Willis

FOCUS On Benefits

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Integrating Medicare's Prescription Drug Benefit

Post-65 retiree prescription drug expenses are generally shared costs — although some plans are fully paid by the sponsor while others require the retirees to pay the full cost. Whatever your approach, sponsors of such coverage will want to consider whether and how to incorporate Medicare Part D. Too, all employers have a new notice requirement even if they do not offer retiree medical coverage.

Medicare Part D is part of the *Medicare Prescription Drug Improvement and Modernization Act of 2003.* It includes a new benefit that will cover a substantial portion of retirees' prescription drug costs. Part D coverage will be provided through private insurers with the cost being paid by the Federal government and those who elect the coverage.

The act encourages sponsors who provide retiree coverage to continue a prescription drug benefit. Congress did not want sponsors to drop their prescription drug benefit because private coverage is typically more comprehensive. However, sponsors will need to evaluate their strategy for retiree benefits in 2006 and beyond. The challenge for most sponsors will be to design their plans to minimize costs, decide on a workable policy, and communicate plan changes and procedures clearly and effectively. Blending these goals into a cohesive program is the task at hand during 2005.

A comprehensive review of all the Medicare Part D requirements and various employer options is beyond the scope of this publication. Willis has separately published *Willis EB Alert #34* which does offer a detailed overview of these rules. Please contact your Willis to request a copy of

this publication. Also, the Centers for Medicare and Medicaid Services (CMS) issued final regulations to implement the Medicare Part D prescription drug benefit which begins in 2006. CMS guidance can be accessed at http://www.cms.hhs.gov/medicarereform/pdbma/employer.asp.\

IRS Clarifies HSA Participation

Health Savings Account (HSA) legislation included an ambiguity which some thought might prevent an individual from funding his or her HSA because his or her spouse was covered under a non-high deductible health plan (HDHP). This was not the result intended and thankfully the IRS has issued guidance clarifying its analysis.

An individual is eligible to contribute to an HSA even if his or her spouse has non-qualifying family coverage — provided the spouse's coverage does not cover the individual. The ruling also clarifies that the low-deductible plan will not affect the spouse's eligibility to make HSA contributions up to his or her annual contribution limit.

The maximum amount that an eligible individual may contribute to an HSA is based on whether the *individual* has self-only or family high-deductible health plan coverage. For 2005, the contribution limit is the lesser of the annual deductible under the HDHP (minimum of $1,000 for self-only coverage and $2,000 for family coverage) or $2,650 for self-only coverage and $5,250 for family coverage.

HSA proponents will be relieved to learn of this IRS ruling. Revenue Ruling 2005-25 is available online at http://www.irs.gov/pub/irs-drop/rr-05-25.pdf

Cost of Canadian Drugs Not Deductible

In IRS Information Letter 2005-0011 (March 14, 2005) the IRS states that the cost of drugs imported by an individual from Canada is not deductible. This fact is determined by Internal Revenue Code Section 213(a) that specifies no deduction is allowed for illegal operations, treatments, or drugs. The IRS notes as support that the Food and Drug Administration has taken the position that it is illegal for individuals to import drugs from other countries. The *Medicare Modernization Act of 2003* permits the government to grant waivers allowing individuals to obtain drugs from Canada legally, once it has been determined that this can be safe and cost-effective. However, the Department of Health and Human Services subsequently concluded that such a program would not lead to significant savings and that it would be difficult and costly to ensure the safety and effectiveness of drugs imported by individuals.

Sponsors of health FSAs, HRAs, and HSAs may be asked to reimburse the cost of prescription drugs that participants have imported from Canada. A similar analysis must be made to determine if such expenses may be reimbursed. Generally, the conclusion is that they are not reimbursable. Plans should consider adopting language that specifically excludes coverage for drugs obtained by participants outside the U.S. and brought into the country. (In some cases, prescription drugs legally purchased and consumed outside of the U.S. may be reimbursable.) For a copy of Information Letter 2005-0011, please visit: http://www.irs.ustreas.gov/pub/irs-wd/05-0011.pdf

DOL Rescues Abandoned Plans

Abandoned plans are individual accounts that are still active but have no plan sponsor. That typically occurs in situations such as when an employer goes out of business and no one terminates the plan (such as a 401(k) plan) before the employer wraps up its other business and shuts down.

The custodians of the plans, such as banks, mutual fund companies and insurers, are left holding the assets. The custodians often do not have the authority to terminate the plans or distribute funds. The participants and beneficiaries are unable to access their plan benefits. Plans assets are then depleted by ongoing administrative costs. Department of Labor proposed rules are intended to correct this situation.

The proposed regulations specify when a plan is abandoned, the procedures for terminating the abandoned plans and distributing assets and who can do so. When a plan has been abandoned the rules call for the appointment of a qualified termination administrator (QTA). The QTA will make the plan abandonment determination and will be responsible for all activities necessary to terminate and dissolve the plan. There are specific procedures that the QTA must follow such as locating and updating plan records, providing notice to the Employee Benefits Security Administration as well as participants and beneficiaries, and calculating and distributing benefits. The rules also establish a fiduciary safe harbor for the investment of rollover distributions for missing participants and relief from fiduciary liabilities and annual reporting requirements. The regulations are proposed to be effective 60 days after they are issued in final form.

Lawsuits Allowed for Unintentional Age Bias

Employees who sue their employers for age discrimination no longer need to prove that the discrimination was intentional. The United States Supreme Court recently ruled that an individual protected by the Age Discrimination in Employment Act (ADEA) may bring a claim against an employer if a policy, practice or employment action has had a disparate impact because of an individual’s age, regardless of the employer’s intent. The disparate impact theory allows plaintiffs to challenge an employer’s neutral practices that have a disproportionately negative impact on persons age 40 and older.

Before the March 30, 2005 ruling, a plaintiff had to produce evidence of discriminatory intent in order to win an age discrimination suit. The recent ruling lowers this burden, but not without granting employers some protection. An employer may defend an ADEA discrimination claim if reasonable factors other than age, such as cost cutting, account for the disparate impact.

As a result of this ruling, employers should review their employment and benefit practices to ensure that they do not adversely impact employees protected by the ADEA.

Use of Deceased Patient’s PHI

After the implementation of *Health Insurance Portability and Accountability Act of 1996* (HIPAA), privacy training, policies and procedures, authorization forms, privacy officials, and the like, most employers are understandably reticent to receive “protected health information” (PHI) much less make it

available for review. However, there are certain circumstances that compel the disclosure of PHI, and a case out of the Pennsylvania courts helps explain why.

In the case of *Creely v. Genesis Health Ventures, Inc.,* 2004 U.S. Dist. LEXIS 25489, Robert Creely claimed that he was not hired because of his race. The director of nursing who interviewed Creely was later terminated by Genesis Health Ventures after he falsified a patient's health record in order to protect an employee. Creely claimed that the director of nursing engaged in a pattern of discrimination against him because of his race. Further, he claimed that this discriminatory behavior was the same type of behavior that ultimately cost the director of nursing his job. To prove his assertion, Creely's attorney sought disclosure of the health records of a deceased patient. However, the attorney for Genesis argued that Genesis could not disclose the record because HIPAA privacy regulations required confidentiality which must be protected even after the death of the patient whose records were at issue.

The court noted that HIPAA's regulations permit disclosure of medical information in the course of judicial proceedings, but that protected health information must be used only for the litigation and the proceeding for which it was requested, and the PHI must be destroyed (or returned) at the end of the litigation. This use of PHI is permitted under HIPAA even if it is not possible to notify the individual whose records will be used, as in the case of a deceased person.

Complaint Process for HIPAA Violations

Complaints of non-compliance under the Health Insurance Portability and Accountability Act (HIPAA) will be administered by the Centers for Medicare and Medicaid Services (CMS). The CMS will handle complaints about violations of the Transaction and Code Sets Rule, the Security Rule, the National Employer Identification Rule, and the National Provider Identification Rule. CMS' approach is to seek voluntary compliance although it does have the right to issue subpoenas and assess penalties.

CMS will only accept complaints for violations that occurred on or after the date the rules were effective. For example, the Security Rule becomes effective April 20, 2005 (April 20, 2006 for small group health plans) and the National Provider Identification Rule is still under development. Complaints regarding non-compliance with the Privacy Rule will continue to be handled by the Office of Civil Rights.

All complaints must be filed in writing. The complaint must:

- describe the acts or omissions believed to be the violation;
- provide contact information; and
- be filed within 180 days of when the complainant knew (or should have known) that the act or omission occurred — unless the time limit is waived by CMS for good cause.

If the complaint is complete and appears to allege a violation of one of the rules, CMS will advise the complainant that the complaint is accepted for further processing. This is not a judgment, just a notice that further investigation will occur. CMS will request additional information if the complaint is insufficient to make a preliminary determination. An individual may withdraw a complaint, but CMS may continue to investigate withdrawn complaints.

A complaint may be filed by using the tool on HHS' Web site at http://www.os.dhhs.gov/ocr/privacyhowtofile.htm or by mailing the information to: The Centers for Medicare and Medicaid Services, HIPAA TCS Enforcement Activities, P.O. Box 8030, Baltimore, MD 21244. The new complaint process begins April 25, 2005.

Employers Press for FMLA Reform

A new report issued by the Employment Policy Foundation estimates that 14.5 percent of employees took FMLA leave last year, and such leaves cost employers $21 billion in lost productivity, continued health benefits, and labor replacement costs.

Employer groups, worried about FMLA rights abuse, have proposed reforms to the federal legislation. Proposals include clarifying the definition of "serious health condition" covered by FMLA, permitting employers to require minimum four-hour increments for FMLA leave and allowing employers to call doctors to verify FMLA claims.

The U.S. Chamber of Commerce, the National Association of Manufacturers, the Society for Human Resource Management and other groups have recommended changes through the Office of Management and Budget. Other groups, like the National Partnership for Women and Families, argue that FMLA has adequate protections for employers and should not be altered.

FMLA reform advocates are looking for clarification of the definition of "serious illness." The Labor Department currently defines a serious health condition as any condition that involves medical treatment and requires absence for more than three days. Employers must account for intermittent FMLA leave in the shortest increment of time that their payroll systems use. The DOL plans to publish a proposed rule this year to address issues raised by the U.S. Supreme Court's decision in *Ragsdale v. Wolverine World Wide*, which held that employers should not be required to provide 12 extra weeks of unpaid leave as a penalty when they fail to give an FMLA notice to an employee. No proposed rules have been released.

Sarbanes-Oxley Backlash and Benefits

According to the *National Law Journal*, the majority of public companies that have just issued their first financial reports in full compliance with the requirements of the 2002 Sarbanes-Oxley Act believe that the costs of compliance outweigh the benefits. This finding is not surprising given the high expenses associated with both internal and external auditing and strained relationships with auditors trying to protect themselves from liability for any unwise decision on the part of the business.

As directed by Section 404 of the Sarbanes-Oxley Act, rules have been adopted that direct companies to subject to the reporting requirements of the Securities Exchange Act of 1934 (other than registered investment companies), to include in their annual reports a report of management on the company's internal control over financial reporting. Among other requirements, the internal control report must include statements of:

- management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company;

- management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year;
- the framework used by management to evaluate the effectiveness of the company's internal control over financial reporting; and
- the registered public accounting firm that audited the company's financial statements included in the annual report has issued an attestation report on management's assessment of the company's internal control over financial reporting.

Sarbanes-Oxley's Section 404 is merely enforcing earlier laws requiring such controls that have been on the books for decades. Before Sarbanes-Oxley, no means was available to monitor whether the internal controls were truly controlling the processes they were set up to control. The costs of documenting compliance with the law are opposed by affected businesses, although advocates of the law say that the true benefit is to stockholders. Regulatory officials have assured businesses that they are open to suggestions for improvement, but reiterate that the benefits of compliance are too important to sacrifice to businesses' convenience.

With many businesses panicking about the high cost and effort of complying with the 2002 Sarbanes-Oxley Act (SOX), compliance-oriented technology has flourished. Companies should be aware that no single automation program is a full solution to the challenges of compliance. First creating a blueprint for compliance and then searching for the software that will help perform necessary tasks is more effective than starting with a search for technology solutions. Because SOX regulates all of a business's information and processes, technology should be able to handle data in a variety of media and automate processes for integrating different forms of information. Businesses should not only be seeking to automate their current processes but should also see SOX compliance as an opportunity to fix outdated or inefficient processes.

Few Are Affected by Overtime Reforms

The *Wall Street Journal* notes that despite a report from the Economic Policy Institute that projected upwards of six million workers would lose overtime pay due to the Bush administration's revision of the Fair Labor Standards Act last year, a recent survey of 400 firms by *Business & Legal Reports* reveals that just 13 percent of respondents have cut their workers' overtime benefits.

The survey also finds that 40 percent of the companies polled actually offered time-and-a-half wages to workers who were not previously eligible for it. However, experts note that some firms are keeping overtime protections in place for all workers in order to uphold morale and avoid litigation — at least for the time being. In particular, banks are watching their labor costs soar as a result of the changes, leading some experts to believe that they will scale back full-time schedules or recruit more part-time and temporary workers to keep costs in check.

2006: Roth 401(k) Hybrid

In 2006, employees may designate salary deferral contributions as Roth contributions. Roth salary deferral contributions are made with after-tax dollars, and investment earnings accumulate on a tax-deferred basis. Roth accounts in a 401(k) plan may be attractive to some because Roth distributions that

meet certain requirements are not taxable — not just the money that went into the plan on an after-tax basis, but also the earnings. This compares to other 401(k) distributions which are fully taxable (unless rolled over to another qualified plan or an IRA).

Plan sponsors are not required to include Roth accounts in their plans. Roth accounts may be added as an option for plan years beginning in 2006. The IRS issued proposed regulations earlier this month that provide guidance for 401(k) plans and also announced that similar rules will apply to Roth accounts in 403(b) plans sponsored by tax exempt organizations and schools.

If available, employees will need to project which approach (or combination) is more advantageous. In the right situation the Roth approach can yield more valuable outcomes. For example, younger workers in a lower initial tax bracket (and a higher tax bracket at retirement) with many future years of compounding earnings may benefit from the Roth approach. Adding more retirement planning choices brings complexity, but the process should become easier as assessment tools are developed.

Another benefit of a Roth account is that upon termination or retirement it can be rolled over into a Roth IRA which, unlike a normal IRA, does not have a required distribution date. Establishing a Roth account in a 401(k) plan gives higher paid employees, who are normally prevented from establishing Roth IRAs due to income limits, the ability to access this estate planning advantage.

In its guidance the IRS includes the following requirements:

- That the employee makes an irrevocable designation when making the election that it is a Roth contribution;
- That the Roth contribution is included in the taxable income of the employee; and
- That the Roth contribution is maintained in a separate account, with specific accounting for the employee's investment in addition to gains and losses.

Roth contributions are fully vested and count towards the annual 401(k) maximum deferral limits. Roth contributions are included in the Average Deferral Percentage nondiscrimination testing and may be matched according to the plan's formula.

The IRS intends to issue final guidance later this year in time for plan sponsors to make decisions for 2006. Plan sponsors interested in establishing Roth accounts should contact their record keepers and payroll companies to determine their ability to handle the administration.

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

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