# Federal Legislative & Regulatory Report

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**January 2010**

## Inside this issue



## I. Washington Update

As legislators return to Washington in 2010, they will again be focusing on health care reform. Both the House and Senate passed a health care bill before the end of the year. The differences between these two legislative proposals must be resolved and a final bill approved before it can be sent to President Obama. Although its passage continues to be a top priority for the Democratic Congress and the Obama Administration, other legislative priorities will also be receiving attention in the coming months.

### *Fee Disclosure and Investment Advice*

Several bills addressing the issue of fee disclosure and investment advice in defined contribution plans were introduced during 2009. However, none were brought to the floor for a vote in either the House or Senate. One bill receiving considerable attention in the House last year was the 401(k) Fair Disclosure and Pension Security Act of 2009 (H.R. 2989). The House Ways and Means Committee received another extension to January 19, 2010 to debate this bill, which was approved by the House Education and Labor Committee last year. Going forward in 2010, there are indications that many legislators may be taking a more deliberate approach to this legislative package to wait to determine if the rules and regulations expected from the Department of Labor will sufficiently address concerns about the issues of fee disclosure and investment advice.

### *Consumer Protection and Financial Markets Reform*

In December 2009, the House passed legislation entitled the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173). This bill is intended to prevent another financial crisis like the one experienced in 2008/2009 and creates a new consumer financial protection agency that

would be devoted to protecting Americans from unfair and abusive financial products and services. It also includes regulatory reforms to increase consumer protection, address the issue of firms deemed "too big to fail," impose limits on executive compensation, assign new liability standards on credit rating agencies, regulate derivatives and more. It is expected that the Senate will begin debate of their version of this legislative package in January or February.

## *Regulatory Update*

The following provides an overview of guidance issued by the Internal Revenue Service (IRS) at the end of 2009 and early 2010 that may be of interest to plan sponsors.

- **IRS Notice 2009-97**: This notice extends the deadline for amending qualified retirement plans to meet certain requirements of the Internal Revenue Code that were added by the Pension Protection Act of 2006 and subsequently modified by the Worker, Retiree, and Employer Recovery Act of 2008. This notice extends the deadline for certain provisions (but not most) that affect both defined benefit and defined contribution plans. This notice can be found here: www.irs.gov/pub/irs-drop/n-09-97.pdf (6 pages, 23 KB).
- **IRS Announcement 2009-89**: This announcement informs 403(b) plan sponsors that, within the next few months, the IRS will publish a revenue procedure for obtaining an opinion letter that the form of a prototype or other "pre-approved Plan" meets the requirements of Section 403(b) of the Internal Revenue Code and regulations. It also intends to publish a revenue procedure for obtaining an individual determination letter for a Section 403(b) plan.

  The Announcement provides a remedial amendment period and reliance for employers that either adopt a pre-approved plan with a favorable opinion letter or apply for an individual determination letter when available. In other words, for plans adopted on or before the December 31, 2009 deadline, if the employer sponsoring the plan either adopts a pre-approved plan that has received a favorable opinion letter from the IRS or applies for an individual determination letter when available, the employer will have a remedial amendment period in which to amend the plan to correct any form defects retroactive to January 1, 2010. The Announcement can be found here: www.irs.gov/pub/irs-drop/a-09-89.pdf (2 pages, 9 KB).

  For more information about Announcement 2009-89, go to Section III, page 4 of this report.
- **Revenue Procedure 2010-6**: This procedure updates the process for requesting determination letters on the qualified status of pension, profit-sharing, stock bonus, annuity, and employee stock ownership plans. It covers plans under tax codes 401(a), 403(a), 409, and 4975 and replaces Revenue Procedure 2009-6 issued in January 2009. The new procedures are effective February 1, 2010. Revenue Procedure 2010-6 can be found here: http://www.irs.gov/irb/2010-01_IRB/ar11.html.
- **Revenue Procedure 2010-8**: This procedure provides guidance for complying with the user fee program of the Internal Revenue Service as it pertains to requests for letter rulings, determination letters, etc. The procedure can be found here: www.irs.gov/irb/2010-01_IRB/ar13.html#d0e15073.

(back to the Table of Contents)

## II. Mandatory Withholding May Apply to 2009 RMDs Paid in 2010

In the Winter 2010 issue of *Employee Plans News,* the IRS discusses when the 20% mandatory withholding tax would apply to certain required minimum distributions (RMDs) paid between January 1, 2010 and April 1, 2010. If these distributions are eligible rollover distributions (ERDs) but are not directly rolled over to an eligible retirement plan, they are subject to mandatory 20% withholding.

The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) waived 2009 RMDs from defined contribution plans, including 401(k), profit-sharing, 403(b), and 457(b) governmental plans, as well as from IRAs. Nonetheless, some plans continue to pay them. If a 2009 RMD is distributed between January 1, 2010 and April 1, 2010 (for example, to a participant who turned 70½ in 2009, but delayed taking his or her 2009 RMD until April 1, 2010), the mandatory 20% federal income tax withholding applies to that distribution unless it is not an ERD for some other reason.

Normally, RMDs are not eligible to be rolled over, because they are not ERDs. WRERA amended the IRC to provide that 2009 RMDs would be treated as ERDs (and therefore permitted to be rolled over) if the only reason they previously weren't considered an ERD was because they were a RMD. Therefore, any 2009 RMDs paid from a defined contribution plan on or before December 31, 2009, were subject to the optional withholding rules. Under the optional withholding rules the mandatory 20% federal income tax withholding that otherwise applies to ERDs did not apply. However, 2009 RMDs paid from a defined contribution plan between January 1, 2010 and April 1, 2010 must have 20% federal income tax withheld from them if they otherwise qualify as ERDs.

### *Reference Material*

Employee Plans News, Winter 2010 – www.irs.gov/pub/irs-tege/win10.pdf (13 pages, 532 KB)

(back to the Table of Contents)

## III. 403(b) Remedial Amendment Period Announced

Last month, the IRS announced (Announcement 2009-89) it will publish a revenue ruling plan sponsors and employers can use to obtain an IRS opinion letter for a 403(b) prototype plan or other type of pre-approved plan.

Employers sponsoring 403(b) plans were required to adopt a written plan intended to meet the requirements of 403(b) and its regulations by December 31, 2009. An employer that timely adopted a written plan and then subsequently adopts a pre-approved plan that has received a favorable opinion letter or applies for an individual determination letter after that program becomes available will have a remedial amendment period to amend the plan and correct any form (document) defects retroactive to January 1, 2010. The employer will have reliance beginning on January 1, 2010 that the form of its written plan satisfies the requirements of 403(b) and its regulations if:

- The pre-approved plan is adopted retroactive to January 1, 2010, **or**
- The plan is amended to correct any form defects retroactive to January 1, 2010.

An employer that first establishes a 403(b) plan after December 31, 2009 by adopting a written plan intended to satisfy 403(b) and the regulations also will have reliance, beginning on the effective date of the plan, provided the employer either adopts a pre-approved plan or applies for an individual determination letter and corrects any plan form defects retroactive to the plan's effective date.

**Favorable Opinion Letters**

Favorable Opinion Letters issued by the IRS for Master and Prototype (M & P) give plan sponsors and employers assurance that the form of the plan satisfies the requirements of 401(a) or 403(b).

A prototype plan generally consists of a basic plan document and one or more adoption agreements. The IRS issues a separate opinion letter for each adoption agreement the M & P sponsor offers to employers for adoption. Retirement plans are not required to have IRS determination letters, opinion letters or advisory opinion letters.

The future revenue procedure will include the remedial amendment period, the time-frames for adopting a pre-approved plan or determination letter and other details regarding the remedial amendment period.

**Note:** Employers may continue to rely on the model plan language provided in Rev. Proc 2007-71 for public schools and other employers to comply with the requirements of 403(b).

### *Reference Material*

IRS Announcement 2009-89 – http://benefitslink.com/IRS/ann2009-89.pdf (1 page, 12 KB)

(back to the Table of Contents)

## IV. IRS Publishes Information Concerning Employment Taxes

This section is divided into two parts:

1. New Process Extends Retroactively Social Security Coverage to Government Employees (immediately below)
2. Updated Federal-State Reference Guide Available Online (Page 6)

### *New Process Extends Retroactively Social Security Coverage to Government Employees*

The Internal Revenue Service has developed a new process designed to facilitate retroactive payments of Social Security taxes and prevent erroneous refunds. The statute of limitations for assessment of Social Security and Medicare taxes is three years from the date 941 returns are deemed to have been filed. When returns are timely filed, the statute of limitations runs from April 15th of the year following the calendar year for which the employment tax returns are due and filed.

**Example:** In tax year 2006, a 4th quarter Form 941 return that is timely filed by the due date of January 31, 2007, has a statute of limitations that runs until April 15, 2010.

In cases where the section 218 modification agreement covers only years for which the statute of limitations on assessment remains open, a government entity should use Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, to amend the quarterly employment tax returns and pay the back employment taxes. If the modification covers years where the IRS statute is barred or closed, the government entity will have to initiate a closing agreement with IRS for those barred statute years and agree to pay the full amount of tax due at the time the closing agreement is executed.

**Employment Taxes**

The IRS is responsible for collecting FICA (Social Security and Medicare taxes) on employee wages. To help governmental employers with their employment tax obligations, the IRS has published information in the January 2010 issue of the *FSLG Newsletter* for governmental employers addressing:

- Retroactive Social Security coverage for government employees and
- Social Security and Medicare coverage of governmental employees.

This article summarizes that information.

The IRS Office of Federal, State and Local Governments will coordinate the closing agreement process for these types of payments, and may be contacted in writing at:

IRS
SE:T:GE:FSL
Att: FSLG Closing Agreement Coordinator
1111 Constitution Ave.
Washington, D.C. 20224

#### Background

State and local government employees were excluded from Social Security coverage before 1950 because of unresolved legal questions of the federal government's authority to tax state and local governments. Beginning in 1951, Section 218 of the Social Security Act permitted states to enter into voluntary agreements with the federal government to provide social security coverage to public employees.

All 50 states, Puerto Rico, the Virgin Islands, and approximately 60 interstate instrumentalities have entered into voluntary Section 218 Agreements with Social Security Administration (SSA). The District of Columbia, Guam, American Samoa and the Commonwealth of the Northern Mariana Islands have not entered into a Section 218 Agreement. Because Section 218 Agreements are voluntary, the extent of social security coverage varies from state to state. At the state level, most public employees participate in Social Security with the exception of state employees in Alaska, Colorado, Louisiana, Maine, Massachusetts, Nevada and Ohio.

State and local governments that have established Section 218 agreements with the SSA can modify these agreements to establish coverage retroactively for five calendar years. In most cases, a governmental entity will be required to pay Social Security and/or Medicare taxes associated the retroactive coverage.

## *Updated Federal-State Reference Guide Available Online*

The *Federal-State Reference Guide* (IRS Publication 963) provides state and local government employers a comprehensive reference source for guidance on social security and Medicare coverage and Federal Insurance Contributions Act (FICA) tax withholding issues. The Guide has been updated annually as a web based document since 2005. Topics addressed in this publication include:

- Determination of worker status
- Public retirement systems
- Social Security and Medicare coverage
- Section 218 Agreements
- Employment tax law and other tax issues.

The Guide also includes information to assist Indian tribal government employers. Although Tribal governments are required to follow substantially the same procedures as other employers, some special provisions that apply to tribal governments are addressed in later chapters of the Guide.

## *Reference Material*

FSLG Newsletter, January 2010 – www.irs.gov/pub/irs-tege/p4090_0110.pdf (11 pages, 60 KB)

Federal-State Reference Guide – www.irs.gov/pub/irs-pdf/p963.pdf (175 pages, 1.4 MB)

(back to the Table of Contents)

## V. Managing Retiree Health Care Risks

The two articles that follow discuss how public- and private-sector employers are managing risks associated with their retiree health care plans.

1. Some Governments Act to Mitigate Costs of Retiree Health Benefits (immediately below)
2. Private Sector Employer Seeks Approval for Guaranteeing Retiree Health Care Benefits (Page 8)

### *Some Governments Act to Mitigate Costs of Retiree Health Benefits*

Retiree health benefits are typically the largest of the other postemployment benefits (OPEB) provided to retired government employees. They pose a significant threat to the fiscal health of many government entities because many governments historically have paid for and accounted for these benefits as they come due during retirement not as they accrue during active employment.

In 2004, the Governmental Accounting Standards Board (GASB), which maintains standards for accounting and financial reporting for state and local governments, issued Statement 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions." GASB 45 requires state and local governments to measure, recognize and report future OPEB obligations based on the current benefit structure. GASB 45 does not require that OPEB benefits be pre-funded as they accrue. State laws may also require local governments to follow GASB standards and bond rating agencies may consider whether GASB standards are followed when addressing a government's fiscal health.

A recent study published by the Government Accountability Office (GAO), entitled "State and Local Government Retiree Health Benefits: Liabilities Are Largely Unfunded, but Some Governments Are Taking Action" (GAO-10-61), indicates that liabilities for retiree health care benefits are, for the most part, unfunded. However, the GAO did find that some state and local governments are reducing health care liabilities by:

- Setting aside assets to pre-fund retiree health benefit liabilities for health benefits before employees retire, and
- Changing the structure of retiree health benefits.

For its report, the GAO reviewed 89 State and Local governments and found that 35% of them had set aside some assets for OPEB liabilities ($25 billion). This amount, however, represents less than 5% of liabilities, meaning that many state and local governments are paying OPEB costs out of current revenues.

Under GASB accounting standards, only assets held in a trust or its equivalent count toward reducing a government's unfunded OPEB liabilities. The GAO found that of the 10 governments selected for closer review, the majority were pre-funding a portion of their retiree health liabilities with the several kinds of irrevocable trusts:

- **Health Benefit Subaccount** [IRC 401(h)] – a separate account in a defined benefit trust that permits up to 25% of total employer contributions to the pension fund to be allocated to retiree health benefits. Earnings on the assets in the 401(h) account accumulate tax-free and retiree health benefit payments from the subaccount are not taxable to retirees

- **Section 115 Governmental Trust** – a trust established by a governmental employer to fund an essential government function which may include providing retiree health benefits. Contributions to the trust are not limited and investment income is not taxed. Benefits are not taxed if the entity has received confirmation (determination) from the IRS that the trust is a Section 115 trust.
- **Voluntary Employees' Benefit Association** [IRC 501(c)(9)] – a trust for the benefit of a voluntary membership of active and retired employees. Tax-free distributions may be made for qualifying retiree health care expenses.

The GAO report included results from a 2008 survey that indicated more states reported having adopted or being likely to adopt a Section 115 governmental trust than a VEBA or 401(h) subaccount because of their simplicity and flexibility. Many Section 115 trusts are administered by the government's pension fund which many officials say they prefer because pension boards had the necessary experience, expertise, and resources to effectively manage the trusts.

Nevertheless, pre-funding health care benefits does not change actual health care costs. To address health care costs, governments are making changes to their retiree health care benefits as well by changing:

- From a defined benefit retiree health plan to a defined contribution plan,
- The level of government contributions by shifting the risk of rising health care premiums to retirees, and
- The eligibility requirements for retiree health care benefits including the number of years an employee must work to be eligible for retiree health benefits.

The GAO estimates that by 2050, the number of state and local government retirees is likely to grow to 5.1 million retirees or 70% from current levels and that health care spending will grow to $237.3 billion. Future policy changes such as reduction in health care benefits, reduction in the number of retirees receiving benefits, increases in state and local taxes or a combination of these policies could change these GAO projections.

## *Private Sector Employer Seeks Approval for Guaranteeing Retiree Health Care Benefits*

The Coca Cola Company (TCCC) provides medical benefits to eligible retired employees in the Untied States under the TCCC Retiree Health Plan. Participants make contributions to the plan which may vary from year to year. The plan is funded through a VEBA trust established by TCCC. TCCC retains the option of making benefit payments out of its general assets and may then seek reimbursement from the VEBA.

The Company has asked the Department of Labor (DOL) for an administrative exemption to the ERISA *prohibited transaction provision*. If granted, the restrictions of this prohibitive transaction provision would not apply to the reinsurance of risks and the receipt of stop-loss premiums by TCCC's captive insurer.

**Prohibited Transaction Provision**

This ERISA provision generally prohibits the extension of credit or a loan between an interested party (such as an employer or an affiliate of an employer) and an employee benefit plan.

In its application to the DOL, TCCC proposed that the VEBA purchase a non-cancellable medical stop-loss policy from Prudential Insurance Company of America or its successor to insure the lifetime health care benefits for certain retirees. The VEBA, not TCCC, will be the stop-loss policyholder. The policy would pay the sum of all individual claims of retirees within a corridor of

$100 to $5,800, based on age, for each retiree for each year. Claims below the corridor would be paid out of TCCC's general assets.

The Coca Cola Company (TCCC) expects Prudential to enter into a reinsurance agreement with Red Re, a captive insurance company affiliated with TCCC. Red Re would assume 100% of the risks under the stop-loss policy for retirees and dependents. Prudential will not be relieved of its liability under the retiree health plan if Red Re is unable or unwilling to satisfy liabilities under its reinsurance agreement with Prudential. TCCC believes that its proposed reinsurance transaction already meets the requirements of one of ERISA's current prohibited transaction exemptions.

**Terms Used in this Discussion**

***Stop Loss Insurance*** is purchased from insurance company by employers who self-fund employee health care benefits to mitigate the risks and costs associated with providing employees and retirees with health care benefits. Stop loss insurance is often considered an alternative to traditional insurance policies.

***Reinsurance*** is basically stop-loss insurance agreement where an insurer transfers a portion of its portfolio to a third party. Insurers use reinsurance to manage risk associated with paying benefits to policyholders.

***Captive Insurer*** is a limited purpose insurance company formed by a parent organization to manage the parent company's risk. The captive insurer does not do business with the general public.

Under the Company's application to the DOL:

- TCCC will retain the option of making benefit payments out its general assets and then seek reimbursement from the VEBA. Many claims outside of the corridor may be paid directly by TCCC without the expectation of reimbursement from the VEBA.
- The VEBA will submit claims that are within the corridor to Prudential. Prudential will then submit the claims to Red Re. To avoid the expense and confusion associated with excessive layers of administration, TCCC will pay claims and then submit them to the VEBA for reimbursement.
- TCCC will fully comply with current PTE 80-26 and not charge interest or fees to the plan when TCCC pays a claim and seeks reimbursement from the VEBA.
- The plan would pay no more that adequate consideration for the insurance contracts and would not pay commissions for the contracts. No participant contributions will be used to pay premiums for the stop-loss policy.
- Any profits earned by Red Re because of favorable claim experience will be returned to the plan.
- The plan will contract with insurers with at least an A rating from A.M. Best. Prudential has an A+ rating from A.M. Best.
- The contract between Prudential and Red Re will be indemnity insurance. Prudential will retain liability for the plan if Red Re is unable or unwilling to cover any liability under the reinsurance arrangement.
- The Plan will retain an independent fiduciary at TCCC's expense to analyze the transactions and monitor compliance. The independent fiduciary, among other requirements, cannot have an ownership interest in TCCC, Red Re or any of their affiliates.

In its application, TCCC states that the plan's independent fiduciary has reviewed the proposed reinsurance transaction and determined that it is appropriate and in the best interests of the plan, and its participants and beneficiaries because of the lifetime guarantee of benefit payments within the corridor by Prudential or its successor. The independent fiduciary will monitor compliance by the parties with the terms and conditions of the proposed reinsurance transaction and take whatever action is necessary to safeguard the interests of plans and the participants and beneficiaries.

The DOL is currently considering TCCC's application.

**Nationwide comment:** According to the DOL website, a number private sector companies have formed captive insurance companies to provide reinsurance for life insurance and long term disability coverage for active and retired employees. Some employers may want to consider using a captive insurer for providing retiree health care benefits that are guaranteed by another insurer if the DOL approves TCCC's exemption.

## *Reference Material*

GASB Statement 45 on OPEB Accounting by Governments: A Few Basic Questions and Answers, (2 pages, 35 KB)

Plain language summary of Statements 43 and 45 (30 pages, 280 KB)

State and Local Government Retiree Health Benefits: Liabilities Are Largely Unfunded, but Some Governments Are Taking Action, GAO-10-61, (49 pages, 770 KB)

Federal Register, Dec. 22, 2009, which includes the TCCC application to the DOL – http://www.dol.gov/federalregister/PdfDisplay.aspx?DocId=23427 (29 pages, 198KB)

(back to the Table of Contents)

## VI. 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 our plan Web site, NRSforu.com. In addition, we report guidance on legislative and regulatory activity relevant to government sector defined contribution plans through:

- *Federal Legislative and Regulatory Report* — distributed monthly and posted on the Legislative / Regulatory tab on the Employer section of NRSforu.com. It's available online and for download.
- *Plan Sponsor Alerts* — published as needed to announce breaking news, and distributed by e-mail and posted in the Plan Sponsor Corner of NRSforu.com.

## About this report

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Albrecht is a member of American Society of Pension Professionals and Actuaries (ASPPA), currently serving on its Government Affairs Committee, is past chair of the ASPPA Tax Exempt and Government Plans Subcommittee and is a subject matter expert (SME) for the ASPPA Education and Examinations Committee. She is a current contributor to Aspen Publisher's "457 Answer Book."

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