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August 2008 Employee Benefits Update

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SELECT COMPLIANCE DEADLINES

409A Compliance Deadline Approaching

Nonqualified deferred compensation plans must be amended by Dec. 31, 2008 to comply with Internal Revenue Code (Code) section 409A. Plan sponsors should assess compliance now as the process may be complex and could require obtaining updated participant elections prior to the deadline.

Medicare Part D Deadlines for Calendar Year Plans

All group health plans that offer prescription drug coverage to Medicare-eligible employees (under either an active plan or a retiree plan) must provide the annual creditable coverage disclosure notice to Medicare-eligible participants and dependents, no later than Nov. 15, 2008. The notice has been updated recently and can be accessed at the CMS website.

Also, group health plan sponsors with a calendar year plan year must apply for the Medicare Part D retiree drug subsidy no later than 90 days prior to the beginning of the plan year, or Oct. 2, 2008. A 30-day application extension is available if the extension request is filed by Oct. 2, 2008. The subsidy application and extension should be submitted to the Centers for Medicare and Medicaid Services (CMS) through the Retiree Drug Subsidy Center website.

Form 5500 Filing Deadline for Calendar Year Plans with Extensions

If a plan administrator filed a Form 5558 for a calendar year plan on or before July 31, 2008, the plan's Form 5500 filing deadline is extended to Oct. 15, 2008. Additionally, if the plan sponsor extended its corporate federal income tax return date, the plan may be eligible for an automatic extension until Sept. 15, 2008, if certain criteria are satisfied.

When preparing Form 5500, plan sponsors may become aware of amendments that were not adopted timely. Certain late amendments can be adopted retroactively under the Voluntary Correction Program of the Internal Revenue Service's Employee Plans Compliance Resolution System. An abbreviated correction application permits certain plan sponsors to adopt certain late amendments for the nominal fee of $375 for each year in which failure to adopt occurred.

Cycle C Determination Letter Filings Due Jan. 31, 2009

Remedial Amendment Period Cycle C individually designed plans must be submitted for a favorable IRS determination letter no later than Jan. 31, 2009 to rely on the extended period during which qualification amendments may be retroactively adopted. Cycle C plans include those sponsored by employers with tax identification numbers (EINs) ending in a three or eight, as well as governmental plans.

2007 Plan Year Contributions for Defined Benefit Plans

Sept. 15, 2008 is the last day on which a 2007 plan year contribution can be made to a calendar year defined benefit plan.

RETIREMENT PLAN DEVELOPMENTS

Plan Assets Cannot be Used to Promote Union Activities or Goals

The Department of Labor (DOL) held in DOL Advisory Opinion 2008 05A that plan assets cannot be used to promote union activities or goals. The Advisory Opinion focused on whether ERISA plan assets could be used to "promote union organizing, campaigning and union goals in collective bargaining negotiations." Under ERISA, fiduciaries must act prudently and solely for the exclusive benefit of participants and beneficiaries, while defraying the reasonable plan expenses. The DOL stated that it has a longstanding position from subordinating the participants' and beneficiaries' interests to unrelated objectives and cited the DOL Advisory Opinion 2007 07A where it held that plan assets could not be expended to garner support for proxy resolutions.

The DOL further stated that a fiduciary cannot "increase expenses, sacrifice investment returns, or reduce the security of plan benefits in order to promote collateral goals" and can only "consider factors relating to the interests of plan participants and beneficiaries in their retirement income." Because promoting unionization and collective bargaining objectives are collateral to participants' and beneficiaries' interests in retirement income, the DOL stated that plan assets could not be spent to further the union's objectives and goals. In addition, the DOL noted that such use of plan assets may also be considered a prohibited transfer of assets with a party in interest or an act of self-dealing.

Proposed Fee Disclosures for Participant-Directed Accounts

The DOL recently issued proposed regulations that would require participant-directed individual account ERISA plans to disclose certain plan and investment-related information to participants. *Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans*, 73 Fed. Reg. 142 (proposed July 23, 2008) (to be codified at 29 C.F.R. pt. 2550). These are the third set of regulations promulgated by the DOL in its effort to increase fee transparency and to better educate plan participants about their retirement plans. These proposed regulations are scheduled to take effect for plan years beginning on or after Jan. 1, 2009.

Under the regulations' plan-related information disclosure requirement, a plan would need to disclose general plan information and information relating to plan administrative expenses and individual participant expenses. The plan would need to disclose general plan information to a participant on or before the date the participant becomes eligible for the plan and annually thereafter. The required general plan information is the same as that required under Code section 404(c), which includes: how a participant can give investment instructions and any limitations on those instructions, how to exercise voting, tender or other rights and the applicable restrictions on those rights, the specific designated investment alternatives under the plan and the identity of the investment managers to whom the investment instructions should be given. As part of the regulations, the DOL will mirror these disclosure requirements with the 404(c) disclosures to prevent needing to comply with two separate, but similar, disclosure requirements.

Information relating to general plan administrative expenses must be given to participants on or prior to the date they become eligible to participate in the plan and annually thereafter. Plan administrative expense information can be disclosed in the summary plan description. To meet this disclosure requirement, a plan must explain the basis on which the plan's administrative expenses, such as legal and accounting fees, will impact the participant's individual account balance. The plan must also give each participant a quarterly statement of the plan administrative expenses charged to the participant's account, which can be included in the participant's quarterly benefit statement. The statement must contain a general description of the services rendered. The expense amount charged to the account can be provided on a summary basis, as opposed to a service-by-service breakdown.

The plan must also disclose the individual account fees that it can charge for certain services, such as the processing of a loan or Qualified Domestic Relations

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Order (QDRO). Individual account expense explanations must be disclosed on or prior to plan eligibility and annually thereafter, and can be included in the summary plan description. In addition, the plan must disclose the actual individual fees charged to the individual's account on a quarterly basis, which can be included in the quarterly benefit statement.

In addition to disclosing general plan information, the plan must also automatically disclose certain plan investment-related information. The regulations require that the information be disclosed in a chart or similar type of format, on or before the participant becomes eligible to participate in the plan, and annually thereafter. The DOL provided a model chart format. The following investment-related information must be disclosed: the name and type of investment (e.g., money market, fixed income), the Web site where additional information regarding the investment can be obtained, the average annual total return for one-, five- and ten-year periods, the same return data for a appropriate benchmark, and the fees and expenses of owning the investment. The preamble to the regulation states that the investment-related information disclosure can be met by providing the participant with the investment's most recent annual report. The plan must also provide certain information, such as prospectuses, to participants upon request.

The duty to prudently select and monitor investments still remains despite these proposed regulations. Written comments to the DOL on the proposed regulations must be received by Sept. 8, 2008.

Second Circuit Holds Cash Balance Plan is Not Age Discriminatory

The Second Circuit joined the Seventh, Third and Sixth Circuits in holding in two cases heard in tandem that the crediting mechanism of cash balance plans is not inherently age discriminatory. *Hirt v. Equitable Retirement Plan for Employers, Managers and Agents*, 2008 WL 2669346 (2d Cir. 2008); *Bryerton v. Verizon Communications, Inc.*, 2008 WL 2669346 (2d Cir. 2008). The Second Circuit adopted the position held by the Seventh, Third and Sixth Circuits and ruled that the phrase "rate of benefit accrual" in ERISA section 204(b)(1)(H)(i) refers to the employer's contributions to the plan and that any difference in a participant's benefits relating to time and interest compounding does not violate ERISA.

IRS Issues Final Regulations on Mortality Assumptions

The IRS issued final regulations containing the mortality assumptions for determining the funding target for single employer defined benefit plans and determining the current liability of multiemployer defined benefit plans. Treas. Reg. § 1.430(b)(3) 1; Treas. Reg. § 1.431(c)(6) 1. The final regulations are very similar to the proposed regulations issued on May 29, 2007. The mortality tables are based on the RP 2000 Mortality Tables, and include both static and generational tables. The mortality tables are also gender-specific and include annuitant and nonannuitant tables due to the different life expectancies for annuitants and nonannuitants. The final regulations also allow the use of substitute mortality tables, subject to the approval of the IRS. Treas. Reg. § 1.430(h)(3)-2.

The final regulations apply to plan years beginning on or after Jan. 1, 2008, while the regulations relating to the use of substitute mortality tables apply to plan years beginning on or after Jan. 1, 2009. Only single-employer defined benefit plans can use substitute mortality tables. Single employer plans that wish to use substitute mortality tables must request approval to use their proposed substitute mortality tables at least seven months prior to the beginning of the plan year for which they are proposing to use the substitute tables.

Former Participants Have Standing to Sue

The First and Fourth Circuits recently held that former defined contribution plan participants had standing to sue under ERISA section 502(a)(2), despite not having a current account balance. *Evans v. Akers*, 2008 WL 2780607 (1st Cir. 2008); *In re Mutual Funds Investment Litigation*, 529 F.3d 207 (4th Cir. 2008). In *Evans*, the plaintiffs alleged that the fiduciaries of the W.R. Grace & Co. Savings and Investment Plan breached their fiduciary duties when they imprudently kept the Grace company stock fund as an investment option under the plan. The plaintiffs maintained that the breach of fiduciary duty reduced the values of their accounts. The plaintiffs in Evans all took lump sum distributions from the plan prior to filing the suit alleging a fiduciary breach under ERISA section 502(a)(2).

Similarly, the plaintiffs in the *Mutual Funds Investment Litigation* alleged a breach of fiduciary duty based on offering as an investment option under the plan mutual funds which were alleged to be involved in market timing, thereby reducing the value of the plaintiffs' accounts. In this case, the plaintiffs had also cashed out their accounts prior to filing their lawsuit. The district courts in both cases held that the plaintiffs did not have standing to bring their claims, on the basis that they were not "participants" because they were seeking monetary damages and not additional plan benefits, as required under ERISA section 409.

Both appellate courts concluded that the plaintiffs were participants as defined under ERISA section 3(7) because defined contribution plan participants are entitled to the entire value of their accounts, which includes the lost amounts due to the alleged fiduciary breaches. A "participant" under ERISA can be a "former employee ... who is or may become eligible to receive a benefit." The courts reasoned that under the analysis of *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, the plaintiffs are participants because they have a "colorable claim that [they] will prevail in a suit for benefits" because they are entitled to the complete value of their accounts. In further support of their holdings, each court cited the LaRue v. DeWolff, Boberg & Assocs., Inc., 128 S. Ct. 1020, 1023 n.1 (2008) for the proposition that a cashed-out employee is able to sue his former employer for a fiduciary breach that caused a loss to his or her individual plan account.

The court dismissed various arguments made by the plans, including the argument that a loss due to a breach of fiduciary duty was not redressable. The courts held that this type of injury is redressable because the recovery would be allocated to each of the injured accounts. The First Circuit also held that the damages were not too speculative because they could be estimated by experts using a prudently invested portfolio.

SEC and DOL Agree to Share Information

On July 29, 2008 the DOL and the U.S. Securities and Exchange Commission signed a memorandum of understanding concerning the cooperation between the two agencies. Both agencies acknowledged that they have matters of mutual interest in retirements and investments. Under the memorandum, the agencies agreed to meet regularly to discuss examination results, enforcements cases, and other matters of interest. Each agency's regional office will have a designated contact person to facilitate inter-agency communication and the agencies will periodically cross-train to learn more about the other agency's roles. The SEC granted the DOL standing access to nonpublic, relevant examination results, and the DOL agreed to keep this information confidential. The DOL and SEC also agreed to share nonpublic enforcement information regarding investment advisers and other firms.

Pay 2008 PBGC Premium Filings Online

The Pension Benefit Guaranty Corporation recently announced that entities can pay comprehensive and estimated flat-rate filings online at My Plan Administration Account, which can be accessed at https://egov2.pbgc.gov/mypaa.

HEALTH AND WELFARE PLAN DEVELOPMENTS

First Fines Imposed Under HIPAA

The Department of Health and Human Services (HHS), the governmental agency responsible for enforcing the Health Insurance Portability & Accountability Act of 1996 (HIPAA), entered into a corrective action plan with Providence Health & Services (Providence), an integrated health system, and fined Providence $100,000 for several violations of the HIPAA Security Rules. This is the first instance of HHS imposing a fine for a HIPAA violation.

HIPAA requires that covered entities maintain policies and procedures to ensure the safety of protected health information (PHI). In the Providence case, the unencrypted electronic PHI of 386,000 patients contained on laptops and electronic storage devices was compromised because an employee's car containing the information was broken into and the items containing the PHI were stolen. HHS determined that the breach was caused by Providence's failure to implement security policies and procedures regarding the security of PHI. An HHS representative stated that compliance with the HIPAA Security Rules requires more than just implementing policies and procedures, it requires security staffing, training and adequate physical safeguards. HHS's actions should alert covered entities to review their current compliance with the HIPAA Security Rules, including analyzing their policies and procedures and monitoring efforts.

OTHER DEVELOPMENTS

Department of Labor Published Additional Guidance on Form 5500 Fee Reporting Rules

On July 14, 2008, the DOL released guidance in the form of answers to 40 frequently asked questions (FAQs), regarding the form revisions and final regulations issued in November 2007 for reporting service provider fees on Schedule C of the 2009 Form 5500 Annual Return/Report of Employee Benefit Plan. Under the 2009 Schedule C, each service provider who receives $5,000 or more in direct or indirect compensation must be identified and a description of the services to the plan must be provided. The amount of direct compensation paid to the service provider and any indirect compensation paid, that is not eligible indirect compensation paid, must also be disclosed. "Eligible indirect compensation" is defined in the instructions to Schedule C as "fees or expense reimbursement payments charged to investment funds and reflected in the value of the investment or return on investment of the participating plan or its participants." Some examples of eligible indirect compensation are finders' fees, soft dollar revenue, float revenue and other transaction-based fees that are not paid directly by the plan or plan sponsor. If the service provider received eligible indirect compensation, the service provider may be subject to an alternative reporting option, which only requires the listing of the service provider's name if the service provider gives the plan certain fee disclosures. Schedule C also requires that the plan indicate any service providers who do not provide the required information.

The DOL recognizes that these new fee disclosure reporting requirements may cause changes to the service provider's information and record-keeping systems, and may be difficult for service providers to implement. Because of the potential ramifications, the DOL stated that the plan administrator does not need to identify a service provider who fails to provide the required information if the plan administrator receives a statement from the service provider that the service provider made a good faith effort to make changes to its information systems to comply with the new reporting requirements and it was unable to do so for the 2009 plan year.

The FAQs clarify that investment funds, such as mutual funds, bank common and collective trusts, and insurance company pooled separate accounts, do not need to include normal operating expenses, including attorneys', accountants' and printers' fees charged against the fund as indirect compensation. The FAQs also indicate that bundled services generally do not need to be separately reported. The DOL also stated that service providers are allowed to report their fees in a formula format. In addition, under the alternative reporting option, the plan administrator must review a service provider's disclosures on an annual basis and maintain adequate documentation relating to its review of the disclosures. Service providers can also make their disclosures to plan administrators electronically.