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NYC Equal Benefits Law

A New York court determined that a state law pre-empted the city's requirement that any entity providing contract services to the city also provide domestic partner benefits equal to the benefits provided to spouses. More importantly from a larger perspective, ERISA also pre-empted that law.

It's important to note that although this particular law was struck down, similar laws in other municipalities have not been held to be preempted. Moreover, this holding was delivered by a trial court and as the case advances through the appeals process the ruling may yet be overturned. Given the recent history of cases on ERISA preemption, that is entirely possible. Still, it does raise a red flag for similar laws in other municipalities.

Injured Veterans Challenge Employers

According to the publication *Insurance Journal*, employers and their insurers need to be prepared for the tens of thousands of physically injured veterans returning to work.

"Workplace injuries that are primarily the result of injuries originally sustained during military service will generally be covered by the employer's workers' compensation program or, in some states, a second injury fund," said Robert Hartwig, chief economist of the Insurance Information Institute. Hartwig observed that, integration of the physically impaired will likely present unexpected challenges to employers that are generally inexperienced in dealing with such large numbers of returning veterans.

In preparing for returning veterans, employers and their insurers need to be aware of the following:

- Workplace injuries that are primarily the result of injuries originally sustained during military service will generally be covered by the employer's workers' compensation program or, in some states, a second injury fund. In certain states, workers' comp benefits may be apportioned or partially offset by other disability payments received.
- Veterans are also entitled to lifetime medical benefits from the Veterans Administration for service-related injuries. The VA also operates a Readjustment and Counseling Service (www.va.gov/racs/) to ease the transition for veterans returning to civilian life.
- Employers should also be alert to signs of possible mental health issues. Monitoring is probably wise for a period of time, especially if the returning worker's job is stressful, involves the operation of heavy machinery or equipment and/or driving.
- Employers need to adhere to obligations pursuant to the Americans with Disabilities Act (ADA). Discrimination based on physical handicap is not permitted in the hiring or promotion process, and reasonable accommodations must be made to meet the needs of disabled workers.
- Failure to comply with the terms of the ADA could result in legal action and fines by the Equal Employment Opportunity Commission. Employers could also be subject to civil litigation.

Tracking Retiree Medical Liabilities

The Financial Accounting Standards Board (FASB) is considering changing the way employers must account for their retiree medical liabilities. Today, the FAS No. 106 accounting rules permit employers to take on more and more of the liability over time. This was included in the rules to reduce the "shock" to employers having to begin accounting for retiree medical benefits. So, the liability that appears in a financial statement is often significantly less than the undisclosed total liability. The FASB, in the interest of promoting corporate transparency, is now considering requiring employers to more completely disclose their full liabilities.

Willis' National Actuarial Practice does not think that this change is as bad as others have feared. When FAS No. 106 retiree medical accounting was first adopted, a large percentage of employers did not amortize their liabilities, but instead immediately expensed the entire amounts. So, many employers' financial statements have no undisclosed liabilities. In addition, the investment community was generally on board with the accounting change so there was relatively little negative impact from investors. Many expect the same to happen this time.

DCAP Grace Period Reporting

Last year the IRS issued Notice 2005-61, clarifying the Form W-2 reporting requirements that apply when an employer adopts a grace period for a Dependent Care Assistance Program (DCAP). Employers may rely on this new tax guidance if the actual total cash reimbursement amount is indefinite when preparing Form W-2. Notice 2005-61 provides that the amount of the employee's DCAP salary reductions for the year (plus any employer matching contributions) will be considered a "reasonable estimate." According to the Notice, employers that add a grace period to their DCAP may report the employee's DCAP salary reduction plus matching contributions in box 10 of Form W-2.

Example: John is an Acme employee. Acme maintains a cafeteria plan that has been amended to give participants a two and one half-month grace period. John elects DCAP salary reduction contributions of \$5,000 for both 2005 and 2006 under Acme's cafeteria plan. At

the end of 2005, John has a \$500 remaining balance.

John subsequently incurs \$500 of DCAP expenses during the two and one half-month grace period, and those expenses are applied to exhaust his remaining year 2005 balance. For reporting purposes, the IRS now allows John's employer to report \$5,000 in box 10 of Form W-2 for both the 2005 and 2006 calendar years. The \$500 from year 2005 that was actually reimbursed during 2006 would, for reporting purposes, remain under the 2005 Form W-2.

Benefit experts note that the IRS has not commented on how to account for DCAP grace period balances when conducting nondiscrimination testing on the dependent care plan. A copy of Notice 2005-61 is available at <http://www.irs.gov/pub/irs-drop/n-05-61.pdf>.

Form 5500 Relief for Hurricane Katrina Victims

The Employee Benefits Security Administration (EBSA) has further extended the deadline for filing the Annual Report (Form 5500) for plan administrators, employers and other entities in areas affected by Hurricane Katrina. The new deadline is August 28, 2006. The current news release does not specifically describe filing dates, but it would make sense to apply it to Forms 5500 required to be completed between August 29, 2005 and August 28, 2006.

This affects filers in the 11 counties in Alabama, 31 parishes in Louisiana and 49 counties in Mississippi listed in IRS guidance published on February 17, 2006. It also applies to entities who are located outside of the affected areas, but who have been unable to obtain information required for the Form 5500 from service providers, banks or insurance carriers with operations located in certain areas affected by Hurricane Katrina.

Extended relief does not apply to counties in Florida — even if they may have been affected by Hurricane Katrina — nor does it apply to areas that were affected only by Hurricanes Wilma or Rita. Areas noted in the published guidance are:

- Alabama Counties: Baldwin, Choctaw, Clarke, Greene, Hale, Marengo, Mobile, Pickens, Sumter, Tuscaloosa, Washington
- Louisiana Parishes: Acadia, Ascension, Assumption, Calcasieu, Cameron, East Baton Rouge, East Feliciana, Iberia, Iberville, Jefferson, Jefferson Davis, Lafayette, Lafourche, Livingston, Orleans, Plaquemines, Pointe Coupee, St. Bernard, St. Charles, St. Helena, St. James, St. John the Baptist, St. Mary, St. Martin, St. Tammany, Tangipahoa, Terrebonne, Vermilion, Washington, West Baton Rouge, West Feliciana
- Mississippi Counties: Adams, Amite, Attala, Claiborne, Choctaw, Clarke, Copiah, Covington, Franklin, Forrest, George, Greene, Hancock, Harrison, Hinds, Holmes, Humphreys, Jackson, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lamar, Lauderdale, Lawrence, Leake, Lincoln, Lowndes, Madison, Marion, Neshoba, Newton, Noxubee, Oktibbeha, Pearl River, Perry, Pike, Rankin, Scott, Simpson, Smith, Stone, Walthall, Warren, Wayne, Wilkinson, Winston, Yazoo

According to the EBSA news release, Form 5500 filers using this extension should check Form 5500, part I, box D and attach a statement labeled "Form 5500, Box D – Hurricane Katrina Disaster Relief Extension." Similarly, Form 5500 EZ filers should check Form 5500 EZ, part I, box B, and attach a statement labeled "Form 5500 EZ, Box B – Hurricane Katrina Disaster Relief Extension."

Filers with questions about their Form 5500 may contact the EFAST Help Line at (866) 463-3278.

HSA Opponents Losing Steam?

A legislative tracking journal, *The Hill*, recently published a series of articles assessing the future of Health Savings Accounts (HSAs). Of particular interest in the series were observations about HSAs as expressed by a number of Washington's most powerful lobbying organizations. According to the report, Congressional Democrats who may oppose President Bush's plan to implement health savings accounts (HSAs) are not likely to get much help from AARP. Although the AARP teamed up with Democrats to resist the President's proposals to overhaul Social Security, the AARP appears less certain about opposing HSAs.

AARP has stated that while they regarded President Bush's Social Security initiative as a direct threat, HSAs do not pose a similar threat to Medicare. In addition, Democrats themselves are not as united against HSAs as they were against Bush's Social Security plans — leaving room for a Republican majority to expand HSAs and provide additional tax incentives for their use.

401(k) Money Surpasses Pension Totals

According to new research data, money in 401(k) plans now exceeds the total in traditional pension plans. Some experts note that this development represents a dramatic change that will force younger workers to plan more carefully for retirement. A study conducted by the Center for Retirement Research at Boston College and reported in the *Boston Globe* show that the value of large 401(k) and similar plans actually surpassed pension totals back in 2002 — but the shift is only now emerging in government statistics.

Even as the value of all retirement plans fell sharply earlier this decade, the overall value of 401(k) plans stabilized at \$1.60 trillion in 2002 — slightly more than the \$1.56 trillion total value then held in traditional pension programs. Both figures reflect plans covering at least 100 people. The gap widened the following year when the value of 401(k) and other defined contribution plans rose to just over \$2 trillion — topping the \$1.95 trillion held in traditional pension plans.

Pension plans have historically been offered by mid-sized and large employers; smaller U.S. companies have for years primarily offered defined contribution plans. In the past decade, the distinction became especially evident as many large employers added defined contribution plans while the number of traditional pension plans declined.

Baby Boomers Back Out

The Bureau of Labor Statistics reported that senior citizens are leaving the labor force sooner than they did five decades ago despite living longer, healthier lives. The report noted that many of the first baby boomers are turning 60 this year, and a majority of them have already left the labor force — surprising to many who assumed seniors would work past age 65.

Some analysts note that the early departure of seniors from the workforce could be attributed partially to the increase in private pension plans, Social Security benefits, and increases in Medicare programs — though the recent trend has been for fewer employers to sponsor pension plans. In fact, the bureau seems to have acknowledged this point when it indicated that seniors leaving the workforce now could return later on in life as companies eliminate or reduce their guaranteed pension plans, and Social Security and Medicare benefits begin facing deficits. Fewer than 20 percent of men aged 65 and older are

still in the labor force, and older Americans are better educated than previous generations, according to the report.

Defined Benefit Pensions — A Dinosaur?

Over the last few years the media has actively reported the growing number of financially troubled companies freezing their defined-benefit pension plans. In a somewhat counter-intuitive twist, some economic analysts are concerned that this number includes many large and healthy corporations at the top of their fields. The publication *Employee Benefits Advisor* reports that businesses freezing their pensions do so for several reasons including competitive pressure from newer companies that never offered a defined-benefit plan.

Companies that consider a freeze should undertake a thorough examination of the possible results to determine whether the move will have the effects they expect. Employees should be surveyed to gauge possible reactions. Companies also have the option of terminating the plan altogether or merely closing it to new hires. If a company decides to go ahead with a freeze, it is legally required to notify its employees 45 days in advance. Most experts suggest that plan sponsors begin the communication process much sooner to prepare employees for other retirement-financing options.

FSA Grace Period Issues

The new two and one half-month grace period for flexible spending account (FSA) expenses raises important administrative implications. Some employers have asked about the potential administrative difficulties generated as a result of the IRS rule authorizing employers to adopt an FSA grace period.

Background

The use-it-or-lose-it rule provides that FSA balances that are not used by the end of the applicable plan year are forfeited. For plans that choose to offer grace periods, only account balances remaining at the end of those two and one half-months are subject to forfeiture. Because this extension is advantageous to employees and may spur interest in FSA participation, many cafeteria plan sponsors are interested in adopting it. However, they need to be aware of certain issues before deciding whether to add a grace period to their plans. Plan sponsors should also note that they were required to add the two and one half-month extension to their plan documents before December 31, 2005 if it was to be available in January, February and the first half of March 2006.

Effect on Claims Administration

Adopting a grace period will complicate FSA claims administration. Administrative systems must be modified to track account balances and ensure that expenses are appropriately reimbursed. Safeguards must be implemented so that the same expense is not reimbursed in two different years. There also may be COBRA and HIPAA issues that the IRS needs to address.

As illustrated below, because timing issues may affect employees in unintended ways, it may be necessary to develop a “sequence rule” for claims payments and communicate it clearly to employees.

Example: An employee elects to participate in a health FSA in both 2005 and 2006. In 2005 he buys a pair of glasses for \$100. He does not submit a claim for reimbursement for the glasses during 2005 and his health FSA account balance at the end of the year is \$100. In January 2006, before submitting a claim for the glasses, the employee (or third party through automatic processing)

submits \$100 of expenses incurred in January 2006 for reimbursement. The administrator incorrectly pays that claim from the 2005 health FSA. As a result, when the employee finally submits a claim for the glasses later in 2006 (e.g. before March 15, 2006), there are no funds left in the 2005 health FSA. Because the 2006 health FSA cannot be used for items purchased in 2005, he cannot receive reimbursement for the glasses.

Many health FSA participants wait until the run-out period following the close of the plan year to submit claims incurred during that year. Employers may want to advise employees to submit all previously incurred claims before the end of the plan year, or as soon as possible thereafter, to avoid the situation described above.

Health FSAs: When Are Expenses Incurred?

Does the IRS require a cafeteria plan to base the reimbursement period for health care flexible spending accounts (FSAs) on the date that the service was performed? Or, is it acceptable to allow the term “incurred” to be interpreted as when the expense was actually billed and/or paid? The IRS is clear on the matter.

According to Internal Revenue Proposed Regulations Section 1.125-2, Q&A 7(b)(6), medical expenses reimbursed under an FSA must be incurred during the participant’s period of coverage under the FSA. Expenses are treated as having been incurred when the participant is provided with the medical care that gives rise to the medical expenses, and not when the participant is formally billed or charged for, or pays for, the medical care.

The IRS insists on this strict interpretation to ensure that the cafeteria plan can in no way be considered a vehicle to defer participant income. We have seen the IRS stick to this position in audit after audit.

What about orthodontia?

In light of the general IRS rule, reimbursing medical FSA participants for their orthodontic expenses has long caused concerns for plan administrators. Orthodontists may be giving patients the option of paying a single discounted sum for an entire course of treatment, or pay a substantial amount at the onset of treatment followed by monthly payments over the course of treatment. Some plans treat the entire expense as “incurred” when the bill for the entire cost is presented to the participant and such plans reimburse the entire amount at once. Others use what amounts to a “cash disbursements” method of determining accrual — thereby reimbursing only for amounts actually paid.

Although the IRS has not formally issued rules to clarify this uncertainty it did issue a nonbinding Chief Counsel’s information letter about ten years ago that recognized the unique nature of orthodontia financing. The IRS said that reimbursable expenses must relate to medical care actually provided during a particular coverage period, and not to when the participant is formally billed or charged for or pays for medical care. In the case of orthodontic expenses however, it may be reasonable for the participant to be reimbursed for the full amount of the expenses actually paid. The IRS further says that it would not be unreasonable for an administrator to request a break-down of the bill and to reimburse only those expenses for which orthodontic services have been provided. In any case, the IRS indicated that the choice of reimbursement methods is up to the plan sponsor.

Harry Beker, the IRS Associate Chief Counsel responsible for regulation of cafeteria plans, has expressed his informal personal opinion that the entire amount paid by the participant at the beginning of orthodontic treatment should be reimbursable, assuming proper substantiation and a sufficient account balance. Many employers feel confident to reimburse orthodontic expenses under authority of Beker’s

statements and the IRS information letter. Other, more conservative employers may prefer to hold to traditional reimbursement principles until the IRS actually modifies the proposed regulations to provide a specific exception to Reg. 1.125-2, Q&A 7(b)(6) for orthodontic expenses. In our view, the question remains unsettled, and employers should proceed with care (and advice of tax counsel).

DOJ Limits HIPAA Criminal Enforcement

Many employers expressed concern over potential civil and criminal penalties when the privacy rule of the *Health Insurance Portability and Accountability Act of 1996* (HIPAA) became effective. The Office of Civil Rights is in charge of civil enforcement. While it may assess civil money penalties up to \$100 per violation (capped annually at \$25,000 for violations of an identical requirement) its favored approach continues to be primarily one of assisting covered entities with compliance efforts.

Perhaps of greater concern are criminal penalties for “a person who knowingly and in violation” of HIPAA’s administrative standards uses a unique health identifier or obtains or discloses individually identifiable health information. Criminal liability cases are subject to Department of Justice jurisdiction. Penalties range from a \$50,000 fine and up to one year imprisonment for lesser violations to a maximum \$250,000 fine and up to ten years imprisonment for violations with intent to sell, transfer or use the information for commercial advantage, personal gain or malicious harm.

Since You Asked: TPA’s Stolen PHI; Shared Responsibility?

A large employer recently contacted us with an interesting *Health Insurance Portability and Accountability Act of 1996* (HIPAA) privacy question. The employer described the following situation. “We received a letter from our Third Party Administrator (TPA) explaining that one of their laptop computers had been stolen. That laptop contained information regarding participants in the employer’s health plan including employees’ first and last names, claim dollar amounts and ICD9 (diagnosis) codes. Do the HIPAA privacy and security regulations require us to notify the individuals whose information was on that laptop?”

Analysis

Clearly, what was lost did constitute Protected Health Information (PHI), and because this employer sponsored a self-funded plan, the organization has some obligations. There is no direct requirement, however, to inform individuals whose information may have been disclosed as a result of the theft. There are two requirements under the privacy rule that probably are triggered by the theft.

- The plan is required, to the extent practicable, to mitigate any known harmful effect of a “disclosure of [PHI] in violation of its policies and procedures or the requirements of [the privacy rule].” Although this was a theft, a disclosure that violated the privacy rule clearly occurred. If the individuals whose information was lost could take action to protect themselves from adverse effects if they knew about the disclosure of their PHI, the plan might be required to notify the individuals about the theft.
- The theft is an accountable disclosure. This means that the plan must make a record of the disclosure for each individual whose information was lost and, when and if requested by the individual, provide a copy of that record to the individual as part of an accounting of disclosures. The record must include:
 - o The date of the disclosure
 - o The name (and, if known, the address) of the person or entity who received the PHI

- o A brief statement of the PHI disclosed
- o A brief statement of the purpose of the disclosure

In addition, as part of maintaining reasonable safeguards for PHI, the employer might want to follow up with the vendor to see if it has implemented measures to prevent such thefts in the future.

If the plan is currently subject to the security rule, this theft is also a security incident. (The latest date on which plans become subject to the security rule is April 21, 2006.) The security rule also requires the plan to mitigate, to the extent practicable, harmful effects of security incidents that are known to the covered entity and to document security incidents and their outcomes. In general, this would include determining how the theft occurred and making sure that measures were taken to correct any deficiencies. Like the privacy rule, there is no direct requirement to report the theft to the individuals whose information was on the computer.

It should be noted that if the plan were a shortcut plan — fully-insured and receiving no PHI (subject to limited exceptions) — then the employer would not need to do anything. The insurer would have the responsibility to take whatever actions were required.

U.S. Benefit Office Locations

Anchorage, AK (907) 562-2266	Atlanta, GA (404) 224-5000	Austin, TX (800) 861-9851	Baltimore, MD (410) 527-1200
Birmingham, AL (205) 871-3871	Boise, ID (208) 340-0645	Boston, MA (617) 437-6900	Cary, NC (919) 459-3000
Charlotte, NC (704) 376-9161	Chicago, IL (312) 621-4700	Cleveland, OH (216) 861-9100	Columbus, OH (614) 766-8900
Dallas, TX (972) 385-9800	Denver, CO (303) 218-4020	Detroit, MI (248) 735-7580	Eugene, OR (541) 687-2222
Farmington, CT (860) 284-6137	Florham Park, NJ (973) 410-1022	Ft. Worth, TX (817) 335-2115	Grand Rapids, MI (616) 954-7829
Greenville, SC (864) 232-9999	Houston, TX (713) 625-1023	Jacksonville, FL (904) 355-4600	Knoxville, TN (865) 588-8101
Las Vegas, NV (702) 562-4335	Long Island, NY (516) 941-0260	Los Angeles, CA (213) 607-6300	Louisville, KY (502) 499-1891
Memphis, TN (901) 248-3100	Miami, FL (305) 373-8460	Milwaukee, WI (414) 271-9800	Minneapolis, MN (763) 302-7100
Mobile, AL (251) 433-0441	Mountain View, CA (650) 944-7000	Naples, FL (239) 514-2542	Nashville, TN (615) 872-3700
New Orleans, LA (504) 581-6151	New York, NY (212) 344-8888	Omaha, NE (402) 778-4851	Orlando, FL (407) 805-3005
Philadelphia, PA (610) 964-8700	Phoenix, AZ (602) 787-6000	Pittsburgh, PA (412) 586-1400	Portland, OR (503) 224-4155
Roswell, NM (505) 317-3397	St. Louis, MO (314) 721-8400	San Diego, CA (858) 678-2000	San Francisco, CA (415) 981-0600
San Juan, PR (787) 756-5880	Seattle, WA (206) 386-7400	Spokane, WA (206) 386-7400	Tampa, FL (813) 281-2095
Washington, DC (301) 530-5050	Wilmington, DE (302) 477-9640		

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