing/401(k) Council of America.

MARY WILLETT, President of Willett Consulting, lends plan sponsor perspective to this report. Willett served 14 years as Director of the Wisconsin Deferred Compensation Plan and was 2001/2002 President of the National Association of Government Defined Contribution Administrators (NAGDCA). She serves on the Board of Standards for the International Foundation for Retirement Education (InFRE).

This information is of a general and informational nature and is NOT INTENDED TO CONSTITUTE LEGAL OR INVESTMENT ADVICE. Rather, it is provided as a means to inform you of current information about legislative, regulatory changes and other information of interest. Plan Sponsors are urged to consult their own counsel regarding this information. NRM-2920AO.16



I. Congress Passes Pension Reform with EGTRRA Permanency & More

Long-awaited pension reform came to fruition earlier this month as the [Pension Protection Act of 2006](#). President Bush signed it into law on August 17.

Key points for defined benefit plans

The Act makes sweeping changes to the private sector defined benefit system by:

- Imposing tougher funding requirements for well-funded and under-funded plans
- Limiting future benefit increases for poorly funded plans
- Providing benefit accrual safeguards for older participants in cash balance conversions
- Legitimizing cash balance and hybrid defined benefit as viable plan designs going forward.

Because this report is intended to cover issues affecting governmental defined contribution plans, plan sponsors and plan participants, we have greatly limited discussion of the Act's impact on defined benefit plans. Nationwide encourages defined benefit plan sponsors to further investigate how their plans may be affected by the Pension Protection Act of 2006.

Key benefits for defined contribution plans and IRAs

Perhaps most importantly, the Act makes permanent the retirement-plan and IRA provisions of the [Economic Growth and Tax Relief Reconciliation Act of 2001](#) (EGTRRA), most of which were due to sunset after 2010.

Other provisions, including those that authorize automatic enrollment and investment advice, are intended to modernize and enhance the appeal of these plans.

How the provisions take effect

Many of the provisions are effective upon enactment of the bill or in 2007; however certain provisions such as the permissive service credit purchases have retroactive effective dates.

Plans must operationally comply with each provision's effective date:

- All private sector plan sponsors will need to amend their plans for this new Act by the last day of the first plan year beginning on or after January 1, 2009.
- Governmental plans will have to be amended by the last day of the first plan year beginning on or after January 1, 2011.

The massive scope of the Act will require a number of technical corrections and new regulations.

What is not included

- A provision to permit governmental employers to adopt new 401(k) plans
- A provision to permit pre-tax payments for investment advice services

- Modification of the health flexible spending accounts (FSA) “use it or lose it” rule which, under the original House bill, would have permitted \$500 of unused balances to be carried over into another year or transferred to a Health Savings Account.

Table: Description and Effective Dates of Key Provisions of the Act

The following table outlines the key defined contribution, IRA and other provisions that will impact or influence public sector employee and IRA accountholder.

We’ve included provisions of the Act affecting ERISA-covered plans (private sector) as they may influence changes to public sector retirement benefits.

Provision & Section of Pension Protection Act	Description and Effective Dates
EGTRRA Permanency Section 811	<p>The retirement plan and IRA provisions made permanent include:</p> <ul style="list-style-type: none"> Increased contribution limits and indexing of all limits for both retirement plans and IRAs Non-coordination of deferral limits between governmental 457 plans and other non-457 deferral plans Repeal of the constructive receipt rule for eligible governmental 457 plans Catch-up contributions for defined contribution participants and IRA holders age 50 and older Rollovers among qualified, 403(b) and governmental 457 plans and IRAs Non-taxable transfers from 403(b) and 457 plans to governmental defined benefit plans to purchase permissive service credits.. <p>Effective date: Upon enactment.</p>
Saver’s Credit made permanent Section 812	<p>The Saver’s Credit, due to expire at the end of year, gives lower income individuals who make contributions to the employer sponsored deferral plans or IRAs a non-refundable tax credit.</p> <p>The Act makes this credit permanent and indexes the income limits eligible for the credit in \$500 increments (Section 833).</p> <p>Effective Date: Upon enactment.</p>
Improvements in the Portability, Distribution and Contribution Rules	
Purchase of permissive service credit in governmental defined benefit plans Section 821	<p>Employees may purchase additional service credit under a governmental defined benefit plan for periods of time when no service was performed (air-time) or to increase a current benefit.</p> <p>Participants may purchase defined benefit plan service credit through non taxable direct transfers from their 457 or 403(b) plans to governmental defined benefit plans, including plans of different employers. Service credit purchased with 403(b) and 457 non taxable transfers are not subject to the limits that apply to service credit purchases made with after tax contributions.</p> <p>Amounts transferred from 457 or 403(b) plans to a governmental defined benefit plan will be subject to the same distribution rules that apply to the defined benefit plan.</p>

Provision & Section of Pension Protection Act	Description and Effective Dates
	<p>Effective Date: Retroactive to EGTRRA effective date.</p> <p><i>New Rule</i></p> <p>Service credit for employees of primary and secondary educational organizations can now be determined under the law or jurisdiction in which service was performed.</p> <p>Example: Permissive service credit granted for time spent teaching outside the USA will not be considered non-qualified service.</p> <p>Effective Date: Retroactively effective to TRA 1997.</p>
<p>After-tax rollovers between 403(b) and qualified plans</p> <p>Section 822</p>	<p>After-tax contributions and earnings will be eligible for direct rollover to qualified plans (defined benefit or defined contribution) or to other 403(b) plans if the new plan agrees to accept the contributions and separately account these rollovers.</p> <p>Note: It is not clear if this provision will facilitate direct rollovers between Roth 401(k) accounts and Roth 403(b) accounts. Direct rollovers between Roth 401(k) and Roth 403(b) accounts are not currently permitted under the proposed Roth 401(k) distribution regulations.</p> <p>Effective Date: Taxable years beginning in 2007.</p>
<p>Application of the minimum distribution rules to government plans</p> <p>Section 823</p>	<p>The Act directs Secretary of the Treasury to issue regulations that will treat a government plan as complying with the minimum distribution rules – as long as the plan has complied with a reasonable good faith interpretation of the statutory requirements that apply to these distributions.</p> <p>Effective Date: Upon enactment.</p>
<p>Direct rollovers from retirement plans to Roth IRAs</p> <p>Section 824</p>	<p>Distributions from qualified, 403(b) and eligible governmental 457 plans can be directly rolled over into a Roth IRA, subject to the \$100,000 income limit that applies to rollovers (conversions) from traditional IRAs to Roth IRAs. Taxes will be due for the year the rollover is made.</p> <p>Comment: A technical correction may be needed to clarify if the \$100,000 income limit would apply to distributions from employer-based retirement plans to Roth IRAs in 2010.</p> <p>At that time, traditional IRAs may be converted to Roth IRAs regardless of adjusted gross income. The taxes due could be paid over a two-year period.</p> <p>Effective Date: For distributions made on or after January 1, 2008.</p>
<p>Modification of hardship and unforeseeable emergency rules</p> <p>Section 826</p>	<p>Prior to the Act's passage, hardship and unforeseeable emergency distributions could be permitted for hardship situations of the participant's spouse or dependent.</p> <p>Now, a plan may permit hardship or unforeseeable emergency distributions because of a hardship of the participant's beneficiary under the plan even if that beneficiary is not a spouse or dependent. This modification applies to qualified 401(k), 403(b) and 457 plans as well as non-qualified deferred compensation plans subject to IRC 409A.</p> <p>The Act does not address hardship distributions from profit-sharing plans.</p> <p>Effective Date: Upon date of enactment.</p>
<p>Treatment of distributions to</p>	<p>The 10% early distribution tax for withdrawals from qualified plans, 403(b), IRAs or other arrangements before age 59½ will not apply to qualified</p>

Provision & Section of Pension Protection Act	Description and Effective Dates
<p>qualified reservists on active duty for 179 days or longer</p> <p>Section 827</p>	<p>reservists on active duty for at least 179 days.</p> <p>This exception applies to withdrawals made from the period between when active duty begins and ends. The restrictions that apply to 401(k) and 403(b) plans will not be violated for making qualified reservist distributions.</p> <p>The distribution may be repaid to an IRA at any time within a two-year period after active duty ends. Repayments will not be included in IRA contribution limits; no deduction for these contributions will be permitted.</p> <p>Qualified reservists entitled to a tax refund or credit because of the prior payment of the early distribution tax will have one year from enactment of the Pension Protection Act to claim a tax refund or credit.</p> <p>Effective Date: Applies to distributions made after September 11, 2001 and before December 31, 2007.</p>
<p>Inapplicability of 10% penalty tax on early distributions from pension plans of public safety employees</p> <p>Section 828</p>	<p>The 10% penalty tax will not apply to early distributions made from governmental defined benefit plans to qualified public safety employees who separate from service after age 50 (instead of age 55).</p> <p>A qualified public safety employee is defined as an employee of a state or political subdivision of a state that provides police protection, firefighting protection or emergency medical services within the jurisdiction of the state or political subdivision.</p> <p>Note: This exception will be helpful to public safety employees who receive lump-sum distributions from DROP, cash-balance or hybrid defined benefit plans.</p> <p>Effective Date: After enactment.</p>
<p>Rollovers for non-spousal beneficiaries</p> <p>Section 829</p>	<p>Non-spousal beneficiaries entitled to payment from a qualified, 403(b) or eligible governmental 457 plan may have these amounts transferred directly to an IRA. The IRA will then be treated as an inherited IRA and subject to the IRA distribution rules that apply to beneficiaries.</p> <p>Amounts payable to a non-spousal beneficiary under a trust maintained for a designated plan beneficiary may also be transferred to an IRA.</p> <p>Effective Date: Applies to distributions beginning on or after Jan. 1, 2007.</p>
<p>Deposit of tax refunds into IRAs</p> <p>Section 830</p>	<p>Taxpayers will be able to have their federal tax refund directly deposited to an IRA. This provision does not modify the rules that apply to timing and deductibility of IRA contributions.</p> <p>Effective Date: Available for taxable years beginning on or after Jan. 1, 2007.</p>
<p>Inflation indexing of IRA income limits</p> <p>Section 833</p>	<p>Income limits for IRA contributions will be indexed in \$1,000 increments to reflect inflation. The income limits for deductible IRA contributions for active participants in an employer-sponsored plan will also be indexed.</p> <p>Effective Date: Taxable years beginning on or after January 1, 2007.</p>
<p>Tax-free distributions for public safety officers for payment of health and long term care insurance premiums.</p>	<p>Retired public safety officers may exclude up to \$3,000 a year from gross income for distributions from their qualified, 403(b) or 457 plans to pay for health insurance and qualified long-term care premiums for themselves, their spouse or dependents. The retirement plan must send payments directly to the insurer. Amounts used to pay premiums cannot be refunded from the contracts.</p> <p>An eligible retired public safety officer is a law enforcement officer, firefighter, chaplain or a member of a rescue squad or ambulance crew who</p>

Provision & Section of Pension Protection Act	Description and Effective Dates
Section 845	<p>worked for the public employer sponsoring the plan and who separated from service because of disability or attainment of the plan's Normal Retirement Age.</p> <p>Effective Date: Taxable years beginning on or after January 1, 2007.</p>
Miscellaneous Provisions	
QDRO determinations Section 1001	<p>A QDRO is a domestic relations order that meets certain procedural requirements and creates or recognizes the right of an alternate payee, including a former spouse, to any plan benefit payable to a participant.</p> <p>The DOL must issue regulations clarifying that a domestic relations order can be a QDRO regardless of the time it is issued or if it modifies a prior order or QDRO.</p> <p>Effective Date: Upon enactment.</p>
Indian Tribal government pension plans treated as government plans Section 906	<p>A plan maintained by an Indian tribal government, its subdivisions, agencies or instrumentalities will be treated as a government plan provided participants are performing essential governmental functions and not commercial activities even if these activities are essential governmental functions.</p> <p>The Act clarifies that Indian Tribal Governments are subject to the same pension plan rules and regulations that apply to State and other local governments and their police and firefighters. Employer pick-up (414)(h) contributions are available to the tribal government plans that are treated as government plans.</p> <p>Note: The eligibility of Indian Tribal governments to adopt governmental 457(b) plans remains unclear.</p> <p>Effective Date: Plan years beginning on or after date of enactment.</p>
Timing rules for rollover distribution notices Section 1102	<p>Plans must provide participants a 402(f) distribution notice no less than 30 days and no more than 180 days before the date their distributions from the plan are to begin.</p> <p>The 402(f) notice is required to explain:</p> <ul style="list-style-type: none"> • Optional distribution forms available under the plan, • A participant's right to roll the distribution another plan or IRA, and • Taxation rules that apply to the distribution. <p>Note: The previous requirement was to provide this notice no less than 30 and no more than 90 days before the distributions were scheduled to begin.</p> <p>Effective Date: On or after January 1, 2007.</p>
Special rule for calculating high three-year average compensation for defined benefit plan purposes Section 832	<p>Annual benefits payable to a defined benefit participant generally cannot exceed the lesser of 100% of average compensation for the employee's high three years or \$175,000 (for 2006).</p> <p>The current § 415 regulations require that the three consecutive year period to be based on the time the employee was both an active participant in the plan and had the greatest aggregate compensation.</p> <p>Under the Pension Protection Act, the high three years are the consecutive calendar years (not more than three) during which the employee had the greatest aggregate compensation.</p>

Provision & Section of Pension Protection Act	Description and Effective Dates
	Effective date: Plan years beginning on or after January 1, 2006.
Rollovers & unemployment benefits Section 1105	Pension distributions that are rolled over to other plans or IRAs will not reduce an individual's unemployment compensation. Effective Date: Upon enactment.
Phased retirement Section 905	Defined benefit and money purchase plans may permit in-service distributions to a participant who has reached age 62, even if Normal Retirement Age is later than age 62. Effective Date: Applies to distributions made in plan years beginning in 2007 or later.
ERISA provisions that could influence public sector plan sponsors	
Automatic enrollment Section 902	<p>Automatic enrollment is viewed as an effective way to increase plan participation. Several states have laws that impede automatic enrollment plans. The Pension Protection Act (PPA 2006) incorporates prior IRS automatic enrollment guidance which permits employers to change automatic deferrals from year to year and requires employers to give participants annual notice to their right to opt out of the plan or to change their deferrals.</p> <p>PPA 2006 expressly states ERISA will preempt state law for all ERISA plans that provide for automatic enrollment. ERISA automatic enrollment plans will need to provide participants with an annual statement that explains:</p> <ul style="list-style-type: none"> • The participant's right to opt out of the plan • The participant's right to change the rate of contribution • The default investments the plan will use if the participant does not provide investment direction. PPA 2006 directs the Department of Labor (DOL) to issue guidance for appropriate default investments when participants do not provide investment direction. • Although the plan may specify automatic contributions between 3% and 10%, the ERISA nondiscrimination safe harbor automatic deferral rate is 3% for the first year, 4% for the following year, 5% for the third year and 6% in subsequent years. <p>Current employees will be exempt from automatic enrollment, on the date it becomes effective under the plan, if they are already deferring to the plan or have previously elected not to participate.</p> <p>Other provisions — Automatically enrolled participants have 90 days to opt out of the plan and withdraw their contributions and earnings. Corrective distributions and any related earnings will be taxed in the year they are paid. They will not be subject to the 10% early distribution tax that generally applies to withdrawals before age 59½ if amounts are distributed within 2½ months after the year automatic contributions were made to the plan. These rules will also apply to participants automatically enrolled in 403(b) and 457 plans.</p> <p>Effective Date: These rules will apply for plan years beginning on or after January 1, 2008.</p>
Mapping Investment Options	Generally, under ERISA, plan fiduciaries are not responsible for investment results when participants direct their own investments. This is because these participants are considered to be exercising control over their accounts.

Provision & Section of Pension Protection Act	Description and Effective Dates
Section 621	<p>Plan blackout periods – when participants cannot direct their accounts – occur for several reasons. Most commonly, these periods occur when the plan changes or removes investment options available to participants. Participant assets are then reallocated (or “mapped”) to other investment options in the plan. Because participants cannot direct their accounts during blackout periods, responsibility for the investment direction shifts back to plan fiduciaries.</p> <p>The Pension Protection Act provides that ERISA plan fiduciaries will not be responsible for participant investment losses during plan blackout periods. During the mapping period, plan participants – not plan fiduciaries – will be treated as directing their accounts if:</p> <ul style="list-style-type: none"> • Participant accounts are mapped to new investment options from options that were offered immediately prior to the blackout period • The risk and rate of return characteristics of the new investment options are reasonably similar to options that were offered immediately prior to the blackout period • Plan fiduciaries provide participants with timely notice of the blackout period, information about the new investment options and information about participants’ right to direct their investment before and after the blackout period. <p>The Act directs the DOL to provide guidance describing how plan fiduciaries can meet their fiduciary responsibilities during any blackout period.</p> <p>Effective Date: Plan years beginning after December 31, 2007, with a delay for collectively bargained plans.</p>
Investment advice Section 601	<p>An ERISA prohibited transaction exemption will apply to “fiduciary advisers” offering plan investment advice to participants directing their own accounts. Although this exemption does not apply to advisers providing advice to governmental plan participants, it offers a procedural model that plan sponsors may want to consider incorporating into their advice program.</p> <p>Under ERISA, “fiduciary advisers” who provide participant investment advice are plan fiduciaries include:</p> <ul style="list-style-type: none"> • Registered investment companies • Banks and insurance companies • Registered broker dealers <p>These groups and their affiliates would be eligible for the prohibited-transaction exemption if:</p> <ul style="list-style-type: none"> • Their fees (including commissions) do not vary because of a participant’s investment choices or • Their investment recommendations are based on a computer model that considers a number of specific individual participant factors and is based on all plan investment options. <ol style="list-style-type: none"> 1. The computer model must be certified by an independent third party. 2. Periodic informational reports are provided to the employer. 3. An independent annual audit of the advice arrangement is

Provision & Section of Pension Protection Act	Description and Effective Dates
	<p>performed.</p> <p>The Secretary of Labor will do a feasibility study to determine if a suitable computer model is available for IRA advice services.</p> <p>Effective Date: Advice services provided on or after January 1, 2007.</p>
<p>Plan fiduciaries and the "safest available annuity standard"</p> <p>Section 625</p>	<p>Employers are being encouraged to add annuity distribution options to their defined contribution plans. These options would provide participants and beneficiaries with a stream of lifetime payments.</p> <p>Currently, ERISA fiduciaries that select commercial annuity distribution options must choose annuities that meet the DOL "safest annuity available standard" which is based on the provider's creditworthiness and claims-paying ability.</p> <p>The drafters of the Pension Protection Act recognized that this standard may not always be in the best interest of participants and their beneficiaries. The Act directs the Secretary of Labor to issue final regulations clarifying that the selection of annuity contracts under a defined contribution plan is not subject to the ERISA "safest available annuity standard."</p> <p>Instead, ERISA plan fiduciaries are required to act according to ERISA's prudence standards in selecting the most suitable option and contract for the plan and its participants and beneficiaries. Fiduciaries will no longer be required to select the "safest available annuity" unless they determine it is in the best interest of plan participants and beneficiaries.</p> <p>Comment: Although this requirement does not apply to governmental plans, governmental plan fiduciaries may want to review the DOL's future guidance in developing their own standards for selecting defined contribution plan annuity options and providers.</p> <p>Effective Date: Upon enactment.</p>

The information in the table above as well as throughout this document is believed to be accurate as of the date of its publication and is subject to change thereafter. It is of a general and informational nature and is NOT INTENDED TO CONSTITUTE LEGAL OR INVESTMENT ADVICE. Rather, it is provided as a means to inform you of current information about legislative, regulatory changes and other information of interest. Plan Sponsors are urged to consult their own counsel regarding this information.

Where to find more information

The entire Act – all 907 pages of it! – is available at:

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

The Joint Committee on Taxation Report Technical Explanation of the Act is available at:

<http://www.house.gov/jct/x-38-06.pdf>.

Further background materials about the Act are available on: [the Joint Tax Committee Web site](#), [the House Ways and Means Committee Web site](#), [the House Education and the Workforce Committee Web site](#), and [the Senate Finance Committee Web site](#).

Synopses

The organizations listed below are independent of Nationwide® and its affiliates. Obviously, Nationwide cannot be responsible for the accuracy of their information.

National Association of Governmental Defined Contribution Administrators:

<http://www.nagdca.org/legislation/HR%204%20Compromise%20Chart.pdf>.

Profit Sharing/401(k) Council of America chart of key features affecting DC plans:
<http://psca.org/WASH/PDF/HR4/HR4-chart.pdf>.

American Society of Pension Professionals and Actuaries document of key provisions:
<http://www.asppa.org/government/comment08-02-06.htm>.

Deloitte publication – Securing Retirement, an overview of the Pension Protection Act:
http://deloitte.12hna.com/newsletters/pubs/us_gre_securingretirement_030806.pdf

EBRI Fast Facts – How many Americans could be affected by the Act:
<http://ebri.org/pdf/publications/facts/fastfacts/fastfact080106.pdf>.

II. IRS issues Final Regulations for Employer HSA Contributions

The Internal Revenue Service recently issued [final regulations](#) that apply to employer contributions made to Health Savings Account (HSA) on or after January 1, 2007.

Background

In an effort to control their escalating health-care costs, more and more employers are offering employees high deductible health plans (HDHP). Often, HDHPs are paired with HSAs into which employees may deposit contributions from current income to pay for future medical costs not covered under the HDHP.

Only individuals with eligible HDHP coverage and who meet certain requirements can establish HSAs. These accounts may be funded through individual contributions, employer contributions or a combination of employer and employee contributions.

To encourage employees to select HDHP coverage, employers may make contributions to employee HSAs — but those who do must make comparable contributions for all eligible participating employees or face significant excise taxes.

Employer HSA contributions are tested for comparability on a calendar, not a plan year basis. Employers that fail the comparability test for their HSA contributions will be subject to a 35% excise tax on the aggregate amount contributed to all employee HSAs for a calendar year.

Key points in the final regulations

The final regulations include new guidance that:

- Divides HDHP family coverage into several sub-categories
- Clarifies the treatment of collectively bargained employees for purposes of the employer comparable contribution rules
- Provides additional guidance on the cafeteria plan exception to the comparability rules
- Provides ways employers can locate former employees entitled to HSA contributions.
- Defines a reasonable interest to be used for employer HSA make-up contributions

Table begins on next page

The table summarizes the major provisions of the final regulations.

Unless noted otherwise, all employees used in the examples are non-union employees.

For a more in-depth discussion of HSAs, please review the index in the December 2004 and December 2005 editions of this report, found under the Legislative / Regulatory tab on the Employer side of our Web site, nrsforu.com.

Table: Major provisions of the Final Regulations for Employer HSA Contributions

Topic / Reference Section	Employer Contribution Comparability Requirements	Comments and Examples
<p>Definitions</p> <p>54.4980G-1 Q and A -1,2 and 3</p> <p>54.4980G-4 Q and A 1</p>	<p>Eligible participating employees — employees who during the calendar year:</p> <ol style="list-style-type: none"> 1. Are enrolled in an HDHP as of the first day of the month, are not enrolled in Medicare, and do not have any other type of broad based medical coverage except for dental or vision coverage; 2. Are <i>current full-time employees</i> who customarily work more than 30 hours a week, <i>current part-time employees</i> who customarily work less than 30 hours a week or <i>former employees</i> (who are not covered under a COBRA continuation provision); and 3. Have the same type of HDHP coverage (self-only or family coverage). <p>Employer comparable contributions</p> <p>Comparable employer HSA contributions are made either in the same amount or the same percentage of the HDHP deductible for all eligible employees in the same HDHP coverage category as of the first day of each month during the calendar year.</p>	<p>The employer contribution comparability rules apply separately to each category of employee HDHP coverage. Employees with self only coverage are tested separately from employees with family coverage.</p> <p>Example: An employer that contributes to HSAs of employees with family coverage and not to the HSAs of employees with self-coverage will not violate the comparable contribution rules. However, if the employer contributes to one employee in a category of employees, the employer must contribute to HSAs of all eligible employees in that category.</p> <p>Caution: Comparable contributions rules are not satisfied if an employer makes contributions in amounts or percentages equal to the employee's HSA contributions. Since all comparable participating employees do not contribute the same amount to their HSAs, they would not receive comparable employer contributions.</p>
<p>Categories of eligible HDHP coverage</p> <p>54.4980G-1 Q and A 2</p>	<p>The two categories of eligible HDHP coverage are:</p> <ol style="list-style-type: none"> 1. Self-only 2. Family, which may be subdivided into: <ul style="list-style-type: none"> - Self plus one - Self plus two - Self plus three or more. <p>An HDHP with the following coverage options would also meet the HDHP coverage requirements.</p> <p><i>Self only</i></p> <p><i>Self plus spouse or dependent</i> — same category of coverage as self plus one</p> <p><i>Self plus spouse and one dependent or</i></p>	<p>Employer contributions to HSAs of employees in the self plus two category cannot be less than the contributions to the self plus one category. Likewise employer contributions to employee HSAs in the self plus three category cannot be less than its contributions to the self plus two category.</p> <p>Example: C and D Corp maintains an HDHP and makes the following HSA contributions for eligible employees covered under its HDHP.</p> <ul style="list-style-type: none"> - \$500 for each eligible employee with self-only coverage, - \$750 for each eligible employee with self plus one coverage, - \$900 for each eligible employee with self plus two HDHP coverage, and

Topic / Reference Section	Employer Contribution Comparability Requirements	Comments and Examples
	<p><i>self plus two dependents</i> — same category as self plus two</p> <p><i>Self plus spouse and two more dependents</i> — same category of coverage as self plus three or more.</p>	<p>- \$1,000 each eligible employee with self plus three or more coverage.</p> <p>These contributions satisfy the employer comparability rules.</p>
<p>HSA contributions not subject to the comparability contribution rules</p> <p>54.4980G-3 Q and A 1,2,3</p>	<p>Contributions not subject to the comparability rules are</p> <ul style="list-style-type: none"> • Rollover contributions from other HSAs or Archer MSAs • Employee after tax contributions • Contributions for non employees including independent contractors, sole proprietors or partners in a partnership • Employer contributions made to HSAs through a cafeteria plan • Employer HSA contributions made pursuant to a bona fide collective bargaining agreement. (See next row) 	<p>Example 1: If an employee asks his/her employer to deduct after tax amounts from the employee's pay send them to the employee's HSA provider, these amounts will not be subject to the comparability rules because they are not considered employer contributions.</p> <p>Example 2: Barry is a sole proprietor who is eligible to contribute to his HSA and contributes \$1,000 to his own HSA for the calendar year. He also contributes \$500 for the same calendar year to each of his eligible employee's HSA.</p> <p>Since Barry is not considered an employee for comparability purposes, the comparability rules are satisfied.</p>
<p>Employer HSA contributions for collectively bargained (union) employees</p> <p>54.4980G-3 Q and A 6</p>	<p>Union employees who are covered by a bona fide collective bargaining agreement (CBA) are not comparable participating employees if health benefits were the subject of good faith bargaining.</p> <p>Former employees covered under a CBA are also not considered comparable participating employees for contribution purposes.</p>	<p><i>All union employees in the following example are covered under collective bargaining agreements where health benefits were negotiated in good faith between employer(s) and employee representatives.</i></p> <p>Example: The HDHP of Acme Products covers both union and non-union employees and offers all employees an HDHP with self-only coverage.</p> <p>For 2007, Acme will contribute \$500 to the HSA of each eligible non-union employee covered under the HDHP, but not make any contributions for its union employees.</p> <p>Acme's HSA contributions for its non-union employees will satisfy the HSA comparability rules because they do not apply to union employees.</p> <p>The comparability rules would also not apply if an employer:</p> <ul style="list-style-type: none"> • Made HSA contributions for union employees but not for its non-union employers or • Made different HSA contributions for multiple bargaining units

Topic / Reference Section	Employer Contribution Comparability Requirements	Comments and Examples
		covered under separate CBAs that require different contributions for each bargaining unit.
Contributions made through a cafeteria plan (Section 125) 54.4980G-5 Q and A 1, 2 and 3	Employee pre-tax salary reduction amounts that an employer contributes to employee HSAs are not subject to the comparability rules if the written cafeteria plan gives employees the right to choose cash or other taxable benefits instead of having these amounts contributed to the employee's HSA. The cafeteria plan rules — not the comparability rules — will apply even if an employee does not actually elect to contribute any amount to an HSA by salary reduction.	Employer HSA matching contributions made through a cafeteria plan are subject to the cafeteria plan non-discrimination rules – not the comparability rules.
Employer HSA contributions for different classes of non-union employees 54.4930G-3 Q and A 5 and 9 and 10	If two classes of employees (such as management and non-management) are comparable participating employees and the employer does not make the same contribution for all them, <i>the comparability rules will not be satisfied</i> . This is because these categories are not permissive for comparability purposes. Other non-permissive classes of employees for comparability purposes include: <ul style="list-style-type: none"> • Employees who have reached a specific age and/or service requirement • Employees who participate in health assessment, disease management or wellness programs • Employees who receive additional HSA contributions because they are eligible for HSA catch-up contributions. 	The only categories of comparable participating employees for testing purposes are: <ul style="list-style-type: none"> • Current full-time employees • Current part-time employees • Former employees (except those covered under a COBRA continuation provision).
Contributions for employees with non-employer provided HDHP coverage 54.4980G-3 Q and A 7	An employer that contributes only to the HSAs of eligible employees with coverage under the employer's HDHP is not required to make comparable contributions to the HSAs of eligible employees who are not covered under the employer's HDHP.	Example: In a calendar year, ABC Parts Company offers an HDHP to its full-time employees. Most full-time employees are covered under ABC's HDHP. ABC makes comparable contributions only to these employees' HSAs. Willard is a full-time eligible employee of ABC and is not covered under ABC's HDHP but is covered under his

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		<p>spouse's HDHP through her employer. ABC isn't required to make comparable HSA contributions for Willard.</p> <p>Caution: If an employer contributes to the HSA of any eligible employee with any HDHP coverage, including coverage outside the employer's HDHP, the employer will have to make HSA contributions to all eligible employees including those not covered under the employer's HDHP.</p>
<p>Contributions for an employee and spouse employed by the same employer and covered under the employer's HDHP</p> <p>54. 4980 G-3 Q and A 8</p>	<p>In general, employers are only required to contribute to the HSA of the employee-spouse who elected family coverage under the employer's HDHP.</p> <p>The employer is not required to contribute to the HSA of the employee-spouse who is covered under the HDHP because his/her spouse HSA elected family coverage.</p>	<p>Example: In 2007, ABC Corp will offer full-time employees an HDHP. Helen is a full-time eligible employee of ABC and has family coverage for herself and her spouse Frank who is also an eligible full-time employee with ABC.</p> <p>ABC will be required to make comparable contributions to Helen's HSA but is not required to make comparable contributions to Frank's HSA.</p> <p>Caution: If the employer contributes to the HSA of an eligible employee who is covered under any HDHP, the employer must make contributions to the HSAs of both employee-spouses if they are both eligible individuals.</p>
<p>Contributions for employees who have HSAs and/or Archer Medical Savings Accounts</p> <p>54.4980G-3 Q and A 13</p>	<p>The comparability rules apply separately to employees who have HSAs and employees who have Archer MSAs.</p>	<p>If an employee has both an MSA and HSA, the employer may contribute to either the HSA or MSA but not to both.</p> <p>Example: Pegasus Machine contributes \$600 to each MSA of eligible employees and \$500 to each HSA of eligible employees.</p> <p>Xavier has an MSA and an HSA. Pegasus contributes \$600 to his MSA for the calendar year but does not contribute to his HSA. Pegasus' MSA contributions satisfy the comparability rules.</p>
<p>Employer contributions for employees working full-time during the entire calendar year and other employees who work full-time for less than the entire calendar year.</p>	<p>Generally an employer must consider all eligible full- and part-time employees for any month during the calendar year.</p> <p>Full-time and part-time employees are tested separately.</p>	<p>Example: If an employer contributes \$240 to the HSA of each full-time employee who works the entire calendar year, the employer must contribute \$60 to the HSA of a full-time employee who works 3 months of the calendar year.</p>

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54.4980G-4 Q and A 2 and 3		
Contributions for former employees and missing former employees 54.4930G-3 Q & A 10	Employers that make contributions to the HSA of any eligible former employee with the same category of HDHP coverage must make comparable contributions to all former employees with the same category of HDHP coverage. Employers making comparable contributions to the HSAs of former employees must take reasonable steps to locate any missing comparable participating former employee including using certified mail, and/or the IRS/ Social Security letter forwarding services.	The employer is not required to make comparable contributions to the HSAs of former employees who have elected COBRA continuation coverage.
Timing and method for making employer HSA contributions 54.4980G-4 Q and A 3,4,5	An employer may comply with the comparability rules by making contributions for the calendar year to employee HSAs in one of the following ways: <ul style="list-style-type: none"> • Pay-as-you-go basis • Look-back basis • Pre-funded basis 	The same timing and funding method must be used for all eligible employees. Contributions made at the employer's usual payroll interval for different groups of employees are considered made "at the same time." Example: If salaried employees are paid monthly and hourly employees are paid bi-weekly, an employer may contribute to the HSAs of hourly employees on a bi-weekly basis and to the HSAs of salaried employees on a monthly basis and still comply with the comparability rules.
Employer pay-as-you-go contributions 54.4980G-4 Q and A 3	<i>Pay-as-you-go basis</i> – Employer makes contributions one or more times for the calendar year determined by employee eligibility for each month of the year.	Contributions are still made at the same time for all eligible employees within the same category, in the same amount or the same percentage of the HDHP deductible.
Employer look-back contributions 54.4980G-4 Q & A 3	<i>Look-back basis</i> – Employer makes contributions at the end of the calendar year by taking into account all employees who were eligible for any month during the calendar year.	Example: An employer contributes \$600 (\$50/month) a calendar year on a look-back basis to the HSAs of all eligible employees with self-only coverage under the employer's HDHP, and \$1,200 (\$100 per month) for each calendar year to the HSA of each eligible employee with family HDHP coverage.
Employer pre-funded contributions and new hires	<i>Pre-funded basis</i> — An employer may make all of its HSA contributions for employees who are eligible at the beginning of the calendar year instead	Example: On January 1, Murphy Corp contributes \$1,200 for the calendar year on a pre-funded basis to the HSA

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54.4980G-4 Q & A 4	<p>of contributing on a pay-as-you-go or look-back basis.</p> <p>An employer that pre-funds contributions will not violate the comparability rules if an employee terminates employment prior to the end of the calendar and the HSA received more contributions on a monthly basis than employees who have worked the entire year.</p>	<p>of each eligible employee.</p> <p>In mid-May, the Murphy Corp. hires Bernice who becomes eligible for employer HSA contributions on June 1. The employer is required to make comparable contributions to Bernice's HSA beginning in June and will satisfy the comparability rules if the employer makes contributions to her HSA in any one of the following ways:</p> <ul style="list-style-type: none"> A) Pre-fund her HSA by contributing \$700 B) <i>Pay-as-you-go</i> basis — The employer contributes \$100 a month to her HSA C) <i>Look-back</i> basis — The employer would contribute to her HSA at the end of the calendar year for each month she was eligible for employer HSA contributions. <p>Note: The employer must still follow the same contribution method for all new hires that are hired after the initial funding period.</p>
<p>Failure of employee to establish HSA and employer contributions</p> <p>54.4980G-4 Q and A 6</p>	<p>Employers are not required to make HSA contributions for employees who have not established an HSA by the time the employer funds the accounts unless the employee sets up the HSA by December 31 of the calendar year.</p> <p>If the employee's HSA is established after December 31, the employer is not required to make contributions for the prior calendar year.</p>	<p>Example: Acme will contribute \$500 per calendar year on a pay-as-you-go basis to each eligible employee's HSA beginning on January 2007.</p> <p>Charles will be an eligible employee during the entire calendar year but will not establish his HSA until March of the same year. Acme must make up the missed employer contributions for January and February by April 15 of the following calendar year (2008).</p>
<p>Application of excise tax if employer contributions fail to satisfy the comparability rules for a calendar year and requirements for waiver of the tax</p> <p>54.4980G-1 Q and A 4 54.4980G-5 Q and A 4</p>	<p>If employer contributions do not satisfy the comparability rules, the employer will be subject to an excise tax equal to 35% of the amount the employer contributed to all comparable participating employees' HSAs.</p> <p>Waiver of excise tax</p> <p>The excise tax may be waived if comparability failure is due to reasonable cause and not willful neglect.</p> <p>Tax that is excessive relative to the failure involved may also be waived.</p>	<p>Example: In 2007, the DEF Corp will have 8 employees with HDHP self-only coverage with a \$2,000 deductible.</p> <p>For 2007, DEF contributes \$2,000 each to the HSAs of two employees and \$1,000 to the HSAs of the remaining six employees for total HSA contributions of \$10,000.</p> <p><i>DEF's contributions do not satisfy the comparability rules.</i> DEF is subject to an excise tax of \$3,500 (35% X \$10,000) for failure to meet the comparability rules.</p>

Topic / Reference Section	Employer Contribution Comparability Requirements	Comments and Examples
Recovery of employer contributions from employees HSAs and correction of non-comparable contributions 54.4980G-1 Q and A 4 54.4930G-4 Q and A 12	Employers cannot recoup any contributions that they have made to employee HSAs even if they would fail the comparability test.	To correct non-comparable contributions for the calendar year, employers may make additional contributions plus reasonable interest until April 15 of the following calendar year.
Reasonable interest rate for corrective contributions 54.4980 G-4 Q & 13	A reasonable rate of interest for making corrective contributions is based on all facts and circumstances.	Employers that use prescribed federal short-term interest rates are deemed to be using a reasonable interest rate.

These regulations are available at:

http://www.treasury.gov/press/releases/reports/hsa_comparable_contributions_4830.pdf.

III. NAGDCA Promotes National Save for Retirement Week

Senators Gordon Smith (R-OR) and Kent Conrad (D-ND) introduced on August 3, 2006 [Senate Resolution 550](#) which, if passed, would declare the last week of October as National Save for Retirement Week. The resolution is backed by the National Association of Government Defined Contribution Administrators (NAGDCA).

The resolution has been referred to the Senate Judiciary Committee for review. NAGDCA says it expects the resolution to be placed on the Unanimous Consent (UC) Calendar following the Labor Day recess.

NAGDCA has dedicated a section of its Web site to National Save for Retirement Week, <http://www.nagdca.org/retirementweek/>, and plans to make resources specifically designed for plan sponsors and participants available soon.

IV. Keeping watch

You can find the most recent information on issues affecting governmental defined contribution plans, plan sponsors and plan participants on the Employer page of your plan Web site. In addition, we report guidance on legislative and regulatory activity relevant to government sector defined contribution plans through these publications:

- *Plan Sponsor Voice* quarterly newsletter — our most recent edition was published last month, and is available online on the Hot Topics / News page of [our Web site](#).
- *Federal Legislative and Regulatory Report* — distributed monthly, posted on the Legislative / Regulatory tab on the Employer section of [our Web site](#). On that same page, you'll find our Index of Legislative and Regulatory Articles by Topic. It's available online and for download — your choice.
- *Plan Sponsor Alerts* — published as needed to announce breaking news, and distributed by e-mail and posted in the Plan Sponsor Corner of the home page of [our Web site](#).

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