

Insider

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EEOC Issues Final Regulations Implementing the ADA Amendments Act

By Stephen Douglas and Rich Gisonny

The Equal Employment Opportunity Commission (EEOC) has finalized amendments to its Americans with Disabilities Act (ADA) regulations, which implement changes made by the ADA Amendments Act of 2008 (ADAAA). The ADAAA, which took effect on January 1, 2009, significantly expanded the scope of ADA-protected disabilities, essentially overturning several U.S. Supreme Court rulings and rejecting portions of the EEOC's earlier ADA regulations. The final EEOC regulations became effective on May 24.

The changes will affect a wide range of HR, compensation and benefit programs, and could increase the number of ADA-based challenges to employers' hiring, termination, promotion and compensation decisions. Certain features of benefit plans — such as so-called disability-based distinctions under a medical plan — might also come under increased scrutiny. So employers should review their HR policies, employee handbooks and employee benefit programs to minimize the risk of lawsuits and liability.

The final regulations provide additional guidance on key terms under the ADAAA, emphasizing that the definition of "disability" is to be construed broadly. They state that the primary focus in applying the ADA should be on whether discrimination has occurred rather than on whether an individual meets the definition of having a disability.

Background

The ADAAA did not amend the core definition of "disability" under the ADA, which continues to be (1) a physical or mental impairment that substantially limits one or more major life activities, (2) a record of such an impairment or (3) being regarded as having such an impairment. The 2008 law significantly redefined some key terms embedded in the definition of disability, such as "major life activities," "substantially limits" and "regarded as having such impairment."

Another important change involves the effect of "mitigating measures" on disability status. Under the ADAAA, the determination of whether impairments substantially limit a major life activity may not consider the "ameliorative effects of mitigating measures," such as medication, hearing aids and prosthetics.

Overview of EEOC's final regulations

The EEOC's final ADAAA regulations make the following key changes:

- Establish a broad interpretation of disability for determining whether an individual is protected by the ADA
- Set out nine rules to guide the analysis used to establish a disability rather than listing impairments that would "consistently," "sometimes" or "usually not" be disabilities (as had been proposed). Under the final regulations, some impairments — such as epilepsy, diabetes, cancer, HIV infection and bipolar disorder — virtually always constitute a disability under the ADA.
- Establish that a limitation need not "significantly" or "severely" restrict a major life activity to meet the new standard. Determining whether an impairment substantially limits a major life activity requires an individualized assessment and, according to the

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Insider

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EEOC, the term “substantially limits” should be construed broadly in favor of expansive coverage to the maximum extent permitted by the ADA.

- State that, in analyzing whether an individual is substantially limited in a major life activity, he or she should be compared with most people as opposed to the average person. The regulations do not define “most people,” other than to state that scientific, medical or statistical evidence generally is not required.
- Expand the definition of “major life activities” through two non-exhaustive lists:
 - The first list includes caring for oneself, performing manual tasks, seeing, hearing, eating, sleeping, walking, standing, sitting, reaching, lifting, bending, speaking, breathing, learning, reading, concentrating, thinking, communicating, interacting with others and working. Previous EEOC guidance identified some of these activities, while Congress added others in the ADA.
 - The second list includes major bodily functions, such as functions of the immune system, special sense organs and skin; normal cell growth; and digestive, genitourinary, bowel, bladder, neurological, brain, respiratory, circulatory, cardiovascular, endocrine, hemic, lymphatic, musculoskeletal and reproductive functions. Many of these bodily functions were explicitly referenced in the ADA, while the EEOC added others as further illustrative examples.
- Eliminate mitigating measures (other than ordinary eyeglasses or contact lenses) as a relevant factor in assessing whether someone has a disability. While the beneficial effects of mitigating measures generally are not considered, any negative effect of a mitigating measure — such as medication — on performing a major life activity can be considered in determining whether someone is substantially limited and has an ADA-protected disability.
- Provide that an impairment that is episodic (e.g., epilepsy) or in remission (e.g., cancer) is a disability if it would substantially limit a major life activity when active
- Amend the definition of “regarded as having an impairment,” making it unnecessary to show that the employer perceived the individual to be substantially limited in a major life activity. Instead, an applicant or employee subjected to an ADA-prohibited action (e.g., failure to hire, denial of promotion or termination) because of an actual or perceived impairment will meet the “regarded as” definition of disability unless the impairment is both transitory and minor. However, an employer’s basing its actions on an individual’s impairment does not necessarily constitute unlawful discrimination under the ADA. For example, the employer’s action might be warranted if the individual was unqualified for the job or would pose a direct threat to others.
- Provide that whether an actual or perceived impairment is transitory (i.e., expected to last for six months or less) and minor is now an affirmative defense to the “regarded as” coverage
- Provide that people covered only under the “regarded as” prong of the definition of disability are not entitled to reasonable accommodation
- Provide that qualification standards, employment tests or other selection criteria based on uncorrected vision will not be used unless such criteria are job-related for the position in question and consistent with business necessity

Going forward

The ADA and the EEOC’s final regulations lower the bar for establishing that an ADA-covered disability exists and confirm that, going forward, the EEOC’s primary focus will be on whether employers have complied with their obligations and whether discrimination has occurred, and not whether the individual meets the definition of disability.

An EEOC fact sheet on the final regulations and a series of related questions and answers are available at www.eeoc.gov.

TW Pension 100: 2010 Disclosures of Funding, Discount Rates, Asset Allocations and Contributions

By Vishal Apte and Brendan McFarland

During 2010, aggregate funded status¹ for defined benefit (DB) plans sponsored by the Towers Watson 100 (TW 100)² increased from 82% to 84%. The results are based on just-reported pension disclosures from the Securities and Exchange Commission (SEC) 10-K filings of the 100 largest publicly traded U.S. plan sponsors with year-end 2010 fiscal dates.

This annual analysis³ examines reported funding results at year-end 2010, the discount rates used to measure liabilities, target asset allocation policies, returns on plan investments and plan contributions made for 2010 as well as those expected for 2011.

Gradual improvement in funded status continues

Among the TW 100, between year-end 2009 and year-end 2010, pension plan assets increased by 10%, and plan liabilities grew by 7%. The pension deficit decreased from \$181.8 billion to \$172.2 billion — a funding gain of \$9.6 billion over the year (as shown in *Figure 1*).⁴

While aggregate funded status increased over the last year, it remains \$267 billion lower than it was at year-end 2007 for companies in this analysis. At year-end 2010, the average funded percentage (unweighted) for the TW 100 was 83%, compared with 80% at year-end 2009 — and 104% at year-end 2007 (as shown in *Figure 2*).

¹ A plan's funded status is the difference between plan assets and its projected benefit obligation (PBO).

² The TW 100 consists of the sponsors of the 100 largest U.S. pension plans among U.S. publicly traded organizations, ranked by PBO at year-end 2009. For some companies, the allocation of disclosed PBO and assets between U.S. and non-U.S. plans is estimated.

³ See "TW Pension 100: 2009 Disclosures of Funding, Discount Rates, Asset Allocations and Contributions," *Insider*, April 2010; "Watson Wyatt Pension 100 — 2008 Disclosures of Funding, Discount Rates, Asset Allocations and Contributions," *Watson Wyatt Insider*, April 2009.

⁴ On a global basis, aggregate funding results for these companies are similar to those mentioned above. For all pensions, domestic and foreign, the total PBO increased from \$1.27 trillion to \$1.36 trillion. Global pension assets also rose from \$1.03 trillion to \$1.14 trillion by year-end 2010. So on a global basis, aggregate funded status rose from 81% to 83% by year-end 2010.

Figure 3 (page 4) depicts the distribution in funded percentages over the last four years for this same set of plan sponsors.

From 2009 to 2010, most of the changes in funded status were among plan sponsors in the middle of the funding distribution. In 2009, 49% of companies had funded percentages between 60% and 80%. In 2010, the number fell to 34%. By contrast, only 41% of companies had funded levels between 80% and 100% in 2009, whereas 56% of companies achieved that funded level in 2010.

Funding did not improve for all plan sponsors in this analysis over 2010 — funded status actually declined for 23 of these companies. But most of these declines were quite small; only one company realized a loss of more than 5 percentage points.

Discount rates fall again

Over 2010, the growth in plan obligations — accounted for partly by lower interest rates — once

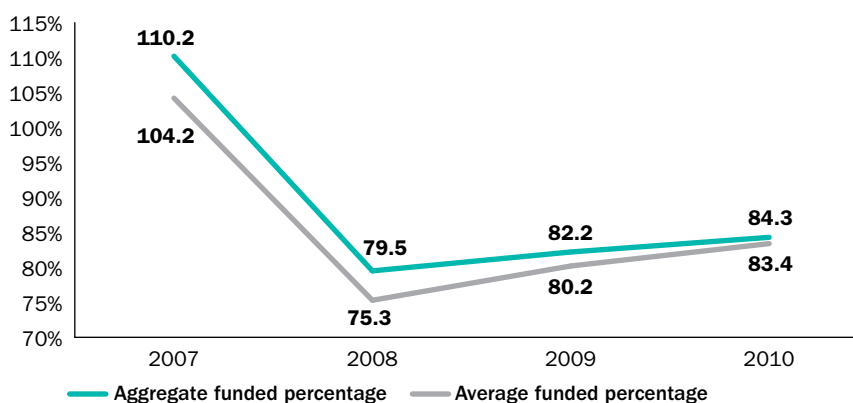
“While aggregate funded status increased over the last year, it remains \$267 billion lower than it was at year-end 2007 for companies in this analysis.”

Figure 1. Aggregate funded status for top 100 pensions (\$ billions)

	PBO	Plan assets	Surplus/(deficit)
12/31/2007	\$923.7	\$1,018.3	\$94.6
12/31/2008	\$950.1	\$755.7	(\$194.4)
12/31/2009	\$1,024.3	\$842.5	(\$181.8)
12/31/2010	\$1,098.5	\$926.3	(\$172.2)

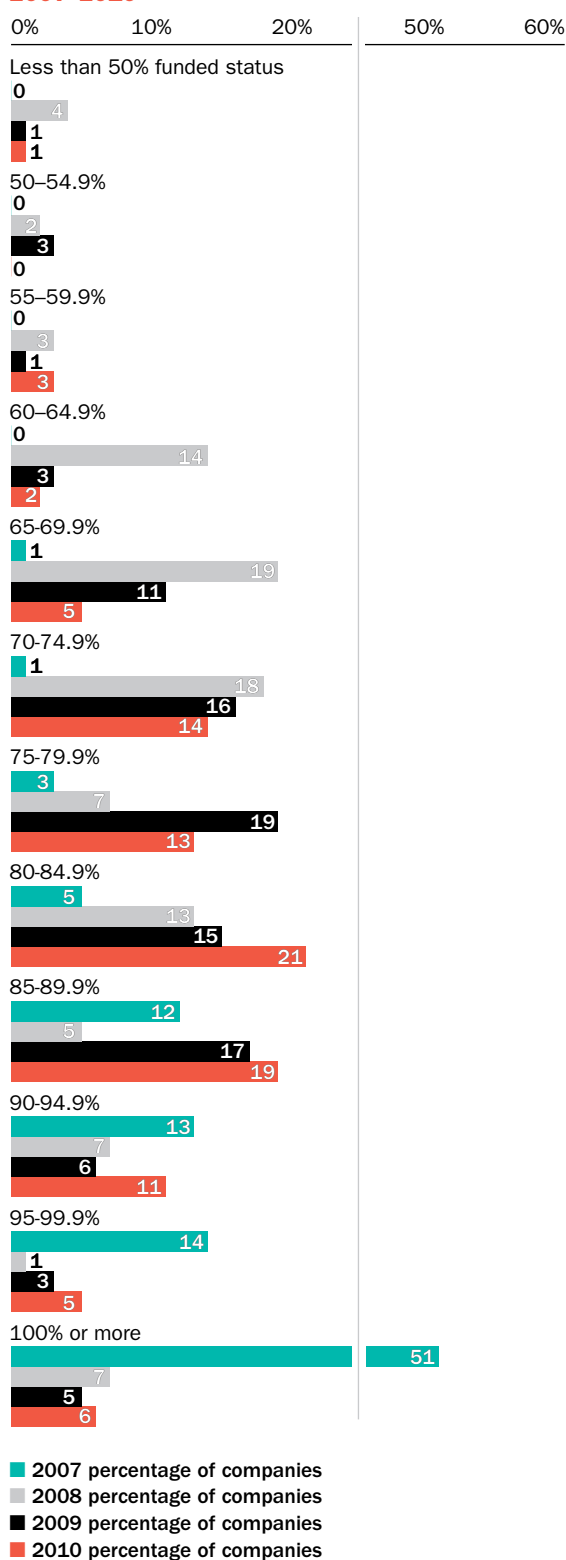
Source: Towers Watson.

Figure 2. Funded status percentage for TW 100, 2007–2010



Source: Towers Watson.

Figure 3. Distribution of funded status for TW 100, 2007–2010



Source: Towers Watson.

Figure 4. Average discount rate assumptions for TW 100, 2007–2010

Year	Average discount rate
2007	6.29%
2008	6.39%
2009	5.92%
2010	5.46%

Source: Towers Watson.

Figure 5. Investment returns on pensions for TW 100, 2008–2010

	2008	2009	2010
Aggregate investment return	-19.9%	15.3%	13.2%
Average investment return	-22.7%	17.8%	13.0%

Source: Towers Watson.

Figure 6. Average target asset allocation percentages for TW 100 pensions, 2009–2011

Year	Equity	Debt	Cash	Real estate	Other
2009	54.6%	34.2%	0.2%	3.4%	7.7%
2010	52.4%	35.4%	0.6%	3.5%	8.2%
2011	50.1%	37.1%	0.8%	3.2%	8.8%

Source: Towers Watson.

again counteracted strong market gains. From 2008 to 2009, the average discount rate fell by 47 basis points (from 6.39% to 5.92%) as shown in *Figure 4*. Over 2010, interest rates fell almost as far — down an additional 46 basis points. By the end of 2010, the average discount rate for these plan sponsors was 5.46%.

Investment returns were up again

During 2010, strong market returns (along with large contributions from sponsors) gave plan assets a 10% boost.⁵ At year-end 2010, aggregate and average (unweighted) investment returns were roughly 13% (see *Figure 5*). While market gains were smaller in 2010 than in 2009, sponsors have achieved two years of solid investment gains since the 2008 financial crisis. These positive returns have played a major role in lifting funded status over the last two years.

Sponsors continue gradual shift away from equities

We analyze target allocation strategies in the 85 companies that provided allocation data for 2009, 2010 and 2011 (*Figure 6*).⁶ Over the last three years, plan sponsors, in aggregate, continued their incremental shift away from concentrating their investment risk in public equities. While most plan sponsors didn't make big changes to their investment policy over the last year, a few shifted their allocation strategies more significantly during 2010 — eight of the 85 reduced their target equity allocation by more than 7%. Only one company increased its target allocation to equity, and the increase was 4%.

Employers make large contributions

As mentioned above, the value of assets increased significantly due to strong investment returns and large employer contributions (offset somewhat by significant benefit payments). For the second year in a row, aggregate plan contributions surpassed annual benefit accruals, which helped reduce funding

⁵ While investment returns on assets were 13% and cash contributions were much larger than benefits accrued during 2010, plan assets grew by only 10% due to sizable benefit payouts. Companies in this analysis paid out \$67.3 billion in benefits during 2010.

⁶ Target allocation information is usually depicted in ranges in pension disclosures. For purposes of this study, the midpoint of ranges was taken and results were normalized to total 100%.

Figure 7. Actual and expected plan contributions by employers in the TW 100 (\$ billions), 2008–2011

Plan year	Contribution
2008	\$14.3
2009	\$30.0
2010	\$40.5
2011	\$27.7 (expected)

Source: Towers Watson.

deficits. Aggregate contributions for this group were \$40.5 billion in 2010, while service cost (benefits earned over the prior year) was \$19.2 billion.

The majority of sponsors contributed more than their service cost over the last year. The median (unweighted) ratio of contribution to service cost for companies in this analysis was 2.84. For the 31 plan sponsors whose funded status rose by 5 percentage points or more over the last year, the median contribution-to-service-cost ratio was 4.31.

Figure 7 shows actual contributions for 2008, 2009 and 2010 and expected contributions for 2011.⁷ Sponsors plan to contribute more than benefit accruals during 2011 as well.

“The value of assets increased significantly due to strong investment returns and large employer contributions.”

Conclusion

For the second year in a row, declining interest rates have pushed pension liabilities higher. Over both years, however, sponsors realized strong asset returns and made substantial contributions to their pensions, thereby easing deficits and achieving a modest aggregate funding gain of 2 percentage points — from 82% in 2009 to 84% in 2010.

These companies' aggregate pension deficits fell from roughly \$182 billion at the end of 2009 to \$172 billion at the end of 2010. While that is good news, the aggregate deficit for the TW 100 remains quite large. To provide some long-term perspective, these same firms had a \$95 billion pension surplus in 2007. As the economy continues to slowly improve, plan funding keeps climbing as well. But a return to full funding health is likely to take more time, favorable markets and extra contributions from plan sponsors coupled with a turnaround in interest rates.

⁷ Five firms were missing data on expected contributions for 2011 and so were dropped from the analysis on plan contributions.

News in Brief

Law Repeals Expanded 1099 Reporting Requirements, Amends Subsidy Repayment Requirements

By Precious Abraham and Ann Marie Breheny

The Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act (H.R. 4) repeals reporting requirements that had been expanded under the Patient Protection and Affordable Care Act (PPACA). The PPACA required businesses to issue Form 1099s to all payees who received \$600 or more in a year and to report certain payments for rental properties that are not part of a trade or business.

The House had approved the legislation on March 3 — but the revenue offset sparked opposition. In general, the revenue offset increases required repayments from taxpayers who receive subsidies to purchase health insurance coverage through an insurance exchange for which they do not qualify (see *Insider*, March 2011).

The Senate approved H.R. 4 on April 5 by a vote of 81-19, and President Obama signed it into law on April 14. The 1099 reporting requirement is the first PPACA provision to be repealed.

2009 Plan Funding of the TW 100 on a Regulatory Basis: Actuarial Assumptions and Methods

By Brendan McFarland and Mark Warshawsky

In general, the Pension Protection Act of 2006 (PPA) narrows plan sponsors' choices of actuarial assumptions and methods for their defined benefit (DB) plans. More recently, however — especially following the financial crisis and consequent legal and regulatory relief — it has become apparent that sufficient short-term discretion remains to make sponsors' actuarial elections and choices interesting and useful to know.

Figure 1. Pension plans sponsored by the TW 100 by plan type and status, 2009 (number of plans)

Type	Open	Closed	Frozen	Total
Career average	6	5	3	14
Final average	29	22	8	59
Flat benefit	12	1	5	18
Cash balance	33	7	10	50
Pension equity	7	3	1	11
Other	2	0	0	2
Total	89	38	27	154

Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

Figure 2. Participants by status in pension plans of the TW 100, 2009

(number of participants)

Retired	3,840,751
Terminated vested	2,832,637
Active	3,541,583
Total participants	10,214,971

Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

The Department of Labor (DOL) now posts the completed Forms 5500 — including Schedules SB and other relevant actuarial and accounting statement attachments — on its website on an almost real-time basis. Calendar-year plans filed the 2009 Form 5500 on October 15, 2010. This website availability enables us to gather and code the data directly and comprehensively for a defined set of sponsors.

The Towers Watson 100 (TW 100) is a group of sponsors of the largest U.S. plans, based on the size of their pension liabilities. For TW 100 U.S. plans with at least 1,000 participants, we collected 2009 plan year Forms 5500, Schedules SB and attachments, and accountants' reports filed with the DOL. Information was available for 93 companies and 154 qualified pension plans.

For the TW 100, this analysis identifies valuation methods, asset values, funding targets, funded status, plan contributions, funding balances and actuarial assumptions for the 2009 plan year.

Plan characteristics

Of the 154 plans, during the 2009 plan year, about three-fifths were open, and the rest were closed or frozen (see *Figure 1*).¹ About three-fifths were traditional DB formulas, while two-fifths were hybrid plans.² Nineteen plans included only union members, and 15 (three of which included only union participants) were not yet subject to PPA funding rules because they were sponsored by government contractors.

The plans analyzed have 10.2 million participants divided into active, retired and terminated vested status as shown in *Figure 2*. Only 35% of all participants are actively employed.

Assets: Values and methods

As reported in Schedule SB, the market value of total pension assets for these companies was \$685.6 billion at the beginning of the plan year, commonly January 1, 2009. The mean value per plan was \$4.45 billion. Because most plan sponsors used smoothing techniques to reduce volatility, however, the actuarial value of assets was \$741.5 billion.

As market values declined, actuarial values held up better. For the most part, actuarial value is used to

¹ Open plans are still accepting new participants and current participants are accruing benefits. In closed plans, a segment of existing workers (but no newly hired ones) are accruing benefits, while in frozen plans, there are no continuing accruals of benefits.

² Traditional DB formulas include career average, final average and flat benefit where the retirement benefit is denominated as a flow of income at retirement for life. Hybrid plans, including cash balance and pension equity, by contrast, quote a current accrued account balance to plan participants. Where there was a combination of formulas, we chose the most prominent one.

determine required cash contributions. The overall ratio of market value to actuarial value was 0.925; the simple average ratio was 0.919. For 9% of plans, actuarial value was set equal to market value. The rest employed smoothing — most often over 24 months, as shown in *Figure 3*.

Smoothing would have reduced the ratio of market value to actuarial value even further for 2009, except the law places lower and upper thresholds of 90% and 110%, respectively, on actuarial value compared to market value. As shown in *Figure 4*, this constraint affected 83% of PPA-governed plans.

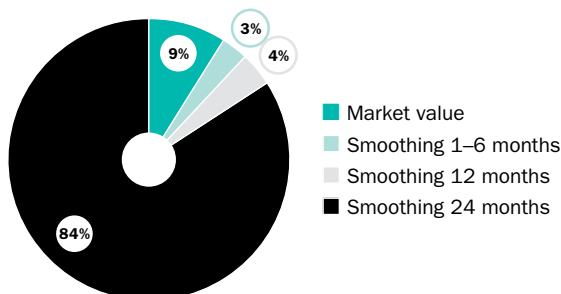
The predominant use of smoothing is quite different from the asset valuation method used in 2008, as 67% of sponsors that used smoothing in 2009 employed market value in 2008. (The other 33% of plans that used smoothing in 2009 used a simple averaging method in 2008.) Smoothing was encouraged by a December 2008 law and subsequent regulations that changed the original PPA asset averaging concept. The move to smoothing was likely a reaction to the dramatic stock market decline in 2008 and should not necessarily be viewed as a long-term trend, as plan sponsors are permitted to change their asset valuation method again in 2010 (when it will be more locked-in).

Funding targets

The funding requirements are based on the present value of accrued benefits, referred to as the “funding target.” Funding targets (that is, plan liabilities) for the 2009 plan year totaled \$673.7 billion, and the mean value per plan was \$4.37 billion. On a plan-weighted basis, 63% of the funding target was attributable to retired and terminated vested participants, and 37% was attributable to active participants (both vested and non-vested), as shown in *Figure 5*.

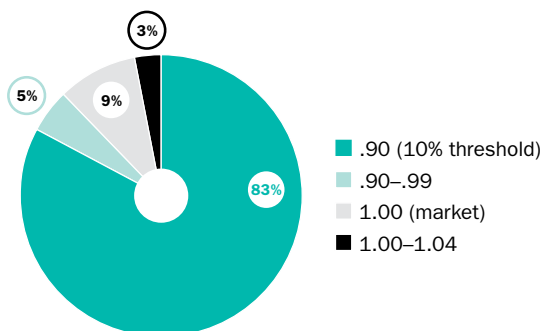
“On a plan-weighted basis, 63% of the funding target was attributable to retired and terminated vested participants.”

Figure 3. Types of asset valuation methods, 2009



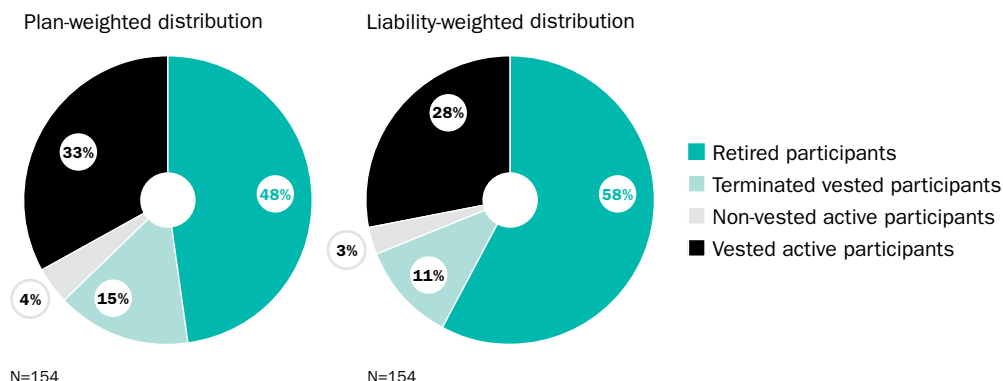
N=139
Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

Figure 4. Distribution of ratios of market to actuarial value, 2009



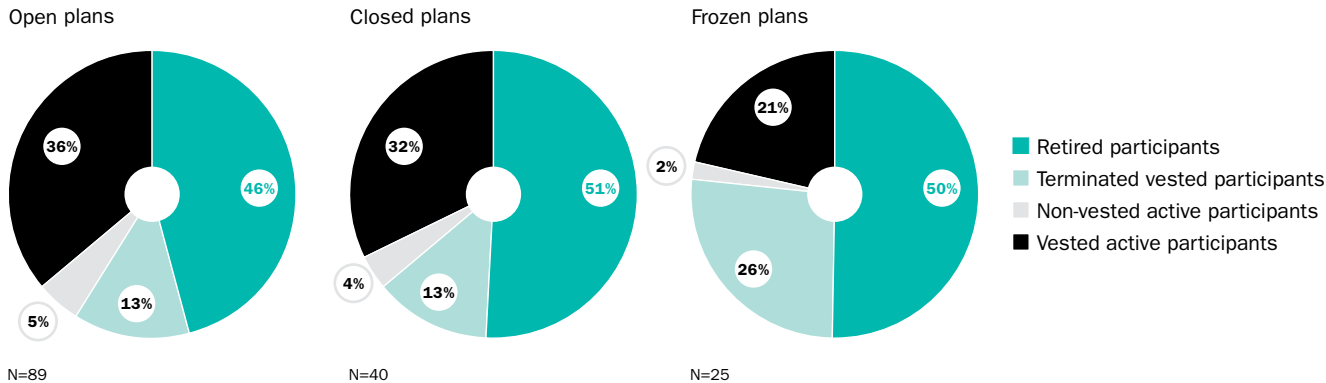
N=139
Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

Figure 5. Distribution of funding target across participant status, 2009



N=154
Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

Figure 6. Plan-weighted distribution of funding targets across participant status, 2009



N=89
 Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

On a liability-weighted basis, however, 69% of the funding target was attributable to retired and terminated vested participants and only 31% to active participants. These figures bracket the participant count ratio described above.

Plan status — open, closed or frozen — affects these proportions as well. On a plan-weighted basis, 59%, 64% and 76% of the funding target was attributable to non-active participants for open, closed and frozen plans, respectively (see Figure 6). Over time, as the closed group of active participants retire or terminate, all liabilities in closed and frozen plans will become attributable to inactive participants.

Across all plans for the 2009 plan year, the mean funding target was \$111,700 per retired participant, \$28,534 per terminated vested participant and \$81,169 per active participant.³

Funded status

Two important PPA funded status measures are disclosed in Schedule SB: the funding target attainment percentage (FTAP) and the adjusted funding target attainment percentage (AFTAP).

The FTAP is the ratio of the actuarial value of assets, reduced by the funding standard carryover balance and prefunding balance (“funding balances” — notional accounts arising from past contributions in excess of the minimums required) to the funding target.

The AFTAP is identical to the FTAP except that the numerator and denominator are increased by purchases of annuities for non-highly compensated plan participants in the last two years, and, more

significantly, assets are not reduced by funding balances if the plan is fully funded. To be considered fully funded for this purpose, the actuarial value of assets must be at least 94% and 96% of the funding target in the 2009 and 2010 plan years, respectively, and 100% thereafter.

As stated above, 139 out of the 154 plans analyzed are subject to the PPA’s funding rules. Figure 7 shows the average FTAP and AFTAP on plan- and liability-weighted bases. According to these measures, average funded status was relatively high in 2009 — much higher than in the accounting disclosures. This resulted from using the smoothed actuarial value of assets and a higher discount rate to value funding targets (a temporary event as explained below). Only three of the 139 plans were deemed to be “at-risk,” meaning their 2008 FTAP was less than 70%. Plans designated at-risk are subject to additional rules that generally increase funding requirements.⁴

Figure 7. Funded status, mean ratios, 2009⁵

	FTAP (N=154)	AFTAP (N=139)
Plan-weighted	92.72%	107.04%
Liability-weighted	89.89%	111.32%

Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

Figure 8 (next page) shows the distribution of FTAPs and AFTAPs, respectively, across plans. For 2009, in the majority of plans, FTAPs ranged from 75% to 95%, and in more than three-quarters of plans, AFTAPs were higher than 95%.

³ By contrast, at the end of 2008, the average 401(k) balance was \$45,519, according to the Employee Benefit Research Institute.
⁴ For these plans, the ratio of the “at-risk” funding target (line 4b in Schedule SB) to the “normal” funding target (line 3d(2)) is 1.044.
⁵ For the 139 plans subject to PPA funding rules, their FTAP status was 92.31% on a plan-weighted basis and 89.59% on a liability-weighted basis.

“According to these measures, average funded status was relatively high in 2009 — much higher than in the accounting disclosures.”

Contributions: Minimum required and actual

Of the 139 plans subject to the PPA in 2009, 109 had non-zero minimum funding requirements totaling \$9.6 billion — \$8.3 billion in normal cost and \$1.3 billion for amortization installments. Of this amount, \$6.6 billion was “paid” through funding balances and \$3.0 billion was paid by cash contributions. Thirty-two percent of these plans paid the minimum amount required entirely through funding balances and 22% paid entirely in cash — with the others paying in some mix.

The TW 100 companies contributed more than the minimum required amount. Of the 109 plans, 85 contributed \$21.8 billion in cash. The 30 plans with no funding requirement contributed \$.9 billion. The 15 not subject to the PPA contributed \$3.8 billion.

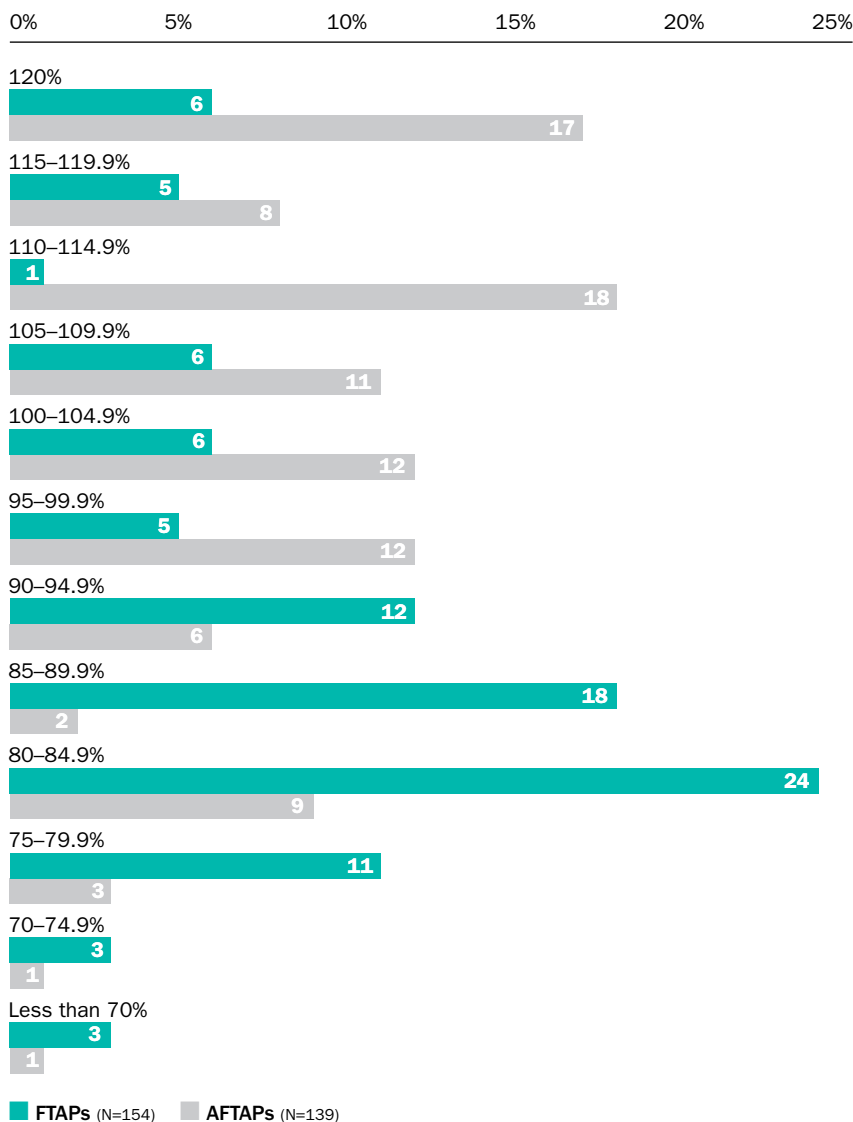
The fact that many plan sponsors contributed non-required amounts — with some not used to create funding balances — may reflect sponsors’ trying to avoid an at-risk designation or the benefit restrictions imposed by law on plans funded below certain levels. Other factors might have influenced sponsors’ behavior as well, such as wishing to preserve the ability to use funding balances, or to avoid triggering the Pension Benefit Guaranty Corporation’s special reporting requirements or restrictions in loan covenants.

Funding balances

Some plan sponsors use funding balances to manage the timing of their contributions, despite associated restrictions and disincentives. Of the 139 plans subject to the PPA, 126 (91%) had a funding balance at the beginning of the 2009 plan year. For these plans, on average, funding balances were 17% of the funding target, calculated as a mean on a plan-weighted basis. *Figure 9* (next page) shows the distribution across plans of the funding balances as a percentage of funding targets.

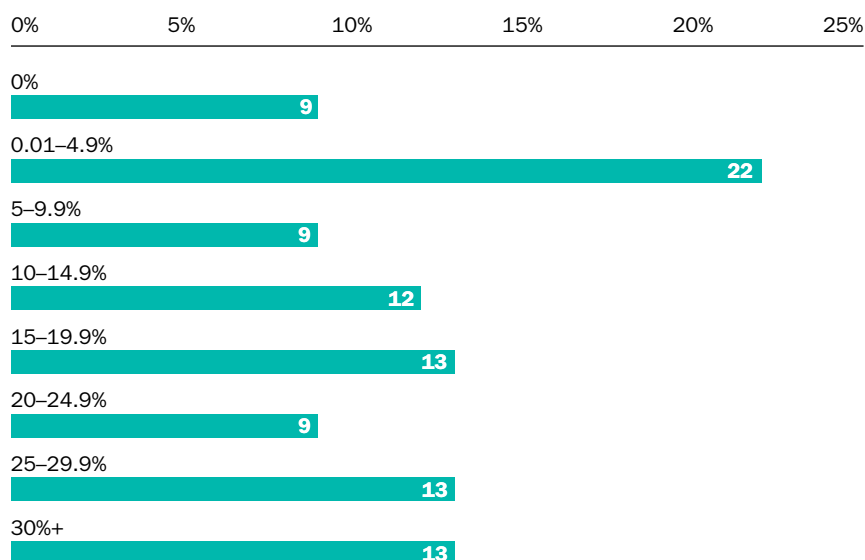
At the beginning of the 2009 plan year, 99 of the 109 plans with minimum funding requirements had prior-year funding balances. Fourteen percent of these plans did not use their funding balance in 2009. Overall, \$6.6 billion of the available \$115.4 billion in funding balances were applied to satisfy minimum funding requirements.

Figure 8. Distribution of FTAPs vs. AFTAPs, 2009



Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

“\$6.6 billion of the available \$115.4 billion in funding balances were applied to satisfy minimum funding requirements.”

Figure 9. Distribution of funding balances as a percentage of funding targets, 2009

N=126

Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

Figure 10. Interest rate used for funding purposes, 2009

Full yield curve			Segment rates		
Month	Plan count	Average	Month	Plan count	Average
December	10	6.86%	December	7	6.46%
October	117	8.17%	October	1	6.41%
September*	2	7.13%	September	2	6.26%

*One sponsor has a non-calendar plan year.

Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

Figure 11. Assumed rates of retirement (%), 2009

Age	Average	Median
55	6.61	5.0
58	6.66	5.25
60	12.76	10.0
61	13.58	12.0
62	26.88	25.0
63	21.57	20.0
64	23.30	20.0
65	60.02	50.0
66	51.69	35.4
67	54.27	40.0
70	96.53	100.0

Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

Actuarial assumptions and methods

In determining required contributions, the most significant actuarial assumption is the interest rate used to value the funding target and normal cost. Under the PPA, plan sponsors may choose either the yield curve, reflective of a one-month average of corporate bond yields across all maturities, or a segment rate approach, a simplified yield curve computed as a 24-month average corporate bond yield. In addition, plans could choose a method that looks back as much as four months from the beginning of the plan year in deriving a rate.

For 2009, of the 139 PPA-governed plans, 129 used the yield curve. Of those, 117 selected October, the month in 2008 that produced the highest effective rate, 8.17%. The higher the rate, the lower the funding target. Only 10 plans used segment rates, with most selecting December (see *Figure 10*).

Following the financial crisis, IRS regulations effectively made the October 2008 yield curve available for the 2009 plan year as a form of temporary funding relief. Of the 117 plans that selected the October 2008 yield curve, 42 had used the December 2007 yield curve and 69 had used segment rates in the 2008 plan year. Four plans used the October yield curve the prior year (data about prior-year interest rate assumptions could not be found for two plans). For years after 2009, sponsors that employ the yield curve may not use a look-back approach. For 2010 valuations, plan sponsors can elect a new interest rate method.

Figure 11 shows retirement rate assumptions by age. Retirement rates generally increase with age, spiking at 62 (the Social Security early retirement age) and 65 (the Medicare eligibility age). The rates reported are before any at-risk adjustments.

Schedule SB reports an average retirement age for active plan participants. Across all plans, this assumed retirement age averaged 61.3 years, with the distribution frequency of average retirement ages highest at ages 61 and 62, significant frequency at ages 60 and 63, and a smattering at older and younger ages.

All plans but one used the mortality rate assumption prescribed in law, with separate tables for non-annuitants and annuitants. One plan used a substitute table based on its own mortality experience.⁶

Assumed termination (withdrawal) rates can be important in determining plan costs. Some plans simply vary termination rates by employee age

⁶ This option is available only for the very largest plans in the country.

regardless of service (Figure 12a). A more common method, however, is to consider both age and years of service in a select and ultimate format. Figure 12b reports ultimate rates by age.

In determining normal cost, the assumed rate of salary increase is used primarily for final-average-pay and pension equity plans — less so for other plan types. Forty-one plans simply used a flat rate of increase, averaging 4.23%. Seventy plans used a scale graded by age, with average rates starting at 8.79% at age 20, moving down to 6.9% at 30, 5.09% at 40, 4.03% at 50 and 3.53% at 60.

Conclusion

As described in our simulation modeling work,⁷ 2009 was a year of significant regulatory funding relief, particularly in allowing sponsors to calculate funded status using the actuarial value of assets and the October 2008 yield curve. While some plan sponsors used the relief in combination with funding balances to stave off the need for cash contributions, many others contributed more than required, thereby improving the funded status of their plans. Future analyses should be instructive in reflecting a longer-term view of plan sponsor elections under the PPA.

⁷ See “Funding Obligations for Single-Employer DB Pension Plans: Updated Projections for 2011–2014,” *Insider*, April 2011.

Higher PBGC Premiums Might Be on the Table in Upcoming Budget and Deficit Reduction Discussions

By Precious Abraham and Ann Marie Breheny

Higher Pension Benefit Guaranty Corporation (PBGC) premiums for defined benefit (DB) plan sponsors could come under discussion on Capitol Hill, as lawmakers struggle with the fiscal year 2012 budget and deficit reductions. Deficit reduction is key these days, and lawmakers and the administration have staked out their respective positions for the adversarial negotiations ahead.

President Obama’s budget proposal for fiscal 2012 and other deficit reduction proposals would increase PBGC premiums for some DB plan sponsors, and the House Budget Committee is considering the

“While some plan sponsors used the relief in combination with funding balances to stave off the need for cash contributions, many others contributed more than required.”

Figure 12a. Withdrawal rates by age regardless of service

Age	Plan count	Average	Median
25	52	16.52%	16.24%
40	52	7.19%	6.34%
55	50	2.46%	1.83%

Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

Figure 12b. Withdrawal rates by age based on service (values reflect the ultimate basis)

Age	Plan count	Average	Median
25	87	12.95%	13.0%
40	84	6.87%	6.35%
55	86	3.54%	1.71%

Source: Towers Watson calculations based on Form 5500 data sets, Employee Benefits Security Administration, U.S. Department of Labor (available at www.dol.gov/ebsa/foia/foia-5500.html#2009).

idea. Details remain sketchy and the outlook is uncertain, but discussions are likely to be driven by some lawmakers’ concerns about the PBGC deficit and fears of a “taxpayer bailout.”

PBGC premium increases proposed by administration, deficit reduction reports

President Obama’s budget proposal for fiscal 2012 would allow the PBGC board to adjust premiums. It also directed the agency to consider the “risks that different sponsors pose to their retirees and the PBGC” — suggesting the possibility of basing premiums on a plan sponsor’s credit rating or other factors. The proposal calls for two years of study and public comment before changing premiums and phasing in any increases. The proposal is scored to raise \$16 billion over 10 years.

“Measuring the risk posed by a plan or plan sponsor could be controversial, and lawmakers might be reluctant to relinquish their authority over premiums to the PBGC board.”

The budget proposal was based on recommendations from the bipartisan National Commission on Fiscal Responsibility and Reform — a commission President Obama appointed in February 2010. In a report released December 1, 2010, the fiscal commission recommended allowing the PBGC board to increase both flat-rate and variable-rate premiums, thereby bringing in an estimated \$16 billion by 2020. In addition to influencing President Obama’s budget proposal, the commission’s report is expected to form the basis of bipartisan deficit reduction legislation in the Senate and to play a central role in ongoing related discussions.

The Bipartisan Policy Center’s deficit reduction proposal also recommended higher PBGC premiums. Its recommendations would “align premium costs more closely with the risks that participating companies pose,” according to the report. The proposal recommended increasing the flat-rate premium by 15% and the variable-rate premium to \$12 per \$1,000 in underfunding. It also recommended basing the variable-rate premium “partly on the riskiness of a private pension plan’s investment allocation (e.g., how much is invested in stocks versus bonds).” The proposal is estimated to raise \$5 billion by 2020.

House budget resolution

The House recently approved its budget resolution for fiscal 2012. House Budget Committee chair

Paul Ryan (R-Wis.) served on President Obama’s fiscal commission. Although the resolution does not specifically propose to increase PBGC premiums, a committee report that accompanies the resolution expresses concern about the PBGC’s financial situation and recommends reform. The report states: “While this budget does not assume the president’s proposal, it recognizes the need to reform the PBGC to ensure that a future taxpayer-funded bailout does not occur.” The report notes that potential savings could reach roughly \$2.7 billion over 10 years — significantly less than those anticipated in the president’s budget proposal.

Looking ahead

The fiscal 2012 budget negotiations are occurring in the context of intense debate on federal spending, deficit reduction and fiscal discipline. The current PBGC premium hike proposals are vague, so the congressional committees with jurisdiction over PBGC premiums would have to work out the specifics, and the path to enactment could be rocky. Measuring the risk posed by a plan or plan sponsor could be controversial, and lawmakers might be reluctant to relinquish their authority over premiums to the PBGC board. However, the prospect of generating revenue and the specter of a looming taxpayer bailout conveyed by some lawmakers could help PBGC premium increases gain traction.

Proposed SEC Rules Require Scrutiny of Potential for Conflicts of Interest in Compensation Advisors

By Steve Seelig and Stephen Douglas

On March 30, the Securities and Exchange Commission (SEC) voted unanimously to propose regulations to require compensation committees to closely examine the “independence” of their compensation consultants, legal counsel and other advisors. The SEC also proposes to require companies to disclose in their proxies the way they evaluate and address potential conflicts of interest.

The proposed regulations have two main elements:

- **Listing-exchange requirements for advisor independence.** Listing exchanges (e.g., NYSE and NASDAQ) will develop rules to guide compensation committees in determining the independence of their compensation advisors. They would base the rules on the five factors identified in the Dodd-Frank Wall Street Reform and Consumer Protection Act. (A separate proposal requires listing exchanges to set standards for the independence of compensation committee members that are substantially similar to those already in place for NYSE- and NASDAQ-listed companies.)

- **Proxy disclosure requirements regarding conflicts of interest.** Companies must disclose whether their compensation consultants have potential conflicts of interest and, if so, what they have done to mitigate them.

The Dodd-Frank approach is more aggressive than the SEC's current position, which requires disclosure only of fees paid to multiservice consulting firms. The new, stricter regimen will seek to uncover — for the first time — potential conflicts among all categories of consultants, including single-service “boutique” firms that used to be considered essentially safe harbors.

This article describes statutory requirements under Dodd-Frank and the additional guidance in the SEC's proposed regulations.

Consultant independence — the statutory framework

To ensure advisor independence, Dodd-Frank specifies five factors to consider in selecting compensation advisors and directs the SEC to issue regulations to guide the listing exchanges in implementing the new rules. The SEC may identify additional factors as long as the regulations remain competitively neutral among categories of compensation advisors (e.g., multiservice consulting firms, boutiques) and preserve compensation committees' ability to hire any category of advisor. The five factors are:

1. Whether the advisor's firm provides other services to the company (the only factor companies must consider under current SEC rules)
2. The fees the company pays to the firm that employs the compensation advisor expressed as a percentage of the firm's total revenue (i.e., whether the firm has a “fee concentration” conflict that could influence the advisor's advice)
3. Policies and procedures maintained by the advisory firm to prevent or mitigate conflicts of interest
4. Any business or personal relationship between the compensation advisor and a member of the compensation committee
5. Whether the compensation advisor owns company stock

The law also clarifies that engaging compensation advisors remains a compensation committee decision, and companies must provide appropriate funding for the committee's advisors. Moreover, the law underscores that compensation committees have no obligation to follow their advisors' counsel and must exercise their own judgment in fulfilling their duties.

Dodd-Frank requires companies to disclose in their proxies or consent solicitation materials whether the compensation committee retained or obtained the advice of a compensation consultant and whether doing so involved any conflicts of interest. If so, the company must disclose the nature of the conflict and how it is being addressed.

The SEC's proposed rules

The proposed regulations provide little guidance beyond the five factors governing the assessment of advisor independence. Under the proposal, listing exchanges can identify additional factors, although the SEC will retain the authority to determine whether the factors are competitively neutral and preserve the committee's ability to hire consultants from any category of firm.

The SEC requested comments on whether it should provide materiality, numerical or other thresholds to clarify whether and when independence factors must be considered by a compensation committee.

The SEC proposes to make the following amendments to current regulations:

- Specify that the five independence factors used to select compensation advisors are also used to determine whether a conflict exists
- Require disclosure of the compensation consultant's role only when he or she advises the compensation committee (or management in companies where the compensation committee has no consultant)
- Require no disclosure when a compensation consultant provides advice to management if another unrelated consultant works for the compensation committee
- Require a general description of the services provided by the compensation consultant even if he or she provides only noncustomized benchmark data or services relating to broad-based plans
- Clarify that compensation committees can obtain advice from a compensation consultant without a formal engagement, client relationship or payment of fees

The proposed regulations would not change the current fee disclosure regulations, including the exceptions for consulting to broad-based plans and providing noncustomized benchmark data. The SEC requested comments on whether to require more extensive disclosure of the compensation committee's process for selecting advisors.

“The Dodd-Frank approach is more aggressive than the SEC's current position.”

Compensation committee independence

Under Dodd-Frank, listing exchanges must adopt standards requiring each member of the company's compensation committee to be a member of the board of directors and to be independent. Factors to be considered in defining director independence include:

- A director's sources of compensation, including any consulting, advisory or other compensatory fee paid by the company
- Whether the director is affiliated with the company, a subsidiary of the company or an affiliate of a subsidiary of the company

The proposed regulations note that any committee performing the functions of a compensation committee (including oversight of executive compensation) must meet these requirements, even if it is not formally designated as a compensation committee.

Companies affected

Companies with equity securities listed on public exchanges must meet the independence rules for

compensation committee members and compensation advisors. The independence standards for compensation committee members do not apply to controlled companies, limited partnerships, companies in bankruptcy, open-ended management investment companies and foreign private issuers whose annual reports explain the lack of an independent compensation committee. However, all of these companies (other than controlled companies) must comply with the independence rules applicable to compensation advisors.

In addition, the consultant conflict-of-interest rules apply to all companies subject to the SEC's proxy rules, whether listed or not, including controlled companies. The SEC requested comments on whether to require foreign private issuers (which generally aren't subject to the proxy rules) to disclose compensation consultant conflicts of interest.

The SEC's proposed regulations allow listing exchanges to exempt additional companies from any of the independence requirements.

Next steps and implications

The due date for comments was May 19, 2011. After adoption, listing exchanges will have 90 days to propose rules to comply with the final SEC regulations. Based on this timeline, the exchange proposals might not be finalized in time for the 2012 proxy season.

The new rules emphasize the importance of seeking advisors that are most appropriate for the company's needs, taking into account the advisor's reputation and resources (e.g., data, global reach, breadth of services), as well as the qualifications, experience, character and availability of the individual consultants who work directly with the committee.

Committees should carefully evaluate all conflicts that could potentially hinder the consultant's providing fully objective advice and then determine whether and how they could be mitigated. As both Dodd-Frank and the proposed SEC rules confirm, mitigation processes can be put in place to ensure that companies receive fully objective and independent advice from their advisors, regardless of the category of firm they select.

“Based on this timeline, the exchange proposals might not be finalized in time for the 2012 proxy season.”

News in Brief

IRS Announces 2012 HSA Amounts

By Cindy Brockhausen and Rich Gisonny

The IRS has announced the official 2012 inflation-adjusted amounts for health savings accounts (HSAs). These include the maximum annual HSA contribution amount, minimum annual deductible for a high-deductible health plan (HDHP) and maximum annual out-of-pocket expenses for an HDHP. The IRS updates these amounts annually to reflect cost-of-living adjustments.

HSA amounts for 2012

Individual coverage	2011	2012
Maximum annual HSA contribution	\$3,050	\$3,100
Minimum annual deductible for HDHP	\$1,200	\$1,200
Maximum annual out-of-pocket expenses for HDHP	\$5,950	\$6,050
Family coverage	2011	2012
Maximum annual HSA contribution	\$6,150	\$6,250
Minimum annual deductible for HDHP	\$2,400	\$2,400
Maximum annual out-of-pocket expenses for HDHP	\$11,900	\$12,100

The 2012 HSA catch-up contribution amount for participants who turn age 55 by December 31, 2012, is \$1,000 (this amount is fixed by statute and is the same catch-up contribution amount that applies in 2011).

Fiscal Year 2012 Budget, Deficit Reduction Proposals Have Implications for Health Plans

By Precious Abraham and Ann Marie Breheny

Deficit reduction will be a central focus in the upcoming 2012 budget battle, and the discussions could herald changes ahead for employer-provided health plans. Amendments to the health care reform law, Medicare and the tax code would significantly affect employers, workers and retirees.

House approves Paul Ryan's "Path to Prosperity"

On April 15, the House approved a budget resolution (H.Con.Res. 34) put forth by Budget Committee chair Paul Ryan (R-Wis.). The resolution establishes a framework for action by other House committees as well as a starting point for budget negotiations.

The budget resolution would repeal key provisions of the Patient Protection and Affordable Care Act (PPACA), although the resolution and related documents are short on details. However, according to the resolution, an accompanying Budget Committee report, Representative Ryan's "Path to Prosperity" report and a Congressional Budget Office analysis, the proposal would:

- Repeal the individual and employer health insurance mandates
- Repeal the health insurance exchanges and the subsidies to help low-income taxpayers (those with household incomes up to 400% of the federal poverty level) purchase coverage through the exchanges
- Revoke the provisions to expand Medicaid coverage to all low-income individuals, provide tax credits to small employers that offer health care coverage to their employees and establish a high-risk pool to help people with pre-existing conditions obtain coverage before 2014
- Cancel the Early Retiree Reinsurance Program, which reimburses employers for certain claims incurred by retirees who are not yet eligible for Medicare
- Repeal provisions to close the Part D "doughnut hole" and establish the Independent Medicare Advisory Board
- Abolish the Community Living Assistance Services

- and Supports Act — a long-term care program to be funded by employee payroll contributions
- Abolish the new unearned income Medicare contribution and the excise tax on high-cost Medicare group health plans (generally called the Cadillac tax)

The budget resolution would retain the Medicare cuts enacted by the PPACA but redirect savings from those cuts to strengthen Medicare.

The Medicare reforms are among the most radical of the proposals. Beginning in 2022, Medicare would be converted to a premium support program. Newly eligible beneficiaries would buy coverage from private plans competing on a Medicare exchange. The program would provide premium support to beneficiaries on an income- and health risk-adjusted basis, with the payments adjusted annually for inflation and the beneficiary's age.

Health plans in the Medicare exchange would have to accept all applicants and could not vary premiums for same-age beneficiaries. Seniors covered under traditional Medicare when the premium support program begins could either keep their traditional Medicare coverage or participate in the premium support program. Certain low-income beneficiaries would receive a government-funded medical savings account to help pay cost-sharing expenses. Beginning in 2022, the Medicare eligibility age would rise gradually, reaching age 67 in 2033.

The proposal calls for a 10-year fix to the sustainable growth rate — Medicare's physician reimbursement formula. Current physician payment rates expire on December 31, 2011, so Congress will have to do something by the end of the year, through either the budget process or another legislative vehicle. The plan also calls for medical liability reform, such as caps on non-economic and punitive damages.

The budget proposal also would reform taxes and tax expenditures. It would reduce the number of income tax rates and lower the top rate. Although the changes to tax expenditures are not specified, the Budget Committee report suggests "eliminating or limiting as necessary nearly all existing tax deductions, exclusions and other special provisions." Reforming tax expenditures could have far-reaching implications for a broad range of employer benefit

"Beginning in 2022, Medicare would be converted to a premium support program."

programs. The “Path to Prosperity” states that taxpayers “deserve a tax code that does not discriminate, for example, between the self-employed and those employed by large companies” — suggesting that the tax exclusion for employer-provided health benefits could be on the chopping block.

President Obama’s fiscal proposal

On April 13, President Obama unveiled a counterpoint to Representative Ryan’s budget resolution. The president’s proposal addresses many of the same issues in the budget resolution — including Medicare reform and tax reform — but, unsurprisingly, the initiatives reflect very different policy positions. Although the president’s proposal is also short on detail, it generally builds on the framework developed by the National Commission on Fiscal Responsibility and Reform and his budget proposal for fiscal year 2012 (see *Insider*, January 2011 and March 2011).

In the April 13 speech unveiling the proposal, President Obama said he would “not allow Medicare to become a voucher program that leaves seniors at the mercy of the insurance industry, with a shrinking benefit to pay costs.” Instead, he proposed building on the health care reform law to achieve additional Medicare savings through payment reforms, using “Medicare’s purchasing power” to cut spending on prescription drugs and speeding generic drugs to market. He also suggested giving the Independent Payment Advisory Board additional enforcement mechanisms and allowing the board to promote value-based designs.

President Obama also expressed support for tax reform. A White House fact sheet calls on lawmakers to “undertake comprehensive tax reform that produces a system which is fairer, has fewer loopholes, less complexity and is not rigged in favor of those who can afford lawyers and accountants to game it.” In his speech, the president said tax

reform should “build on the fiscal commission’s model of reducing tax expenditures so that there’s enough savings to both lower rates and lower the deficit.” The fiscal commission proposed capping the exclusion for employer-provided health coverage in 2014 and phasing it out between 2018 and 2038.

President Obama asked Senate Majority Leader Harry Reid (D-Nev.), Senate Minority Leader Mitch McConnell (R-Ky.), House Speaker John Boehner (R-Ohio) and House Minority Leader Nancy Pelosi (D-Calif.) to each appoint members to participate in bipartisan, bicameral discussions aimed at developing a legislative framework for deficit reduction. Vice President Biden will lead those discussions. The group has met twice (May 5 and May 10). Given the current legislative environment, such negotiations seem unlikely to produce a unified proposal.

More proposals on the horizon

The “gang of six” — Senators Dick Durbin (D-Ill.), Mark Warner (D-Va.), Kent Conrad (D-N.D.), Saxby Chambliss (R-Ga.), Tom Coburn (R-Okla.) and Mike Crapo (R-Idaho) — were drafting a deficit reduction proposal expected to be based on the recommendations of the National Commission on Fiscal Responsibility and Reform. However, disagreements prompted Senator Coburn to drop out of the discussions, casting doubt on the likelihood that a proposal will emerge.

It is too early to tell which — if any — health and welfare provisions may see action during the 2011–2012 legislative session. However, deficit reduction, tax reform and the health care reform law will remain under active legislative discussion throughout this session and likely into the 2012 elections. As the discussions evolve, employers should remain alert for proposals with direct and indirect implications for their health and welfare programs.

“The fiscal commission proposed capping the exclusion for employer-provided health coverage in 2014 and phasing it out between 2018 and 2038.”

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