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Projected Financial Conditions of Social Security and Medicare Worsen

Both Short- and Long-Run Measures of Status Take Hits; Disability Program Needs Near-Term Changes

By Mark J. Warshawsky

The recently released annual reports for 2011 from the trustees¹ on the financial states of Social Security and Medicare show the “great recession” continues to take a toll on both programs. Current revenues from payroll taxes have fallen even more steeply than under prior projections. Other short-term factors include higher projected health care costs and a recent fall-off in immigration. Even greater life expectancy, according to the trustees, will drive costs higher over the long term.

Absent reform, Social Security will suffer cash flow shortfalls indefinitely. The shortfall — the gap between payroll and benefit taxes and expenditures — was \$49 billion in 2010 and is expected to be \$46 billion in 2011. The Social Security trust fund reserves are projected to be exhausted in 2036 — one year earlier than in last year’s report. But the disability insurance trust fund, a separate component of the overall program, is projected to be depleted by 2018.

The gap between Medicare’s expenditures and dedicated sources of program income, such as payroll taxes and premiums, was \$251.8 billion in 2010 — almost half of total program spending. This represents a significant and growing drain on the federal budget. The Hospital Insurance (HI) trust fund — a major

component of Medicare — is projected to be exhausted by 2024, five years earlier than in last year’s report.

Owing to provisions in the law for when prices fall or do not increase, there was neither a cost-of-living adjustment (COLA) to Social Security benefits nor an increase in the Social Security payroll tax base for the last two years. Medicare Part B premiums were also held constant for most beneficiaries, excluding new and high-income enrollees, despite increasing health care costs. With a recent pick-up in price inflation, the trustees now project a small COLA, an increase in the payroll tax base and higher Part B premiums for most beneficiaries. Part D premiums, however, are not expected to increase much.

The 2010 trustees’ report reflected the effects of health care reform legislation. These long-run projections were tentative, because there is little precedent for — and thus knowledge about the impact of — many of the health care reform provisions. Moreover, the political will required to implement some key provisions might be lacking. Delayed cost-reducing provisions have been repeatedly overridden in recent years as implementation dates approached. This year’s Medicare report explicitly acknowledges this uncertainty by including an alternative, more pessimistic, outlook.

The very concept of government trust funds has become more controversial and nebulous at the same time. The health care reform provisions that last year were credited with improving Medicare’s finances also appeared in the budget to fund health insurance

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¹ The government trustees are the secretaries of the Treasury, Labor, and Health and Human Services, and the Social Security commissioner; the two public trustees’ positions were filled this year.

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entitlement programs for the low- and moderate-income non-elderly populations. This “double counting” casts doubt on the economic — or even political — significance of the Medicare trust fund to the program.

It is also increasingly acknowledged that, despite “holding” \$2.6 trillion in government bonds, the Social Security trust fund is not an independent source of support, like an employer-sponsored pension fund holding stocks and bonds. Rather, a government trust fund is simply a call for higher taxes, less spending or more deficits elsewhere in the federal budget — an increasingly doubtful proposition when the annual deficit is nearly \$1.3 trillion and future fiscal prospects are bleak.

Social Security is sinking faster

The fall and stall in economic activity has been deeper and longer than the trustees expected. The once-large surpluses of tax income over expenditures have given way to deficits, according to the trustees’ intermediate projections. From 2008 through 2011, higher unemployment and stagnant wages cut deeply into payroll tax collections.² The trustees expect continued, albeit slightly lower, cash flow deficits in 2012, 2013 and 2014. Large deficits will emerge in earnest in 2015 and then balloon as the rest of the baby boom generation retires (under current assumptions for labor force participation rates of older workers).

This year’s report showed a significant decline in Social Security’s current and projected financial condition in both the short and long runs. The gloomier outlook is mainly caused by lower starting death rates and faster near-term declines in death rates at older ages, much lower immigration in 2007–2010 and lower projected immigration through 2014, and a slower economic recovery (lower taxable earnings and higher unemployment).

Even as trust fund bonds are redeemed to make up program deficits, the trust fund reserves are expected to run out in 2036 (one year earlier than last year’s projection). At that point, dedicated tax revenue could fund slightly more than three-fourths of scheduled benefits.

Immediately and permanently increasing the payroll tax rate by 2.15 percentage points or cutting benefits by 13.8% (12.8% in last year’s report) would make Social Security solvent for the next 75 years. But because the annual balance is projected to be –4.24% of taxable payroll in 2085, these changes would only lend a temporary veneer of well-being and generational equity to the program.³ Every year that passes adds to the deficit, demonstrating the need for an even longer projection horizon as well as sustained/permanent solvency reforms.

A more comprehensive “infinite horizon” measure would call for raising the payroll tax rate by 3.6 percentage points, cutting benefits by 21.9% or some (presumably gradual) combination of the two to achieve sustainable solvency and share the burden of reform between current and future generations.

The projected depletion of the disability insurance trust fund in 2018 is not a change from last year’s report but, of course, is now one year closer. In the past, the government would have responded to the shortfall by transferring to disability the portion of the payroll tax meant for retirement. Given concerns about the federal budget deficit, frustration over the long delay in reforming Social Security, and the run-up in disability claims and outlays, reform of the disability program becomes a more likely scenario.

² Note that Public Law 111-312 reduces the Social Security tax rate for 2011 by two percentage points to employees and self-employed workers. The subsequent loss of payroll tax revenue will be made up by transfers from the Treasury to the trust funds. This transfer further illustrates the illusory nature of the trust fund budgeting concept underlying traditional notions of financing for Social Security.

³ Even if the problem were “solved” in the first year under a 75-year horizon, the following year’s trustees’ report would show a negative actuarial balance and hence show the need for subsequent reforms.

Medicare: Improvements promised by health care reform both doubtful and insufficient

As mentioned above, the 2010 trustees' report projected that health care reform would appreciably improve Medicare's financial picture, with three changes being particularly important:

1. Slower growth in provider payments due to productivity adjustments — which affect all HI (Part A) and about half of Supplementary Medical Insurance (SMI) (Part B) providers. Health care reform links payment rates for certain Medicare services to overall economic productivity, so the annual price updates for these providers will be adjusted downward by growth in economy-wide productivity improvements. Consequently, the trustees assume the prices Medicare pays for these health services will rise about 1.1% per year more slowly than assumed in the past.
2. Reduced payments to Medicare Advantage plans
3. Increased HI payroll taxes on high-income workers (because the income thresholds are not indexed, over time an increasing proportion of workers will become subject to the additional HI tax rate)

In addition, current law reduces the Medicare payment rates for physician services by almost 30% in 2012. The trustees must assume these cuts will be made despite the virtual certainty that Congress will override them as it has in previous years.

Since 2008, the HI trust fund has paid out more in hospital benefits and other expenditures than it received in taxes, and the imbalance is projected to continue throughout the projection period. To make up the difference, the federal government will redeem trust fund bonds. Although health care reform is projected to increase revenues and to reduce HI spending, the trust fund nevertheless runs dry in 2024 (five years earlier than projected in last year's report).

The projected 75-year actuarial deficit for Part A is 0.79% of taxable payroll under current law, up from 0.66% in last year's report. However, the trustees believe that Congress may not allow the productivity adjustments to be made fully beyond 2020 or at all beyond 2036 because the labor-intensive health care sector may not be able to reduce its costs of doing business to the same extent as the overall business sector. Under this alternative scenario, the HI true actuarial deficit is 2.15% of taxable payroll, up from 1.91% in last year's report. The worsening finances are caused by recent lower taxable payroll and higher health care costs in the short run.

“Under the trustees' alternative projection, [Medicare] Part B costs would be 4.92% of GDP by 2085.”

The SMI part of Medicare includes physician and other services (Part B) and prescription drugs (Part D). Both parts are financed by enrollee premiums and, primarily, general revenue transfers from the federal budget. Part B benefit costs increased by 3.5% in 2010 — an unusually low increase by historical experience. Part D benefit costs increased only 2%, roughly in line with last year's projections.

Part B outlays were 1.46% of gross domestic product (GDP) in 2010 and are projected to reach about 2.42% of GDP by 2085. According to the trustees, these projections are considerably understated because the substantial reductions in physician payments required under current law are unlikely to be realized. If the slated reductions in future price updates for most other Part B providers prove similarly unrealistic, the costs are even further understated. Under the trustees' alternative projection, Part B costs would be 4.92% of GDP by 2085.

Part D outlays are estimated to increase from 0.43% of GDP in 2010 to 1.7% by 2085. The projections are slightly lower than those in last year's report because Part D enrollees are using significantly more generic versus brand-name drugs, thereby reducing projected growth in prescription drug spending.

Trustees expect increases to Social Security benefits, Medicare premiums and the taxable wage base in 2012

The trustees expect the December 2011 Social Security benefit increase will be 0.7%, the first COLA since 2008. Since 1975, automatic annual COLAs have been tied to annual increases in the Consumer Price Index (CPI). The CPI decreased significantly during the last five months of 2008, and COLAs are therefore deferred until the price index surpasses 2008 levels.

A hold-harmless provision under current law prevents recipients' net Social Security benefits from decreasing when the increase to their Medicare Part B premium is bigger than the increase to their cash benefits.⁴ As there was no COLA, the Part B premium increase for 2011 exceeded the increase to cash benefits in all cases, thereby exempting those protected by the hold-harmless provision from paying

⁴ The net benefit equals the increase in the Social Security benefit minus the increase in the Part B premium.

“While some of the factors driving costs up and program revenue down are likely temporary, others may reflect long-term demographic and economic shifts.”

the higher premium. So these beneficiaries paid the same Part B monthly premium in 2011 they paid in 2009–2010 — \$96.40.

The hold-harmless provision does not protect new enrollees during the year, high-income enrollees subject to the income-related premium adjustment,⁵ and those dually eligible for Medicare and Medicaid (state Medicaid programs pay their full premiums). To keep the Part B trust fund solvent, these enrollees — who account for roughly 25% of all beneficiaries — paid substantially higher premiums. In 2010, their monthly premium rose to \$110.50. In 2011, monthly premiums rose to \$115.40 for newly eligible enrollees with annual incomes between about \$15,000 and \$85,000. Single enrollees with incomes above \$85,000 (or married enrollees filing jointly with incomes above \$170,000) pay from \$161.50 to \$369.10 per month. Also, health care reform froze the income thresholds used to calculate Part B income-related premiums at 2010 levels for 2011 through 2019, so more retirees will be paying the higher premiums over time.

Under the intermediate economic assumptions, the trustees estimate a monthly Part B premium of \$106.60 for 2012, compared with the 2011 “standard” premium of \$115.40. As a result of the COLA, more Part B enrollees will pay the full Part B premium in 2012, and many others will pay more than the \$96.40 they paid in 2009–2011. The standard Part B premium is thus projected to decrease due to the greater number of enrollees paying a higher (or full) Part B premium, thereby spreading the Part B financing among more enrollees. The trustees expect premiums for upper-income enrollees to range from \$149.20 to \$341, increasing with income levels. The annual deductible in Part B insurance is also expected to decline from \$162 in 2010 to \$150 in 2011. The actuary is setting all these levels to reflect the likelihood that Congress will again defer the reductions in physician payment rates scheduled under current law.

The trustees estimate that average monthly Part D premiums will rise by \$1 to \$31 in 2012. Moreover, under health care reform, Part D enrollees whose

incomes exceed certain thresholds (unindexed through 2019) pay higher premiums, as under Part B. The trustees estimate the monthly income-related adjustments or surcharges will range from \$12.50 to \$71.60, increasing with income levels, in 2012.

The positive Social Security COLA allows the government to increase the Social Security taxable wage maximum from \$106,800 to an estimated \$110,700 in 2012. Similarly, the government can increase the retirement-earnings-test exempt amount, currently set at \$14,160 for those younger than normal retirement age, to an estimated \$14,640 in 2012. Many of these adjustments may have near-term implications for employer retirement plans using permitted disparity with Social Security.⁶

Finally, the average wage index used in determining annually various bend points in the Social Security benefit formula and earnings required for a quarter of coverage is estimated to have increased in 2010 (after declining in 2009). Therefore, in 2012, the dollar values for the bend points will rise, and the amounts beneficiaries must earn to receive a quarter of coverage will also increase slightly.

The way forward

According to the 2011 trustees’ projections for Social Security and Medicare, program insolvency is drawing closer and threatens to go deeper. While some of the factors driving costs up and program revenue down are likely temporary, others may reflect long-term demographic and economic shifts.

For Social Security, the trustees foresee cash flow deficits in both the short and long term. The disability insurance trust fund faces near-term deficits (2018), which are likely to necessitate near-term reforms to that program.

The financial health of Medicare will depend to some extent on the effects of health care reform on the program. But even assuming the reforms increase revenues and reduce HI spending as planned, the trust fund is still expected to run dry in 2024.

Reform of both Social Security and Medicare has come under intense scrutiny by President Obama’s bipartisan National Commission on Fiscal Responsibility and Reform, which has made several suggestions for improving both programs’ finances. The current negotiations between Congress and the president (spring and summer 2011) over raising the federal debt ceiling are sure to consider reform of these programs and, perhaps, will include them in the resolution.

⁵ Beneficiaries whose incomes exceed \$85,000 in 2009 (\$170,000 for joint filers) must pay an income-related monthly adjustment amount and thus a larger share of the total Part B premium.

⁶ According to the 2009 Towers Watson Benefits Data Source database, about 44% of pension plans are explicitly integrated with Social Security.

Recent Compliance-Related Developments Affecting Reward Programs

By Stephen Douglas, Rich Gisonny and Bill Kalten

Employers should be mindful of recent legal developments that could affect their compensation and other reward programs. These developments include:

- A court ruling that payments for unused sick days are part of an employee's regular pay rate for purposes of calculating overtime pay (in previous rulings, courts have reached differing conclusions on this issue)
- In a departure from an earlier ruling, a court's determination that pharmaceutical sales representatives (PSRs) are not entitled to overtime pay
- A Department of Labor (DOL) initiative connecting employees to attorneys for Fair Labor Standards Act (FLSA) and Family and Medical Leave Act (FMLA) claims

Court finds that payments for unused sick days are part of FLSA regular rate for overtime pay purposes

The FLSA generally mandates overtime pay — at least one and one-half times the regular rate of pay — to nonexempt employees who work more than 40 hours a week. The regular rate includes “all remuneration for employment paid to, or on behalf of, the employee,” with certain exclusions. One exclusion is for payments made for occasional periods when the employee does not work because of vacation, holiday, illness, the employer's failure to provide sufficient work or other similar cause. So compensation paid when an employee takes a vacation or sick day is not considered part of the regular rate. If employees are allowed to sell unused vacation or sick leave back to the employer in return for additional compensation, however, it's not entirely clear whether the associated payments should be included in the employee's regular rate for overtime pay calculation purposes.

In *Chavez v. City of Albuquerque*, the 10th U.S. Circuit Court of Appeals addressed this issue, ruling that payments for unused sick days must be included in the regular rate of pay when calculating overtime under the FLSA. The court said payments for unused sick days are analogous to “attendance bonuses,” which are includable in the regular rate. The court also found, however, that payments for unused vacation days are not included in the employee's regular rate. According to the court, the difference is

that “payments for non-use of vacation days are analogous to holiday work premiums or bonuses for working particular undesirable days.” The DOL reached essentially the same conclusion in a 2009 FLSA Opinion Letter that addressed a vacation buyback program and a cash stipend for non-use of sick leave.

In earlier cases, the 6th and 8th Circuits also considered the effect of the buyback of sick time on an employee's regular rate but reached conflicting conclusions. In *Acton v. City of Columbia* (8th Cir., 2006), the court ruled that sick time buyback payments must be included in the regular rate. But in *Featsent v. City of Youngstown* (6th Cir., 1995), the court ruled that sick time buyback payments are not part of the regular rate.

Given the conflicting rulings on sick time buyback payments, employers with such programs should discuss the proper treatment of these payments for overtime pay purposes with legal counsel.

Court rules that pharmaceutical sales representatives are exempt from overtime pay

In *Christopher v. SmithKline Beecham Corp.*, the U.S. Court of Appeals for the 9th Circuit decided that GlaxoSmithKline PSRs met the “outside sales” exemption from the FLSA's overtime pay requirements. This decision conflicts with a decision last year by the 2nd U.S. Circuit Court of Appeals (*In re Novartis Wage & Hour Litigation*) holding that PSRs were not exempt.

The court in the *Novartis* case held that the Novartis PSRs did not actually “make sales,” which is a condition of the outside sales exemption. The *Christopher* court, however, looked to the “structure and realities of the heavily regulated pharmaceutical industry.” In particular, the court noted that PSRs are hired for their sales experience, are trained in sales methods and receive commissions tied to sales. While PSRs might not sell drugs directly to patients or physicians, they obtain commitments from physicians to prescribe the drug at issue, and the commitments are tantamount to a sale.

In reaching its decision, the 9th Circuit explicitly rejected the DOL's view that there was no sale to end-users. The *Christopher* court also noted that the DOL had tacitly allowed pharmaceutical manufacturers to treat PSRs as exempt employees for more than 70 years.

“Given the conflicting rulings on sick time buyback payments, employers with such programs should discuss the proper treatment of these payments for overtime pay purposes with legal counsel.”

“If the DOL cannot pursue an alleged FLSA or FMLA violation, it will give the employee a toll-free number for the ABA-approved Attorney Referral System.”

DOL connects employees to attorneys for FLSA and FMLA claims

The DOL assists employees with issues related to minimum wage, overtime pay and family medical leave. According to the department, however, it is unable to resolve thousands of claims each year because of limited capacity. While the DOL is not capable of investigating every alleged violation of the FLSA and the FMLA, Congress also gave employees the right to pursue their own litigation under these laws. But exercising these rights and finding an appropriate attorney are significant obstacles for many employees, according to the DOL.

So the DOL and the American Bar Association Standing Committee on Lawyer Referral and Information Service have set up a system to connect

employees with local referral organizations approved by the ABA. If the DOL cannot pursue an alleged FLSA or FMLA violation, it will give the employee a toll-free number for the ABA-approved Attorney Referral System. Callers will be advised of ABA-approved attorneys in their local area. In addition, if the DOL investigated the complaint at all, it will give the employee any information on file about violations at issue and back wages owed, which should prove useful for an attorney who takes the case.

This new referral system could increase FLSA and FMLA actions against employers. Employers may consider reviewing their compensation practices and leave policies to ensure they are in compliance with their legal obligations. Additional information about the new referral system is available at the DOL's website.

Retirement Plan Disqualification — Not Just a Threat

By Francis Grealy, Bill Kalten and Dave Ronald

In two recent cases — *Michael C. Hollen v. Commissioner* and *Christy & Swan Profit Sharing Plan v. Commissioner* — the U.S. Tax Court upheld the Internal Revenue Service's (IRS) disqualification of a retirement plan because of plan document and operational failures.

“Both the SCP and the VCP are available for significant failures only if the sponsor discovers the failure before the plan is under examination by the IRS.”

Although the IRS can — and on occasion still does — disqualify ongoing qualified retirement plans, the agency generally tries to avoid such draconian measures. The IRS is well aware that maintaining a plan's qualified status is a daunting task. That's why the IRS has a system that enables sponsors to bring their plans back into compliance without losing the valuable tax benefits that qualified plans provide. The Employee Plans Compliance Resolution System (EPCRS) is composed of three correction programs:

1. Self-Correction Program (SCP)
2. Voluntary Correction Program (VCP)
3. Audit Closing Agreement Program (Audit CAP)

Under the SCP, plan sponsors can correct insignificant operational problems anytime without paying a fee or even notifying the IRS. Even significant problems can be corrected as long as the correction is substantially complete within two years of the failure. The EPCRS lists factors to consider in determining whether an operational failure is insignificant, including the number of years involved, the number of failures during that period, the percentage of plan assets involved and the percentage of participants affected.

Where the SCP is not available, qualification failures can be corrected through the VCP. To use that program, sponsors must file an application with the IRS and pay a small fee (small compared with the costs of plan disqualification).

In general, both the SCP and the VCP are available for significant failures only if the sponsor discovers the failure before the plan is under examination by the IRS. If the IRS discovers a significant failure, Audit CAP is the only available remedy, and the cost of correction is much higher. Under Audit CAP, the sponsor must pay a negotiated percentage of the maximum amount the IRS could collect from the sponsor, the participants and the trust if the plan were disqualified.

All qualified plans should be reviewed periodically to ensure both operational and documentary compliance with qualified plan rules. In merger and acquisition situations, a compliance review is particularly important if the buyer will be taking the seller's plan. In that case, the buyer has no control over past plan administration and cannot be assured of compliance without a thorough review.

These two recent court cases serve as a reminder that plan disqualification — while seldom deployed — remains in the IRS arsenal of penalties. And given the higher costs of correcting failures discovered by the IRS, sponsors should conduct their own periodic compliance reviews to identify and correct any qualification issues themselves.

Legislation to Amend Commuter Benefits Introduced

By Precious Abraham and Ann Marie Breheny

Four recently introduced bills would affect employer-provided commuter and parking benefits.

The Transportation Flexible Savings Accounts Act (H.R. 1680) would allow employees to establish commuter flexible spending accounts (FSAs) under cafeteria plans. The Family Account to Save on Transportation Act (S. 924) would temporarily authorize transportation FSAs — and allow them to include the cost of the employee's gas in certain cases. The Commuter Relief Act (H.R. 1825) would set uniform limits for parking and transit, allow employees to cash out their parking benefits, and permit employees to receive transit and bicycle benefits during the same month. The Commuter Benefits Equity Act would permanently increase the exclusion for transit and vanpooling benefits.

Transportation Flexible Savings Accounts Act and Family Account to Save on Transportation Act

Introduced by Representative Anthony Weiner (D-N.Y.), the Transportation Flexible Savings Accounts Act would amend the tax code to allow commuter FSAs under cafeteria plans and treat transportation fringe benefits as qualified benefits under such plans. Although the monthly parking limit is \$175 (indexed to \$230 for 2011) under the tax code, the monthly parking limit for a transportation FSA would be \$100 under the legislation.

The Family Account to Save on Transportation Act would allow transportation FSAs under cafeteria plans for two years. The FSAs could include parking, transit and vanpooling costs under existing tax code limits. The accounts could reimburse employees for the cost of fuel for their personal vehicles for one month whenever the national average retail price for regular gasoline for the preceding four-month period was higher than the price of gas in 2010.

Commuter Relief Act

The Commuter Relief Act sponsored by Representative Earl Blumenauer (D-Ore.) would establish a \$200 monthly limit for parking and transit or vanpooling benefits under the tax code. As noted above, the limit for qualified parking is \$175, currently indexed

to \$230. The limit for transit or vanpooling benefits is equal to the parking limit only through 2011. The \$200 limit would be indexed annually beginning in 2012.

Employers that offered parking benefits generally would have to give employees the option of receiving their parking allowance in cash. The act also would allow employees to receive both bicycle benefits and transit or vanpooling benefits in the same month. Transportation fringe benefits would also be available to self-employed workers.

Commuter Benefits Equity Act

Senator Charles Schumer (D-N.Y.) introduced the Commuter Benefits Equity Act, which would set the limits for both parking and transit at \$230, indexed for inflation beginning in 2012. Without a legislative extension, the limit for transit and vanpooling benefits will be reduced in 2012.

“It is uncertain whether commuter and transportation benefits can grab sufficient attention to move forward when the legislative agenda is so sharply focused on the deficit, health care reform and entitlement programs.”

News in Brief

Legislation Would Tax Some FSA, HSA Distributions

By Precious Abraham and Ann Marie Breheny

Legislation approved by the House would require account holders to pay taxes on distributions from health care flexible spending accounts (FSAs), health savings accounts (HSAs) and Archer medical savings accounts that were used to pay for abortion services. The No Taxpayer Funding for Abortion Act (H.R. 3) would also prohibit subsidies provided under the health care reform law from being used to purchase health insurance policies that cover abortion services.

Taxpayers could not count payments for abortion services toward the tax deduction for medical expenses, and the small business tax credit under health care reform would not be available to a company whose health insurance plan covered abortion.

The legislation would not affect payments or deductions for expenses related to the treatment of an infection, injury, disease or disorder that was caused or exacerbated by an abortion. And the new tax treatment would not apply if the pregnancy resulted from rape or incest, or the abortion was necessary to save the woman's life.

While the Senate is unlikely to approve the act, supporters might try to further the legislation — or some of its provisions — in upcoming health care, tax or budget debates.

Outlook

Representative Blumenauer indicated the Commuter Relief Act would be revenue-neutral because reducing the current parking limit would offset the cost of the other provisions. But even if cost is not an obstacle, it is uncertain whether commuter and transportation benefits can grab sufficient attention to move forward when the legislative agenda is so sharply focused on the deficit, health care reform and entitlement programs.

News in Brief

DOL Formally Proposes Delay of Retirement Plan Fee Disclosure Rules

By Francis Grealy and Bill Kalten

The Department of Labor (DOL) has proposed to extend both the effective date of the interim final rules concerning fiduciary-level fee disclosure (see *Insider*, August 2010) and the transition period in the final rules concerning participant-level fee disclosure (see *Insider*, January 2011). The DOL's intention is to more closely align the application of the two rules and give the parties sufficient time to comply.

The fiduciary-level disclosures apply to defined benefit and defined contribution plans subject to ERISA. The participant-level disclosures apply to ERISA-covered defined contribution plans that allow for investment direction.

The DOL's proposal would extend the effective date of the fiduciary-level disclosure rules from July 16, 2011, to January 1, 2012, something that the DOL previously announced its intention to do. It would also extend the transition period in the participant-level disclosure rules from 60 days to 120 days. The transition period gives plan administrators additional time after the applicability date (i.e., plan years beginning on or after November 1, 2011) to furnish the initial disclosures to participants who already have the right to direct the investment of their individual accounts.

Although service providers and plan fiduciaries were hoping for longer extensions, these should prove helpful. However, service providers may be challenged to update systems for the yet-to-be issued final fiduciary-level disclosure rules in time to comply. In addition, plan administrators with plan years beginning in November or December would have less than 120 days after the deadline for receiving the fiduciary-level disclosures (i.e., January 1, 2012) to provide the participant-level disclosures. Moreover, many sponsors would like to provide participant-level disclosures electronically but updated guidance on acceptable methods for doing so has not been issued.

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