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# November 2010 Employee Benefits Update

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## SELECT COMPLIANCE DEADLINES AND REMINDERS

**Deadline for Final Code Section 409A Corrections**

Plan sponsors have until December 31, 2010, to amend their nonqualified deferred compensation plans to comply with Code section 409A before being subject to a penalty. The IRS established a document correction program intended to encourage taxpayers to review nonqualified deferred compensation plans in order to identify provisions that fail to comply with the requirements of Code section 409A and to correct those plan provisions promptly. The correction program, detailed in IRS Notice 2010-6, provides numerous methods for plan sponsors to correct many types of plan document failures causing noncompliance with Code section 409A. Plans corrected in accordance with the methods and deadlines in Notice 2010-6 qualify for limited relief from penalties.

**Deadline to Amend Calendar Year Plans for HEART Act**

Tax-qualified retirement plans must be amended to reflect certain required provisions of the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act) by the last day of the 2010 plan year. For example, qualified retirement plans must be amended to provide that the survivors of participants who died while performing military service are entitled to any benefits (except benefit accruals) that the participant would have received had the participant died while actively employed. In addition, plans must be amended to account for certain differential pay requirements.

**Cycle E Determination Letter Filings Due January 31, 2011**

Remedial amendment period Cycle E individually designed plans must be submitted for a favorable Internal Revenue Service (IRS) determination letter no later than January 31, 2011, to rely on the extended period during which qualification amendments may be retroactively adopted. Cycle E plans include those sponsored by employers with tax identification numbers ending in a five (5) or zero (0).

**401(k) Plan Annual Notices**

As the year end approaches, sponsors of calendar-year 401(k) plans must provide the following annual notices (as applicable):

- Qualified Default Investment Alternative (QDIA). Plans that invest participant contributions in a QDIA because the participant failed to make an investment election must provide an annual notice at least 30 days before the beginning of the plan year.
- Safe Harbor Notice. Plan sponsors of safe harbor 401(k) plans must provide an annual notice to plan participants at least 30 and not more than 90 days prior to the beginning of the plan year. The safe harbor notice must describe the safe harbor contribution and other material plan features. The safe harbor notice can be combined with the QDIA notice.
- Automatic Enrollment Notice. 401(k) plan sponsors of Eligible Automatic Contribution Arrangements (EACA) and Qualified Automatic Contribution Arrangements (QACA) must provide an annual notice at least 30 days and not more than 90 days before the beginning of the plan year to all participants on whose behalf contributions may be automatically contributed to the plan. The Internal Revenue Service (IRS) previously posted a sample notice for these two types of automatic contribution arrangements that can be tailored to each plan. The automatic enrollment notice can be combined with the QDIA notice.

### Deadline Approaching to Allocate Forfeitures Held in Plan Suspense Accounts

Plan forfeitures held in a plan's suspense account must be used or allocated in the plan year the forfeitures incurred. The IRS has made it clear that no forfeitures in a suspense account should remain unallocated beyond the end of the plan year in which they occurred and no forfeiture should be carried into a sequent plan year. If a suspense account is used, plan sponsors must ensure that all forfeitures for the plan year are promptly used according to the plan's terms before the end of the plan year.

## RETIREMENT PLAN DEVELOPMENTS

### IRS Announces 2011 Cost-of-Living and Inflation Adjusted Benefits

On October 28, 2010, the IRS announced cost-of-living adjustments affecting dollar limitations for pension plans and other retirement-related items for tax year 2011. These rates mostly remain the same as those from 2010. A few select limits —all which remain the same—are listed below.

| | 2010 Limits | 2011 Limits |
|---|---|---|
| 401(k) Contributions | $16,500 | $16,500 |
| Catch-Up Contributions | $5,500 | $5,500 |
| Compensation Limit | $245,000 | $245,000 |
| Highly Compensated Employees | $110,000 | $110,000 |
| Key Employee Office Compensation | $160,000 | $160,000 |
| Maximum Annual Contribution | $49,000 | $49,000 |

**PBGC Announces Maximum Insurance Benefit and Premium Rates for 2011**

On October 19, 2010, the Pension Benefit Guaranty Corporation (PBGC) announced that the maximum insurance benefit for participants in underfunded pension plans terminating in 2011 will be $54,000 per year for those who retire at age 65. The amount is higher for those who retire later and lower for those who retire earlier or elect survivor benefits.

The PBGC maximum insurance benefit is indexed to a contribution and benefit base in Social Security law. Because that amount does not increase for 2011, the PBGC maximum insurance benefit is unchanged from 2010. The chart setting the 2011 annual and monthly maximum benefit guarantees for retirees from age 75 to 45.

The PBGC also announced that there will be no increase in the flat-rate premium for plan year 2011. The per-participant flat-rate premium for plan year 2011 will remain $35 for single-employer plans and $9.00 for multiemployer plans.

**Department of Labor (DOL) Issues Final Regulations on Disclosure of Investment Fees and Expenses to Self-Directed Plan Participants**

The DOL issued final regulations under ERISA that require the disclosure of certain plan and investment information, including fee and expense information, to participants and beneficiaries in participant-directed individual account plans (for example, 401(k) plans). According to the regulation, the new rules are intended to ensure that all participants and beneficiaries in participant-directed individual account plans have the information needed to make informed decisions about the management of their individual accounts and the investment of their retirement savings. The regulation also contains conforming changes to the disclosure requirements for plans that elect to comply with the existing ERISA section 404(c) regulations.

While the regulation is effective as of December 20, 2010, the final rules and amendments will not apply to individual account plans until plan years beginning on or after November 1, 2011, or January 1, 2012, for calendar year plans. The preamble to the regulation notes that the regulation will affect plan sponsors, fiduciaries, participants, and beneficiaries of participant-directed individual account plans, as well as providers of services to such plans.

- *Overview of Regulation*
- The new regulation provides that where investment responsibilities are allocated to participants and beneficiaries, the plan administrators must take steps to ensure that participants and beneficiaries are made aware of their rights and responsibilities with respect to their investments and are provided sufficient information regarding the plan, including fees, expenses, and investment alternatives, to make informed decisions with regard to the management of their individual accounts. The regulation provides a fiduciary duty to disclose certain plan-related information and investment-related information. Thus, the new regulation makes the disclosure of the plan-related and investment-related information an affirmative fiduciary duty of the plan administrator. Some of the key highlights of the new regulation are discussed below.
- *Disclosure of Plan-Related Information*
- The regulation requires that the plan administrator provide each participant or beneficiary specific plan-related information on or before the date on which the participant or beneficiary can first direct his or her investments and at least annually thereafter, including:
  - General plan information, including an explanation of the circumstances under which participants and beneficiaries may give investment instructions, identification of investment alternatives and investment managers, and a description of any "brokerage windows," "self-directed brokerage accounts," or similar arrangements that allow participants and beneficiaries to select investments beyond those designated by the plan.
  - Administrative expense information, including an explanation of any fees and expenses for general plan administrative services (for example, legal, accounting, recordkeeping) which may be charged against the individual accounts of participants and beneficiaries.
  - Individual expense information, including an explanation of any fees and

expenses that may be charged against the individual account of a participant or beneficiary on an individual, rather than on a plan-wide basis (for example, fees attendant to processing plan loans or qualified domestic relations orders, fees for investment advice, fees for brokerage windows, commissions, front- or back end loads or sales charges, and redemption fees) and which are not reflected in the total annual operating expenses of any investment alternative.

- Additionally, and at least quarterly, the plan administrator must provide a statement of the administrative and individual fees and expenses that are actually charged during the preceding quarter to the participant's or beneficiary's account for such services.
- *Disclosure of Investment-Related Information*
- The regulations require that the plan administrator must provide to each participant or beneficiary on or before the date on which he or she can first direct his or her investments and at least annually thereafter, certain information with respect to each investment alternative offered under the plan, including investment identifying information (for example, the name of each investment alternative and the type or category of the investment), specific performance data depending on the type of the investment, and benchmark information that identifies an appropriate broad-based securities market index.
- In addition, certain fee and expense information related to the individual investment alternative must be disclosed, including, for example, each shareholder-type fee (fees charged directly against a participant's or beneficiary's investment, such as commissions, sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees) which are not included in the total annual operating expenses of any designated investment alternative. Furthermore, the regulations require the disclosure of Website addresses that provide access to certain specific information regarding the investment alternatives, and a general glossary of terms to assist participants in understating the investment alternatives.
- *Comparative Format Requirement*
- The investment-related information required to be disclosed must be provided in a chart or similar form that is designed to facilitate a comparison of each investment option available under the plan. The regulation provides a model of the required comparative chart, which if accurately completed by the plan administrator, will satisfy this requirement.
- A plan administrator will not be liable for the completeness and accuracy of information used to satisfy these disclosure requirements when the plan

administrator reasonably and in good faith relies on information received from or provided by a plan service provider or the issuer of a designated investment alternative.

**The Internal Revenue Service Has Issued Proposed and Final Regulations Concerning Hybrid Retirement Plans**

On October 19, 2010, the IRS released final regulations providing guidance for statutory hybrid plans, including cash balance plans. This belated guidance addresses many of the requirements imposed on cash balance plans by the Pension Protection Act of 2006. The final regulations incorporate the previously issued transitional guidance in Notice 2007-6, which interpreted the Pension Protection Act provisions relating to hybrid plans as well as the proposed regulations published in 2007 (the 2007 proposed regulations). The final regulations are consistent with the previously issued guidance and generally apply to plan years that begin on or after January 1, 2011. The regulations setting forth the exclusive list of interest crediting rates that satisfy the market rate of return requirement, however, apply to plan years beginning on or after January 1, 2012. Plan sponsors may rely on the final regulations for periods prior to the effective date.

In addition to the final regulations, the IRS released new proposed regulations (the 2010 proposed regulations) to provide guidance with respect to certain issues not addressed in the final regulations. More specifically, the 2010 proposed regulations provide additional guidance on the following issues:

- The scope of relief from the Code's minimum vesting rule provided under Code section 411(a)(13) and the final regulations
- Application of the 133-1/3% accrual rule to statutory hybrid plans
- Alternative method for satisfying the conversion protection requirements
- Additional permitted interest crediting rates

The 2010 proposed regulations generally would take effect for plan years that begin on or after January 1, 2012. Nevertheless, plan sponsors may rely on the 2010 proposed regulations for periods prior to that date.

Notice 2009-97, issued by the IRS in late 2009, extended the deadline for adopting any amendments to comply with the market rate of return requirement to the last day of the first plan year beginning on or after January 1, 2010, which would be December 31, 2010, for a calendar year plan. In the 2010 proposed regulations, the IRS further modified this extension. When the 2010 proposed regulations are published in final form, the IRS expects that they will grant Code section 411(d)(6) relief for an amendment adopted before those final regulations apply to the plan, but only to the extent that the amendment reduces or eliminates a 411(d)(6) protected amendment as necessary to meet the requirements of Code section 411(b)(5). The IRS explicitly states that this effective date supersedes the requirement in Notice 2009-97 that would have required that the amendment be adopted by the end of the 2010 plan year.

## DOL Issues Proposed Rule Revising Definition of the Term Fiduciary

On October 22, 2010, the DOL issued proposed rules under ERISA that would more broadly define the circumstances under which a person is considered to be a fiduciary by reason of giving investment advice to an employee benefit plan or a plan's participants. The proposal amends a 35-year-old rule that, according to the DOL, may inappropriately limit the types of investment advice relationships that give rise to fiduciary duties on the part of the investment advisor. In addition, the proposed regulation would update the "investment advice" definition of the regulations to establish additional circumstances where investment advice providers are subject to ERISA fiduciary responsibilities.

- *Background*
- Section 3(21)(A)(ii) of ERISA defines a fiduciary as a person who renders investment advice to a plan for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so. The DOL noted that the current regulation provides that a person provides "investment advice" for purposes of section 3(21)(A)(ii) of ERISA only if the person renders advice as to the purchase, sale, or value of securities or other property and either has discretionary authority or control with respect to the purchase of property for the plan, or, in the alternative, the person (1) renders advice as to the purchase, sale, or value of securities or other property, (2) on a regular basis, (3) pursuant to a mutual agreement, arrangement, or understanding, written or otherwise, between such person and the plan or a plan fiduciary, that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan, commonly referred to as the "five-part test."
- According to the DOL, under the current regulation, a plan service provider must satisfy each element of the five-part test in order to be considered a fiduciary under ERISA section 3(21)(A)(ii) unless the service provider renders advice and has discretionary authority or control with respect to purchasing or

selling securities or other property for the plan.

- *General Overview of Proposal*
- The proposed rule provides that a person is a fiduciary if the person (1) renders investment advice described in the proposal to a plan, plan fiduciary, or plan participant or beneficiary for a fee or other compensation and (2) directly or indirectly represents or acknowledges that he or she is acting as a fiduciary within the meaning of ERISA with respect to the plan in rendering the advice. The proposed rule is intended to simplify the current rule's five-part test. The proposal removes the requirement that advice must be provided on a "regular basis."
- In addition, the proposal does not require the parties to have a mutual understanding that the advice will serve as a "primary basis" for plan investment decisions. The DOL notes that under the proposal it is sufficient if the parties understand that the advice will be considered in connection with making a decision relating to plan assets.
- *Meaning of "Investment Advice" for a Fee*
- Under the proposed regulations, the types of advice and recommendations that may result in fiduciary status under ERISA section 3(21)(A)(ii) are:
- Advice, appraisals, or fairness opinions concerning the value of securities or other property
- Recommendations as to the advisability of investing in, purchasing, holding, or selling securities or other property
- Advice or recommendations as to the management of securities or other property
- In addition, a person may be considered a fiduciary as a result of the person's rendering of "investment advice" for a fee or other compensation if the person:
- Represents or acknowledges that he or she is acting as a fiduciary within the meaning of ERISA with respect to the plan in rendering the advice
- Is a fiduciary with respect to the plan within the meaning of ERISA section 3(21)(A)(i) or (iii) (specifically, section 3(21)(A)(i) and (iii) describe a fiduciary as any person who exercises any discretionary authority or control with respect to management of the plan, management or disposition of its assets, or in the administration of the plan)
- Is an investment adviser within the meaning of section 202(a)(11) of the Investment Advisers Act of 1940
- Provides advice or makes recommendations pursuant to an agreement, arrangement, or understanding, written or otherwise, with the plan, a plan fiduciary, or a plan participant or beneficiary, where such advice may be considered in making investment or management decisions with respect to

plan assets, and the advice will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary

- These provisions generally encompass the same types of investment-related advice and recommendations as covered by the current regulation, except that it (a) specifically includes the provision of appraisals and fairness opinions and (b) specifically includes advice and recommendations as to the management of securities or other property (for example, voting proxies, selection of persons to manage plan investments). In addition, the proposed regulation provides that fiduciary status under section 3(21)(A)(ii) may result from the provision of advice or recommendations not only to a plan fiduciary, but also to a plan participant or beneficiary. The preamble notes that this "reflects the Department's long-standing interpretation of the current regulation."
- *Exceptions to Fiduciary Status*
- The proposed regulations do provide for certain activities taken in connection with individual account plans that will not, in and of themselves, be treated as rendering investment advice and would not result in fiduciary status. These include:
- Providing certain investment education information and materials
- The marketing or making available (for example, through a platform or similar mechanism) investment alternatives which participants may select, or the providing general financial information and data to assist a plan fiduciary's selection or monitoring of such plan investment alternatives, if the person making available such investments discloses in writing to the plan fiduciary that the person is not providing impartial investment advice
- The preparation of general report or statements pursuant to ERISA's or the Code's disclosure and reporting requirements

## HEALTH AND WELFARE PLAN DEVELOPMENTS

### **IRS Releases Draft W-2 Form for 2011; Announces Relief for Employers**

On October 12, 2010, the IRS granted temporary relief for 2011 from the Patient Protection and Affordable Care Act (PPACA) requirement to report the cost of employer-sponsored group health care on Form W-2.

- *Background*
- PPACA added section 6051(a)(14) to the Internal Revenue Code (Code), generally stating that the aggregate cost of applicable employer-sponsored coverage must now be reported on Form W-2. Employer-sponsored coverage means coverage under any group health plan made available to employees by

their employer that is excludable from the employees' gross income. In addition, Code section 6051(a)(14) requires that the aggregate cost be determined under rules similar to those for determining the "applicable premium" under the rules providing for COBRA continuation coverage. By statute, Code section 6051(a)(14) is effective for taxable years beginning on or after January 1, 2011.

- *Interim Relief*
- The IRS issued Notice 2010-69 to provide interim relief from Code section 6051 requirements. As a result, employers do not need to report the aggregate cost of employer-sponsored group health coverage on Forms W-2 issued for 2011. The IRS will not treat an employer as failing to meet the requirements of Code section 6051 for 2011 and the employer will not be subject to any related penalties. This relief allows employers additional time to prepare for compliance with Code section 6051's reporting 8 requirement. The IRS also notes in the Notice that it anticipates issuing guidance on the reporting requirement before the end of 2010.
- In conjunction with Notice 2010-69, the IRS also issued a draft Form W-2 for use in 2011. The draft Form W-2 allows for the reporting of employer-sponsored coverage in box 12.

**FAQs About the Affordable Care Act Implementation Part II and III**

The Department of Health and Human Services (HHS), the DOL, and the Department of the Treasury (the Departments) continue to release additional guidance regarding the implementation of the market reform provisions of PPACA in the form of new questions and answers, most recently on October 8th and 13th. The FAQ clarifies that only six changes will be considered to change a health plan so significantly that they will cause a group health plan or health insurance coverage to relinquish grandfather status:

- Elimination of all or substantially all benefits to diagnose or treat a particular condition
- Increase in a percentage cost-sharing requirement (for example, raising an individual's coinsurance requirement from 20% to 25%)
- Increase in a deductible or out-of-pocket maximum by an amount that exceeds medical inflation plus 15 percentage points
- Increase in a copayment by an amount that exceeds medical inflation plus 15 percentage points (or, if greater, $5.00 plus medical inflation)
- Decrease in an employer's contribution rate towards the cost of coverage by more than five percentage points

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- Imposition of annual limits on the dollar value of all benefits below specified amounts

The FAQ stresses that only these changes would cause a cessation of grandfather status under the Departments' interim final grandfather regulations. The FAQs address additional topics relating to (1) grandfathered health plans, (2) dental and vision benefit plans, (3) rescissions of coverage, (4) preventative health services, and (5) exemptions for group health plans with less than two current employees.

## GENERAL DEVELOPMENTS

Social Security Administration Announces 2011 Wage Base and Earnings Limits
On October 15, 2010, the Social Security Administration (SSA) announced that the 2011 wage base for computing Social Security tax will remain $106,800. There will also be no change to the retirement earnings tax exempt amount. Thus, as in the prior calendar year, an individual may earn $1,180 monthly ($14,160 annually) before reaching Social Security normal retirement age and $3,140 monthly ($37,680 annually) after reaching Social Security retirement age.

A few select tax rates for employers and employees that remain unchanged are listed below:

| Social Security | Percent |
|---|---|
| Old-Age and Survivors Insurance | 5.30 |
| Disability Insurance | 0.90 |
| Subtotal, Social Security | 6.20 |
| Medicare (Hospital Insurance) | 1.45 |
| Total | 7.65 |

The Social Security Act provides for an automatic increase in these benefits if there is an increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPIW) from the third quarter of the last year a cost-of-living adjustment (COLA) was determined to the third quarter of the current year. There was no increase in the CPI-W from the third quarter of 2008, the last year a COLA was determined, to the third quarter of 2010; therefore, under existing law, there can be no COLA in 2011. Since there is no COLA, the statute also prohibits a change in the maximum amount of earnings subject to the Social Security tax as well as the retirement earnings test exempt amounts.