Reinhart

February 2009 Employee Benefits Update

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SELECT COMPLIANCE DEADLINES AND REMINDERS

Deadline for Making Corrective Distributions of Failed ADP/ACP Tests Without Excise Tax is March 15, 2009 for Calendar-Year Plans

Sponsors of calendar-year plans that failed the actual deferral percentage (ADP) test and/or actual contribution percentage (ACP) test for 2008 generally must make any corrective distributions by March 15, 2009 (*i.e.*, 2 ½ months after the end of the plan year) to avoid a 10% excise tax. Plans that include an eligible automatic contribution arrangement (EACA) may make ADP and/or ACP corrective distributions up to six months after the end of the plan year without incurring the 10% excise tax. Effective for plan years beginning on or after January 1, 2008, gap-period income (*i.e.*, gains and losses from the end of the plan year to the actual date of distribution) is not required with ADP and/or ACP corrective distributions. In addition, effective for plan years beginning on or after January 1, 2008, participants are taxed on their ADP and/or ACP corrective distributions in the year the distributions are made, and not the year of deferral.

Annual Actuarial Certification of Multiemployer Plan Status is Due by March 31, 2009 for Calendar-Year Plans

Effective for plan years beginning after 2007, the Pension Protection Act of 2006 (PPA) requires actuaries of multiemployer plans to certify to the Internal Revenue Service (IRS) and to the plan sponsor: (1) whether or not the plan is in endangered status or critical status for that plan year; and (2) for a plan that is in a funding improvement or rehabilitation period, whether or not the plan is making scheduled progress toward meeting the requirements of its funding improvement or rehabilitation plan. This certification is due no later than the 90th day of each plan year (*i.e.*, March 31, 2009 for calendar-year plans). As noted in Reinhart's January 2009 Employee Benefits Update, the Worker, Retiree and Employer Recovery Act of 2008 (the Recovery Act) provides that, for the first plan year beginning on or after October 1, 2008, a multiemployer plan sponsor may elect to treat the plan's funded status the same as the plan's status for the preceding plan year.

Notice of Availability of HIPAA Privacy Notice is Due by April 14, 2009 for Large Health Plans

The HIPAA Privacy Rules require covered entities (*i.e.*, health plans, health care clearinghouses and certain health care providers) to provide a notice of privacy practices to each individual who is the subject of protected health information (PHI). Specifically, health plans must provide plan participants with a HIPAA privacy notice. Among other requirements, the HIPAA privacy notice must explain how the health plan may use and disclose PHI. Large health plans (*i.e.*, health plans with more than $5 million in annual receipts) were required to provide the first HIPAA privacy notice by April 14, 2003. At least once every three years, health plans must notify plan participants of the HIPAA privacy notice's availability and explain how to obtain the notice. Large health plans that have not already satisfied this requirement (*e.g.*, by annually providing the privacy notice with open enrollment materials) will need to comply by April 14, 2009.

Deadline for Distributing Excess Deferrals is April 15, 2009

Any elective deferrals exceeding the Internal Revenue Code (the Code) section 402(g) limit for 2008 ($15,500), plus allocable income, must be distributed to affected participants by April 15, 2009 to avoid double taxation. As noted in Reinhart's January 2009 Employee Benefits Update, the Recovery Act eliminates the requirement to distribute gap-period income with excess deferrals effective for plan years beginning on or after January 1, 2008.

OBAMA ADMINISTRATION DEVELOPMENTS

White House Executive Order on Regulatory Review

The Obama Administration issued an executive order on Inauguration Day outlining the President's plan for managing the regulatory process at the beginning of his Administration. The executive order, which is in the form of a memorandum from the President's Chief of Staff to the heads of executive departments and agencies, outlines a course of action to give the President's appointees and designees "the opportunity to review and approve any new or pending legislation." To highlight, the memorandum makes the following requests on behalf of the President: (1) do not send any proposed or final regulations to the Office of the Federal Register (OFR) for publication unless and until the regulation has been reviewed and approved by a department or agency head appointed or designated by President Obama; (2) withdraw unpublished proposed and final regulations at the OFR so they can be reviewed and approved by a department or agency head appointed or designated by President Obama; and (3) consider extending by 60 days the effective date of any regulations that

have been published in the Federal Register but are not yet effective. Exceptions are provided for regulations affecting urgent health, safety, environmental, financial or national security matters and for regulations subject to statutory or judicial deadlines. The executive order encompasses a number of regulations regarding employee benefits, including the Department of Labor's (DOL's) final regulations on investment advice described below.

RETIREMENT PLAN DEVELOPMENTS

Supreme Court Focuses on Following Plan Document Language in Benefit Waiver Decision

The U.S. Supreme Court ruled unanimously that an ERISA plan administrator has a duty to follow the plan's documents and distribute benefits to a former spouse in accordance with a participant's beneficiary designation, despite the former spouse's waiver of benefits in a divorce settlement. *Kennedy v. Plan Administrator for DuPont Savings and Investment Plan*, 2009 WL 160440 (2009). In the absence of a qualified domestic relations order (QDRO), the Supreme Court's decision directs plan administrators to disburse benefits in accordance with plan documents, without examining the validity of external documents and events. The Kennedy holding also emphasizes the importance of communicating to participants the need for maintaining up-to-date beneficiary designations.

Under the facts of this case, William Kennedy participated in his employer's 401(k) plan. Under the plan's terms, a participant could designate a beneficiary to receive the participant's plan funds upon his or her death, and a participant could revise or revoke a beneficiary designation according to the plan administrator's procedures. William designated his spouse, Liv Kennedy, as his sole plan beneficiary. When William and Liv divorced in 1994, Liv waived her right to plan benefits in their divorce decree. William, however, did not execute a new plan beneficiary designation. After William died in 2001, his daughter asked the plan administrator to pay William's benefits to his estate. The plan administrator relied on William's beneficiary designation and paid William's benefits to Liv instead. William's estate filed a lawsuit for William's plan benefits, claiming that Liv surrendered her rights in the divorce decree.

The Supreme Court granted certiorari to resolve a split among the circuit courts over a divorced spouse's ability to waive retirement plan benefits through a divorce decree not amounting to QDRO. The Supreme Court addressed whether the plan administrator was required to honor Liv's waiver and distribute benefits

to William's estate, even though the waiver was inconsistent with plan documents. The Supreme Court held that the plan administrator complied with ERISA by paying plan benefits to Liv in conformity with plan documents, and thus was not required to honor Liv's waiver.

DOL Issues Final Regulations on Investment Advice Exemption

On January 21, 2009, the DOL issued final regulations allowing employers to provide investment advice to 401(k) plan participants without violating the fiduciary rules of ERISA. The DOL's final regulations retain the general requirements and substance of the proposed regulations, but make some structural and clarifying changes. The proposed regulations are discussed in Reinhart's September 2008 Employee Benefits Update. The final regulations specify an effective date of March 23, 2009. However, because these regulations fall under the Obama Administration's executive order (described above), the DOL has proposed to extend the effective date and reopen the regulations for comments. Representative George Miller (D), Chair of the Education and Labor Committee, announced his intention to block the regulations because they would provide "potentially conflicted investment advice." Additional changes to the regulations are likely. Below is a summary of the regulations in their current status.

Under the PPA, investment advice provided to participants or beneficiaries in individual account plans, such as 401(k) plans, will not be a prohibited transaction if the investment advice is provided on a flat-fee basis (fee-leveling) or based on a computer model audited by a third party. The final regulations implement this PPA change and include a prohibited transaction class exemption (PTE) to provide more comprehensive relief for fiduciary investment advice. Specifically, the PTE provides relief for individualized investment advice following the furnishing of recommendations generated by a computer model. The PTE also applies the fee-leveling limit solely to compensation received by the employee or agent providing the investment advice (*i.e.*, not to total compensation received by the fiduciary adviser). The following paragraphs highlight some of the final regulations' clarifications:

- A plan fiduciary is not obligated under the final regulations to provide investment advice to a participant or beneficiary. In addition, the final regulations do not invalidate or affect prior DOL guidance regarding the provision of investment advice and when such advice may constitute a prohibited transaction under ERISA or the Code.

- Investment management and other fees and expenses attendant to the recommended investments must be taken into consideration by arrangements using fee-leveling or a computer model, as well as arrangements providing advice under the PTE.
- A fiduciary adviser may provide investment advice to its own employees (or employees of an affiliate), provided the fiduciary adviser or affiliate offers the same arrangement to participants and beneficiaries of unaffiliated plans in the ordinary course of its business.
- A fiduciary adviser must annually engage an independent auditor to conduct an audit of the investment advice arrangement. Like the selection of an eligible investment expert to certify a computer model, the selection of an auditor is a fiduciary act.

DOL Issues Final Regulations on Civil Monetary Penalties for Failing to Provide Documents

The DOL issued final regulations on the applicable civil penalties when a plan administrator fails to comply with certain disclosure requirements created by the PPA. The PPA established numerous new disclosure requirements for retirement plan administrators. For example, the PPA requires administrators of automatic contribution arrangements to provide notice of the arrangement to plan participants, and also requires multiemployer pension plan administrators to provide certain documents upon request to a participant, beneficiary, employee representative or contributing employer. The PPA authorizes the DOL to assess a civil penalty of not more than $1,000 per day for violations of the new disclosure requirements. In general, the DOL's final regulations explain how the maximum penalty amounts are computed, identify the circumstances under which a penalty may be assessed, describe procedural rules for service and filing and provide for an administrative hearing process to contest a DOL assessment. The final regulations become effective on March 3, 2009.

PBGC Waives Reporting Requirements for Controlled Groups with Plan Underfunding of $15 Million or Less

The Pension Benefit Guaranty Corporation (PBGC) issued Technical Update 08-3 waiving annual financial and actuarial reporting under ERISA section 4010 in certain cases for controlled groups with aggregate plan underfunding not exceeding $15 million for information years beginning in 2008. ERISA section 4010

requires reporting of financial and actuarial information by controlled groups with pension plans that have funding problems. Among other changes, the PPA amended ERISA section 4010 to revise the trigger for the annual reporting requirements, effective for plan years beginning on or after January 1, 2008. Specifically, the PPA replaced the $50 million trigger of ERISA section 4010 with a trigger requiring reporting if the funding target attainment percentage of any plan maintained by the contributing sponsor or a member of its controlled group is less than 80%. Pending the issuance of final regulations, Technical Update 08-3 provides that, effective for information years beginning in 2008, reporting under ERISA section 4010 is generally waived if, for the plan year ending within the information year, the aggregate funding shortfall for all plans (including any exempt plans) maintained by the controlled group (disregarding plans with no funding shortfall) does not exceed $15 million.

PBGC Issues Guidance for Terminating Plans on Calculating Lump Sum Distributions

The PBGC issued Technical Update 08-4 discussing lump sum valuation issues for single-employer plans that terminate after the effective date of the PPA's changes to Code section 417(e)(3) and make a distribution in a subsequent plan year (*e.g.*, a calendar-year plan that terminates during 2008 and pays lump sums in 2009). For plan years beginning after December 31, 2007, the PPA amended Code section 417(e)(3) to change the applicable interest rate and mortality table for calculating lump sum distributions. The PPA's interest rate under Code section 417(e)(3) is phased in for the 2008 through 2011 plan years, while the mortality table change was immediately effective starting with the 2008 plan year.

Technical Update 08-4 provides that the minimum lump sum value of a participant's accrued benefit is calculated based on the applicable interest rate and mortality table in effect under the plan's terms on the plan's termination date, but the time for determining specific assumptions is based on the actual distribution date. For a plan that terminates in 2008 through 2011, the applicable interest rate is determined based on the phase-in percentage in effect for the plan year in which the lump sum is paid (not for the plan year in which the plan terminates). For a plan with a termination date on or after the first day of the first plan year beginning in 2008, a lump sum is determined based on the applicable mortality table on the plan's termination date, taking into account projected mortality improvements under the table through the plan year containing the distribution date.

PBGC Provides Guidance for 2009 Plan Years on Funding-Related Reportable Events

The PBGC issued Technical Update 09-1 providing guidance on complying with the reportable event requirements of ERISA section 4043 for plan years beginning in 2009. ERISA section 4043(a) requires plan administrators and sponsors to notify the PBGC within 30 days after they know or have reason to know that a reportable event has occurred (post-event reporting). ERISA section 4043(b) requires certain nonpublic companies to notify the PBGC at least 30 days before the effective date of certain reportable events (advance reporting). Certain PBGC reporting requirements are waived based on determinations of unfunded vested benefits (UVBs) under the variable rate premium (VRP) rules. The PBGC's reportable event regulations also provide a "Form 1 extension" of some reporting due dates if funding-based waiver criteria are met for the plan year preceding event year.

The PPA modified how the VRP is determined under ERISA section 4006 (dealing with premium rates), which affects the valuation of UVBs. In March 2008, the PBGC updated its premium rate regulations to reflect changes made by the PPA. However, the PBGC has not yet updated its reportable event regulations to implement the premium-related changes made by the PPA and the PBGC's premium regulations. To assist plan sponsors and administrators, Technical Update 09-1 generally provides that, for purposes of the reportable event requirements, a plan's UVBs and the value of its assets and vested benefits are determined for a plan year beginning in 2009 in the same manner as for premiums for the preceding plan year. It also provides options for applying the "Form 1 extension" for plan years beginning in 2009.

HEALTH AND WELFARE PLAN DEVELOPMENTS

HHS Issues Final Electronic Transaction Standards and Code Sets for HIPAA Compliance

HIPAA includes administrative simplification provisions that mandate nationwide standards for electronic data interchange to reduce inefficiencies and operating costs in the health care industry. The Department of Health and Human Services (HHS) published code sets and standards for electronic transactions in 2000 and modified those rules in 2003. HHS has now finalized updated versions of the code sets and standards, as well as a new standard for Medicaid pharmacy subrogation transactions.

The final regulations replace the code sets in the Ninth Revision of the International Classification of Diseases (ICD-9), which are now used to report health care diagnoses and inpatient hospital procedures, with the expanded ICD-10 code sets. The final updates to the electronic transaction standards are required to support the new code sets and contain structural and technical improvements. Compliance with the updated electronic transaction standards is required by January 1, 2012, although small health plans have an additional year to comply with the new standard for Medicaid pharmacy subrogation transactions. All covered entities, including small health plans, must comply with the new code sets by October 1, 2013. Covered entities may use the current or updated transaction standards when conducting electronic covered transactions between the effective date of the regulations (March 17, 2009) and the compliance date.

Sixth Circuit Addresses Vesting of Retiree Health Benefits

The Sixth Circuit recently decided two cases addressing whether retiree health benefits were vested (or guaranteed) based on plan document language, including collective bargaining agreements (CBAs). These decisions emphasize the need for careful drafting of health plan documents to ensure that they contain specific language regarding the intended duration of retiree health benefits, including a description of the right to terminate, amend or change such benefits.

- *Coe v. ArvinMeritor, Inc*. The Sixth Circuit held that a group of retirees vested in their retiree health benefits because the applicable CBAs did not contain specific durational language referring to retiree benefits. *Coe v. ArvinMeritor, Inc.* 2008 WL 5211802 (6th Cir. 2008). In delivering its holding, the Sixth Circuit noted that, although it has repeatedly cautioned that applicable precedent does not create a legal presumption of vesting of retiree health benefits, a reasonable argument can be made that the court has gone on to apply such a presumption. In this case, the employer and the union entered into a succession of CBAs from the late 1970s through 2003 providing for health coverage for both active and retired employees. Beginning in 2001, the company implemented a number of changes to its retiree health plans, such as eliminating dental, vision and hearing-aid coverage. In 2005, the company announced plans to eliminate all health benefits for retirees, dependents and surviving spouses age 65 and older. The union and a class of retirees filed suit to preserve retiree health benefits. The district court held for the plaintiffs and permanently enjoined the company from changing or eliminating retiree health benefits. On appeal, the Sixth Circuit affirmed the district court. The Sixth

Circuit held that the CBA language stating that the health care coverage an employee has at the time he or she retires or terminates employment at age 65 or older "shall be continued thereafter," unambiguously promises lifetime health benefits. The court also held that the CBAs' general durational language could not trump contractual promises of lifetime retiree health benefits. The court noted that a durational limit must include a specific mention of retiree health benefits in order to apply to such benefits.

- *Winnett v. Caterpillar, Inc*. Addressing when retiree health benefits vest, the Sixth Circuit rejected the argument that a 1988 CBA provided active workers with a right to lifetime retiree health benefits that vested as soon as the workers became eligible for retirement. *Winnett v. Caterpillar, Inc.*, 2009 WL 170598 (6th Cir. 2009). The 1988 CBA provided for no-cost retiree health benefits. After the 1988 CBA expired, the employer implemented caps on the amount the employer would pay for retiree health coverage. Subsequent CBAs imposed more limits on retiree health benefits than the 1988 CBA. The plaintiffs became eligible for retirement or a pension before the 1988 CBA expired, but actually retired after the 1988 CBA's expiration. The plaintiffs filed a lawsuit asking for injunctive relief and an order declaring that they were entitled to the no-cost retiree health benefits described in the 1988 CBA. The district court concluded that the right to retiree health benefits vested when the plaintiffs attained retirement or pension eligibility, even for those who continued working after this date. On appeal, the Sixth Circuit reversed the district court. The Sixth Circuit reviewed the retiree health plan documents, and concluded that the documents' plain language did not vest retiree health benefits while workers remained in active employment and still represented by their union. The court refused to extend an inference of lifetime retiree health benefits to pension-eligible active employees. Of course, the court noted, an employer and a union could agree to provide retiree medical benefits that vest upon retirement or pension-eligibility by writing explicit language into the contract.

OTHER DEVELOPMENTS

IRS Provides Interim Guidance for Nonqualified Deferred Compensation Plans Subject to Code Section 457A

Congress enacted Code section 457A in October 2008 as part of the Emergency Economic Stabilization Act of 2008. Effective January 1, 2009, Code section 457A generally provides that any compensation deferred under a "nonqualified

deferred compensation plan" of a "nonqualified entity" is includible in gross income when there is no substantial risk of forfeiture of the rights to such compensation. Although a primary goal behind Code section 457A's enactment was to address the compensation deferral arrangements of offshore hedge funds, the scope of Code section 457A is broad enough to cover deferred compensation practices of a wide range of foreign corporations and partnerships. The IRS issued Notice 2009-8 (the Notice) providing interim guidance on Code section 457A. Taxpayers may rely on the guidance provided in the Notice, and any future expansion of Code section 457A's scope will be applied on a prospective basis only, according to the IRS. The following paragraphs highlight some key guidance provided in the Notice.

- Nonqualified Deferred Compensation Plan. The term "nonqualified deferred compensation plan" is generally defined in the same way the term is defined under Code section 409A, with special rules for equity appreciation rights and short-term deferrals.

- Nonqualified Entity. The term "nonqualified entity" means: (1) any foreign corporation unless substantially all of its income is: (a) effectively connected with the conduct of a trade or business in the U.S. or (b) subject to a comprehensive foreign income tax; or (2) any partnership unless substantially all of its income is allocated to persons other than: (a) foreign persons whose income is not subject to a comprehensive foreign income tax and (b) organizations that are tax-exempt under the Code. This determination is made as of the last day of each of the service provider's taxable years in which the nonqualified deferred compensation is no longer subject to a substantial risk of forfeiture and remains deferred.

- Substantial Risk of Forfeiture. An individual's right to compensation is subject to a substantial risk of forfeiture only if his or her right to compensation is conditioned upon the future performance of substantial service by the individual. If the deferred amount is "not determinable" at the time it would otherwise be included in income under Code section 457A, it is not taxed until it becomes determinable, with additional taxes and interest applicable at that later time.

- Effective Dates. Code section 457A applies to amounts deferred that are attributable to services performed after December 31, 2008. The Notice provides rules for determining periods of service to which compensation is attributable. Deferred amounts attributable to services performed prior to 2009

will not be subject to Code section 457A if they are included in income in the later of: (1) the last taxable year beginning before January 1, 2018; or (2) the first taxable year in which the amounts are no longer subject to a substantial risk of forfeiture. To avoid the application of Code section 457A, plans may be amended before July 1, 2009 to eliminate any substantial risk of forfeiture service requirement retroactive to December 31, 2008, provided the amendment applies consistently to every service provider participating in that arrangement or a substantially similar arrangement.