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EMPLOYEE BENEFITS UPDATE

SELECT COMPLIANCE DEADLINES AND REMINDERS

HSA Contribution Deadline for 2010 is April 15, 2011

The deadline for making 2010 contributions to a health savings account (HSA) is April 15, 2011. Although the dollar limit on HSA contributions is determined monthly, HSA contributions for a taxable year may be made in one or more payments as long as the payments are not made before the beginning of the applicable tax year and not later than the original filing deadline (without extensions) for the individual's federal income tax return for that year (for example, April 15 for calendar year taxpayers).

Annual Funding Notice Deadline is April 30, 2011

All defined benefit plans must provide an annual funding notice to participants, beneficiaries, the Pension Benefit Guaranty Corporation (PBGC), labor organizations representing participants and beneficiaries and, for multiemployer plans, contributing employers. The annual funding notice must be provided within 120 days following the end of the plan year (for example, April 30, 2011, for calendar year plans). Small plans (plans with 100 or fewer participants) generally have until the Form 5500 filing deadline to provide the annual funding notice.

RETIREMENT PLAN DEVELOPMENTS

Department of Labor Delays Effective Date of Service Provider Fee Disclosure Regulations

On February 11, 2011, the Department of Labor (DOL) announced an extension of the deadline to comply with the new service provider fee disclosure regulations under ERISA section 408(b)(2) published July 16, 2010. The regulations require certain service providers to employee benefit plans to disclose information about the services to plan fiduciaries. The information is intended to help fiduciaries assess the reasonableness of the fees being charged for the services and review potential conflicts of interest. The regulations, originally scheduled to apply to contracts or arrangements for services in existence on or after July 16, 2011, will now become effective January 1, 2012. This delay will allow the Employee Benefits Security Administration (EBSA) more time to review comments on the interim final regulations and will also provide additional time for plans and service providers to take the steps necessary to comply. The fee disclosure regulations are discussed in greater detail in the August 2010 Employee Benefits Update.

Internal Revenue Service Issues Guidance on Terminating 403(b) Plans

On February 22, 2011, the Internal Revenue Service (IRS) provided guidance on terminating 403(b) plans. In Revenue Ruling 2011-7, the IRS stated that in order for a 403(b) plan to be considered terminated, all accumulated benefits under the plan must be distributed to all participants and beneficiaries as soon as administratively practicable after termination of the plan. For this purpose, delivery of a fully paid individual life insurance annuity contract, or of an individual certificate evidencing fully paid benefits under a group

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annuity contract, is treated as a distribution. The distributed annuity contract will still be considered a 403(b) contract.

Revenue Ruling 2011-7 also addressed the requirement that, after plan termination, the employer makes no contributions to any other 403(b) plan. The IRS stated that contributions are made to another 403(b) plan only if contributions are made to a 403(b) contract during the period beginning on the date of plan termination and ending 12 months after distribution of all assets from the terminated plan. However, if at all times during this period, fewer than 2% of the employees who were eligible under the terminated 403(b) plan as of the date of plan termination are eligible under another 403(b) plan, then that 403(b) plan is disregarded.

Demutualized Proceeds May Be Used to Benefit All Current Participants

In Advisory Opinion 2011-05A, the DOL found that it would be permissible to use the proceeds of insurance copay demutualizations where a plan is a policyholder for the benefit of all current participants and beneficiaries, not just those who actually contributed to the premium payments for the insurance policy. The DOL also found that the interests of former participants no longer covered under the plan need not be considered. This guidance is consistent with other DOL guidance on this issue.

DOL Discusses Selection of Broker-Dealer

In Advisory Opinion 2011-06A, an asset manager, as a matter of policy, would not execute trades for ERISA-covered plans through a remotely affiliated broker-dealer because of concern that it might result in a prohibited transaction. The parent company of the broker-dealer owned 19.9% of the asset manager's corporate parent and appointed one of the 11 directors to the board of the asset manager's corporate parent.

The DOL concluded that the selection of the broker-dealer would not violate ERISA section 406(a) (principal transactions involving securities) because of the exemption for qualified professional asset managers (QPAM) under Prohibited Transaction Exemption (PTE) 84-14. The exemption under 84-14 is available only if the QPAM is not "related to" the party in interest. The DOL noted that the exemption focuses on ownership interests in the QPAM or the party in interest, but not their affiliates. Thus, the exemption is not affected by ownership interests in a parent company of the QPAM.

However, the DOL declined to determine whether a conflict of interest under ERISA 406(b) was present in this situation. ERISA 406(b) relates to relationships that might affect a fiduciary's best judgment. The DOL noted that, in determining whether other types of common ownership or control relationships between a fiduciary and potential service providers constitutes an interest in the service provider that may affect the fiduciary's best judgment, the fiduciary should consider all the facts and circumstances relating to the nature and extent of the relationship. Further, analysis "should not be confined only to party in interest relationships." This guidance is consistent with other DOL guidance that makes a case for a broad reading of the ERISA section 406(b) prohibition.

IRS Confirms Resolution Procedure for Ineligible 403(b) Plan Sponsors

In the February 11, 2011, edition of *Employee Plan News*, the IRS reiterated its process for resolving situations where a Code section 403(b) program has been adopted or maintained by an ineligible plan sponsor, such as an employer that is not a tax-exempt or educational organization. This "eligibility failure" can be corrected under the Voluntary Correction Program (VCP) of the IRS' Employee Plans Compliance Resolution System (EPCRS). The plan sponsor can file a streamlined submission using Appendix F and Schedule 6 to correct the failure.

DOL Discusses Whether a Domestic Relations Order Issued by a Native American Tribe is a QDRO

In Advisory Opinion 2011-03A, the DOL discussed whether a domestic relations order issued by a federally recognized Native American tribe may be treated as a Qualified Domestic Relations Order (QDRO). The DOL noted that nothing in ERISA requires a domestic relations order to be issued by a state court. The DOL stated that a tribal court order may constitute a judgment, decree, or order made pursuant to a state domestic relations law for purposes of ERISA if it is treated or recognized as such by the law of a state that could issue a valid domestic relations order with respect to the participant and alternate payee in question.

In the situation presented, the domestic relations order was not a QDRO because the law of the applicable state (New Mexico) does not recognize or treat orders of the family court of the Navajo Nation as orders issued pursuant to New Mexico state domestic relations law.

IRS Defines "Readily Tradable" Employer Securities

In Notice 2011-19, the IRS provided guidance on when securities of an employer are readily tradable on an established securities market or readily tradable on an established market for purposes of certain Code provisions relating to employer securities held by employee stock ownership plans (ESOPs). Many ESOP provisions, such as diversification rights, are affected by whether or not employer securities are "readily tradable."

The Notice provides that a security is readily tradable on an established securities market if: (1) the security is traded on a national securities exchange that is registered under section 6 of the Securities Exchange Act of 1934; or (2) the security is both traded on a foreign national securities exchange that is officially recognized, sanctioned or supervised by a governmental authority, and is deemed by the Securities and Exchange Commission (SEC) as having a "ready market" under SEC Rule 15c3-1. A security included on the FTSE Group All-World Index, for example, is deemed to have a ready market under current SEC rules.

HEALTH AND WELFARE PLAN DEVELOPMENTS

Four States Receive Waivers From Restricted Annual Limit Requirement Under PPACA

The Department of Health and Human Services (HHS) granted waivers from the restricted annual limit requirements under the Patient Protection and Affordable Care Act (PPACA) to four states: Florida, New Jersey, Ohio and Tennessee.

PPACA restricts the annual limits that a health plan can impose. For plan years beginning on or after September 23, 2010, but before September 23, 2011, the restricted annual limit may not be less than $750,000. In recognition of the burden these restricted annual limits would place on "limited benefit" or "mini-med" plans, HHS established a waiver program. In general, to receive a waiver, a state, employer, or insurer must show that compliance with PPACA would cause "a significant increase in premiums or a decrease in access to benefits." The waiver program is discussed in greater detail in the October 2010 Employee Benefits Update.

IRS Determines That Lactation Expenses Qualify as Medical Expenses

In Announcement 2011-14, the IRS concluded that breast pumps and supplies that assist lactation qualify as medical care expenses under Code section 213(d). As a result, these items qualify for tax-free reimbursement from a health flexible spending account (FSA), a health reimbursement account (HRA) or a tax-free distribution from an HSA.

DOL Determines Multiple Employer Welfare Arrangement is Not Fully Insured

In Advisory Opinion 2011-01A, the DOL addressed whether the Custom Rail Employer Welfare Trust Fund (CREW) is a fully insured multiple employer welfare arrangement (MEWA) for purposes of ERISA. If a MEWA is not fully insured, any state law that regulates insurance applies to the MEWA to the extent the law is not inconsistent with ERISA. A fully insured MEWA is subject to significantly less state regulation.

The DOL determined that CREW is not fully insured. The DOL stated that to be considered "fully insured" within the meaning of ERISA, all benefits provided by the MEWA must be guaranteed under an insurance policy or contract from an insurer that is licensed or admitted to conduct business under a state's group health insurance laws, and the policy must be regulated under these laws. In this case, CREW had purchased a certificate of insurance from certain underwriters at Lloyd's of London. However, the certificate did not unconditionally guarantee payment of all benefits due to participation in CREW because the underwriter's liability was subject to certain conditions. The certificate issued to CREW was not issued as group health insurance or regulated under the group health insurance laws of a state.

GENERAL DEVELOPMENTS

Regulators Issue Proposed Rules on Incentive-Based Compensation

On February 7, 2011, federal regulators jointly issued proposed rules on incentive-based compensation arrangements under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed rules generally apply to financial institutions with $1 billion or more in assets that maintain incentive-based compensation arrangements for certain covered persons, such as executive officers, directors, and employees.

Key provisions of the proposed rules would:

- Prohibit incentive-based compensation arrangements that encourage covered persons to expose the institution to inappropriate risk by providing the covered person with "excessive" compensation.
- Prohibit covered financial institutions from establishing or maintaining incentive based compensation arrangements for covered persons who encourage inappropriate risks that could lead to a material financial loss.
- Require covered financial institutions to provide disclosures to regulators regarding their incentive-based compensation arrangements for covered persons within 90 days after the end of each fiscal year.
- Require covered financial institutions to maintain policies and procedures appropriate to their size, complexity and use of incentive-based compensation.
- Require the board of directors, or a committee of the board, of covered financial institutions to approve any incentive-based compensation arrangement.
- Require large covered financial institutions (covered financial institutions with total assets of $50 billion or more) to defer at least 50% of the incentive-based compensation paid to executive officers for at least three years.

The proposed rules will be effective six months after publication of the final rule in the Federal Register.

Seventh Circuit Affirms Dismissal of Stock Drop Case

In *Howell v. Motorola, Inc.*, 2011 WL 183966 (7th Cir. 2011), the Seventh Circuit affirmed the district court's finding that a group of 401(k) plan participants failed to establish that Motorola breached its fiduciary duty. The plaintiffs alleged that the plan fiduciaries breached their duties by continuing to make Motorola stock available for investment by plan participants during a stock price decline. The court stated that periodic stock price declines are insufficient to support a claim of breach of fiduciary duty by plan fiduciaries. The court noted that there was no evidence suggesting that Motorola's stock had become so risky that it needed to be withdrawn.

The Seventh Circuit also considered whether the protections under ERISA section 404(c) apply to an employer's investment fund selection for its participant-directed 401(k) plan. ERISA section 404(c) provides fiduciary protection for participant-directed investment choices if certain design and disclosure requirements are met. In *Howell*, the Seventh Circuit noted that the selection of plan investment options and the decision to continue offering a particular investment are fiduciary acts that ERISA 404(c) does not protect. This position is consistent with the DOL's position as to whether ERISA 404(c) protection is available for the selection of investment alternatives made available to participants.

This *Headlines in Employee Benefits Law E-Alert* provides general information and should not be construed as legal advice or a legal opinion. Readers should seek legal counsel concerning specific factual situations confronting them.

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