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Articles in this Edition

RECENT LEGISLATIVE ACTIVITY

Tax Technical Corrections Act Includes Retirement Plan Provisions

House of Representatives Ways and Means Chairman Charlie Rangel (D-NY) and Ranking Republican Dave Camp (D-MI) have introduced the Tax Technical Corrections Act (H.R. 4169), a measure that makes minor, clarifying and typographical changes to recently enacted tax legislation. H.R. 4169 briefly addresses two measures related to employee benefits.

In corrections to the Emergency Economic Stabilization Act of 2008 – economic rescue legislation that included restrictions on nonqualified deferred compensation – H.R. 4169 clarifies legislative intent with respect to nonqualified deferred compensation from certain tax indifferent parties and whether a partnership is considered a "nonqualified entity." According to a Joint Committee on Taxation summary of the technical corrections legislation, an organization that is a partner in the partnership is not considered exempt from U.S. income tax to the extent that the organization's share of the partnership's income is subject to U.S. tax as unrelated business taxable income. Similarly, a foreign person that is a partner in a partnership is not considered a foreign person with respect to whom partnership income is not subject to a comprehensive foreign income tax to the extent that such person's share of partnership income is subject to U.S. income tax as income as income effectively connected with the conduct of a U.S. trade or business. This bill clarifies these rules to reflect legislative intent." H.R. 4169 also clarifies that "the aggregation rules do not treat every entity within an aggregated group as a nonqualified entity merely because one entity in the group is a nonqualified entity."

In corrections to the Heroes Earnings Assistance and Relief Tax Act of 2008 – a military tax relief bill – H.R. 4169 addresses the treatment of flexible spending accounts for military reservists. While the enacted legislation provides that a plan does not fail to be treated as a cafeteria plan or health FSA merely because the plan provides for qualified reservist distributions, H.R. 4169 clarifies that a plan does not fail to be treated as an accident or health plan merely because it provides for qualified reservist distributions.

GAO Issues Study on Retirement Plan Reporting

The Government Accountability Office (GAO) published the report Private Pensions: Additional Changes Could Improve Employee Benefit Plan Financial Reporting, a study of the new Form 5500 reporting requirements for 401(k) plans. House of Representatives Education and Labor Committee Chairman George Miller (D-CA) had asked GAO to examine the new requirements and determine whether they provide (1) clear and understandable guidance to plan sponsors and (2) useful information to the U.S. Department of Labor (DOL) and others.

The report concludes that the recent changes to the Form 5500 are "unlikely to resolve the issues surrounding service provider disclosure to plan sponsors. Absent detailed guidance aimed at clarifying the indirect compensation reporting requirements, [DOL] is at risk of receiving inconsistent and incomparable information on the Schedule C." The report further states that "requiring plan sponsors or administrators to report more complete information to Labor on fees — that is, those paid out of plan assets or by participants — puts the agency in a better position to effectively oversee defined contribution plans."

Specifically, GAO recommends that DOL:

- provide additional guidance and require all indirect compensation be disclosed on the Schedule C,
- coordinate the implementation of its new Form 5500 requirements with the publication of its service provider-fiduciary disclosure regulations (expected in May 2010, see story above), and
- require that asset-based fees be explicitly reported.

A side-by-side chart compares the pending defined contribution plan fee disclosure proposals: the 401(k) Fair Disclosure and Pension Security Act (H.R. 2989), sponsored by Miller; the Defined Contribution Plan Fee Transparency Act (H.R. 2779), sponsored by House Ways and Means Select Revenue Measures Subcommittee Chairman Richard Neal (D-MA); and the Defined Contribution Fee Disclosure Act (S. 401) sponsored by Senate Health, Education, Labor and Pensions (HELP) Committee Chairman Tom Harkin (D-IA). Additional consideration of these measures has not yet been scheduled.

New Defined Contribution Plan Disclosure Legislation Introduced

A bipartisan group of Senators introduced legislation seeking to address long-term retirement security for defined contribution plan participants. The Lifetime Income Disclosure Act (S. 2832) would require sponsors of defined contribution plans to inform plan participants of the projected monthly income they could expect at retirement based on their current account balance.

The bill is sponsored by Senators Jeff Bingaman (D-NM) and Johnny Isakson (R-GA), members of the Senate Health, Education, Labor and Pensions (HELP) Committee, as well as Herb Kohl (D-WI) chairman of the Senate Special Aging Committee. Specifically, defined contribution plans subject to ERISA – including 401(k) plans – would be required annually to inform participants of how the account balance would translate into guaranteed monthly payments based on age at retirement and other factors. The legislation also directs the U.S. Department of Labor to issue tables that employers may use in calculating an annuity equivalent, as well as a model disclosure. Employers and service providers using the model disclosure and following the prescribed assumptions and DOL rules would be insulated from liability.

In a media statement announcing the bill, Bingaman indicated that "by providing similar information for 401(k) plans, the bill would give American workers a more complete snapshot of their projected income in retirement." The bill is endorsed by AARP and The Women's Institute for a Secure Retirement.

RECENT REGULATORY ACTIVITY

DOL Issues ARRA COBRA Model Notices to Aid Compliance with Subsidy Extension Requirements

The Department of Labor (DOL) recently issued model notices to help plans comply with the recent extension of the COBRA premium subsidy assistance program. As we previously reported, the 2010 Department of Defense Appropriations Act (DOD Act), signed by President Obama on December 19, 2009, provided an extension of the COBRA subsidy program originally established under the American Recovery and Reinvestment Act of 2009 (ARRA).

The DOD Act provided a two-month extension of eligibility for COBRA coverage, from December 31, 2009, to February 28, 2010, and a six-month extension of the duration of the premium subsidy period, from 9 months to 15 months. ARRA, as amended by the DOD Act, requires that plans notify certain current and former participants and beneficiaries about the available subsidy and the extension. Each model is designed for a particular group of qualified beneficiaries:

- The Updated General Notice is for all qualified beneficiaries (not just covered employees) who experienced a qualifying event at any time from September 1, 2008, through February 28, 2010, regardless of the type of qualifying event and who have not yet been provided an election notice.
- The Premium Assistance Extension Notice is for certain individuals who have already been provided a COBRA election notice that did not include information regarding the changes made to premium reduction provisions of ARRA by the DOD Act.
- The Updated Alternative Notice is for individuals who became eligible for continuation coverage under a state law.

IRS Extends PPA Deadline for Certain Retirement Plan Amendments

The Internal Revenue Service (IRS) issued Notice 2009-97, which extends the deadline for amending qualified retirement plans to meet certain requirements added by the Pension Protection Act of 2006 (PPA). Under the PPA, the deadline would have been the last day of the first plan year beginning on or after January 1, 2009 (December 31, 2009 for calendar year plans). Notice 2009-97 extends that deadline to the last day of the first plan year beginning on or after January 1, 2010 (December 31, 2010 for calendar year plans) for the following requirements:

- Funding-based limits on benefits and benefit accruals under Sections 401(a)(29) and 436 of the Internal Revenue Code (Code).
- Most new PPA requirements for cash balance and other hybrid plans under Code Sections 411(a)(13) and 411(b)(5) (but no extension for the new hybrid plan anti-"whipsaw" rule contained in Section 411(a)(13)(A)). (Whipsaw is an anomaly under which the plan is required to pay out distributions that are greater than the account balance)
- New employer stock diversification requirements under Code Section 401(a)(35).

The notice indicates that final and additional proposed regulations governing hybrid plans, as well as final employer stock diversification regulations, are expected to be published soon. The amendment extension has been provided to give plan sponsors time to adopt plan amendments that taken into account recently issued final regulations and those that are expected to be issued in the near future.

The notice also provides anti-cutback relief (under Code Section 411(d)(6), which generally prohibits amendments reducing or eliminating previously accrued benefits) for amendments adopted by the new amendment deadline, provided that the "cutback" is only made to the extent necessary to comply with the new benefit restriction rules. Once final hybrid plan regulations are issued, it is expected that the same relief will be granted. However, it is expected that the anti-cutback relief will continue for the market rate of return requirement until the effective date of those final regulations (this is expected to be covered in the forthcoming proposed hybrid plan regulations). Unfortunately, there are still open issues regarding the market rate of return standard in effect prior to the effective date of the regulations and whether anti-cutback relief will be available for post-2009 amendments affecting that period.

IRS Issues Guidance on 2009 Cumulative List, Executive Compensation, 403(b) Plan Documents

The Internal Revenue Service (IRS) has recently issued a number of guidance and administrative items relating to retirement and compensation plans:

On December 11, the IRS issued Notice 2009-98, the 2009 Cumulative List of Changes in Plan Qualification Requirements, which identifies the statutory, regulatory, and guidance changes that must be in plan amendments submitted for determination letter requests for the 12-month period beginning February 1, 2010. The list is to be used primarily by plan sponsors of individually designed plans that are in "Cycle E" (where the last digit of the employer identification number of the plan sponsor is 5 or 0). The Cumulative List is also used for certain other option and advisory requests during the same time period.

“Cycle E” is part of the staggered remedial amendment period and determination letter filing system first established in IRS Revenue Procedure 2005-66 and updated in Revenue Procedure 2007-44. Under the staggered determination letter filing system, plan sponsors generally file for determination letters within staggered cycles that depend on the sponsor’s taxpayer identification number for individually designed plans and during a six-year cycle for pre-approved plans.

Also on December 11, IRS issued Notice 2009-92, which generally clarifies that the delay or acceleration of the payment of nonqualified deferred compensation in order to comply with certain requirements under the Troubled Assets Relief Program (TARP) will not cause the plan to fail to meet the requirements of Internal Revenue Code Section 409A. Specifically, this notice provides that: subject to certain conditions, the compliance (by a financial institution that has received financial assistance under TARP) with an advisory opinion issued after September 30, 2009, by the Office of the Special Master for TARP Executive Compensation, will not result in a failure to comply with the requirements of Section 409A. The order may require a change in the time or form of payment of executive compensation to an employee of the TARP recipient, or condition payment upon a TARP-related condition such as the prior repayment of some or all of the financial assistance, or both. Organizations who are not participating in TARP are not affected by the notice.

On December 10, the IRS issued Announcement 2009-89, stating that the agency expects to publish a revenue procedure for obtaining an opinion letter (determination letter) that the form of a prototype or other “pre-approved plan” meets the requirements of Internal Revenue Code Section 403(b). Announcement 2009-89 also provides for a remedial amendment period and reliance for employers that either adopt a pre-approved plan with a favorable opinion letter or apply for an individual determination letter, pursuant to the upcoming revenue procedure. (Employers should not request ruling or determination letters on the form of their 403(b) plans at this time, pending publication of the revenue procedure).

Employers sponsoring a 403(b) plan must still adopt a plan document intended to satisfy the requirements of the tax code and regulations on or before December 31, 2009. The announcement clarifies that if the employer does this and then (1) adopts a pre-approved plan that has received a favorable opinion letter or (2) applies for an individual determination letter when available, the employer will have a remedial amendment period in which to amend the plan to correct any defects retroactive to January 1, 2010. An employer meeting these requirements will have reliance, effective January 1, 2010, that the plan document meets the requirements of 403(b) and the regulations if, during the remedial amendment period, the pre-approved plan is adopted retroactive to January 1, 2010, or the plan is amended to correct any defects retroactive to January 1, 2010.

DOL/EBSA Issue Advisory Opinion on Mutual Funds

The U.S. Department of Labor (DOL) and Employee Benefits Security Administration (EBSA) released Advisory Opinion 2009-04A, with important implications for mutual funds. The advisory opinion rejects a request from Avatar Associates, LLC for an opinion stating that the assets of target-date or lifecycle mutual funds constitute "plan assets" of investing employee benefit plans, and that assets and advisers of such mutual funds would be subject to ERISA's fiduciary and prohibited transaction rules to the extent the fund invests in affiliated funds.

At the center of the requested ruling was the question of whether a fund adviser's decision to invest in affiliated funds constitutes prohibited self-dealing under ERISA. Since mutual fund assets are generally exempt from ERISA and are instead subject to the Investment Company Act's regulatory scheme, DOL concluded that a mutual fund's investment in shares of affiliated mutual funds does not cause the assets of the mutual fund to become plan assets subject to ERISA.

Avatar also raised this issue in testimony before the Senate Special Aging Committee hearing on target date funds on October 28, 2009, suggesting that a legislative change should be considered. At the hearing, lawmakers demonstrated a limited appetite for such a change and Committee Chairman Herb Kohl (D-WI) appears to be content at the moment to leave these target date issues to the regulators.

Had DOL provided the requested ruling, target-date and lifecycle funds that accepted investments from qualified plans would become subject to all of the rules under ERISA, including the prohibited transaction rules, which could prohibit the fund investing in any products offered by the fund's affiliates.

On December 7, the U.S. Department of Labor (DOL) Employee Benefits Security Administration (EBSA) released its Fall 2009 Semi-Annual Regulatory Agenda.

Most notably, for employer retirement plan sponsors:

- DOL intends to amend the regulatory definition of a "fiduciary" for plan investment advisers to include pension consultants and other plan advisers who do not meet the current regulatory definition. DOL plans to issue proposed regulations on this issue in June 2010.
- Proposed investment advice regulations are expected to be issued in February 2010. As we have reported, the agency recently withdrew its final regulations interpreting the investment advice provisions of the Pension Protection Act of 2006 (PPA) and the accompanying administrative class exemption. It appears the re-proposed rule will not include an administrative class exemption.
- Service provider defined contribution plan fee disclosure regulations are expected to be issued in final form in May 2010, while the participant fee disclosure regulations are expected to be issued in final form in September 2010. Various legislative proposals on plan fee disclosure are still pending in Congress.
- Proposed plan asset regulations (regarding a safe harbor for depositing participant contributions) are expected to be finalized in January 2010.

- Proposed regulations regarding benefit statements are expected to be issued in September 2010.
- In April 2010, DOL intends to issue final regulations regarding Qualified Domestic Relations Orders (QDROs) that are issued late or are issued after another QDRO or that revise another QDRO. These regulations would implement Section 1001 of PPA.

In addition, for health plan sponsors:

- Interim final regulations on the Mental Health Parity and Addiction Equity Act are expected to be issued by April 2010.
- In September 2010, DOL/EBSA plan to issue final regulations regarding the portability of health coverage, while addressing amendments made to HIPAA by the Children's Health Insurance Program Reauthorization Act of 2009.

DOL also announced on December 7 that the agency will make it a top priority to encourage the annuitization of defined contribution plan benefits. DOL Secretary Hilda Solis said in a video webcast that her department is working with the U.S. Treasury Department “to determine how best to enhance retirement security by facilitating access to a lifetime stream of income at retirement.” An official request for information on this topic is currently in development and could be issued in January 2010.

PBGC Releases Draft Information Disclosure Requirements for Reportable Events
The Pension Benefit Guaranty Corporation (PBGC) released a draft of modified information disclosure forms and instructions associated with the recent PBGC proposed regulations modifying reportable event requirements.

PBGC Updates Maximum Guaranteed Benefit, Age Rate Table, Premium Rates
The PBGC issued final regulations announcing the maximum insurance benefit for participants in underfunded single-employer pension plans terminated (either in a distress termination or involuntarily by the PBGC) with a valuation date falling in 2010. Under these regulations, the maximum benefit payable by the PBGC to a plan participant whose plan terminates in 2010 will be $54,000 per year ($4,500 per month) for those who retire at age 65. The maximum insurance benefit is indexed to a contribution and benefit standard in Social Security law. Because that amount does not increase for 2010, the PBGC maximum insurance benefit is unchanged from 2009.

The agency's final regulations on expected retirement age amend the PBGC's current rule on allocation of assets in single-employer plans, substituting a new table that applies to any plan being terminated either in a distress termination or involuntarily by the PBGC with a valuation date falling in 2009. This table is used to determine expected retirement ages for plan participants, the value of early retirement benefits and the total value of benefits under the plan.

The PBGC's notice on flat rate premiums updates these premium levels for 2010, adjusted for inflation each year based on changes in the national average wage index. For 2010, the per participant flat rate premium for single employer plans will be $35, up from $34 for 2009. The 2010 multiemployer plan premium rate remains at $9 per participant, the same as 2009.

RECENT JUDICIAL ACTIVITY

Appeals Court Rules for Employer in 401(k) Company Stock Investment Case

On December 21, the U.S. Court of Appeals for the Third Circuit vacated a district court decision to certify a class of plaintiffs in *Schering Plough ERISA litigation*, returning the case to the lower court. The underlying case involves the question of whether the company violated its fiduciary duties under ERISA by offering an investment in company stock in its 401(k) plan.

The appeals court, specifically reviewing the certification issue, determined that the district court decision was made without satisfying four elements of class certification: number of class members, common question of law or fact, sufficiently typical claims from all members, and fair and adequate protection of the class members' rights by the class representatives. The court ultimately determined that it was not necessary to address the question of whether the fiduciary protection provided under ERISA Section 404(c) for 401(k) plans is an adequate defense in fiduciary breach cases involving company stock investment funds. The court did clearly state, however, that the right of an individual to sue for breach of fiduciary duty for failure to follow a participant's investment direction – as provided in the 2008 *LaRue* – does not affect the question of whether an individual can release their ability to bring a claim on behalf of the plan. The court did not directly answer the question of the impact of the *LaRue* decision on class certification generally.

The same appeals court had earlier found in favor of the plaintiff, ruling that the District Court for the District of New Jersey improperly dismissed the appellants' claim for breach of fiduciary duty by the plan sponsor (this was a second appeal in the case).

District Court Rules for Employer in 401(k) Case

On December 9, the U.S. District Court for the Northern District of Illinois dismissed all claims in *Loomis v. Exelon* Corp., in which 401(k) plan participants alleged that plan fiduciaries breached their duty by providing investment options with excessive fees and by failing to disclose the "revenue sharing" fee structure to participants. Judge John W. Darrah held that the facts and claims in Loomis were not materially distinguishable from those in the recent 7th Circuit decision, Hecker v. Deere & Co., and therefore must be dismissed. (The District Court for the Northern District of Illinois falls within the 7th Circuit.)

Although the plaintiffs in Loomis focused on the allegedly excessive fees charged by the plan's investment options (as opposed to the lack of an acceptable array of investment vehicles), the court held that Hecker had previously addressed both issues (not just the latter) and therefore prevailed on the issue of excessive fees. Generally, the Loomis opinion served to reinforce the Hecker holding that plan fiduciaries are not responsible for selecting investments with the lowest possible fees. The plans in both cases offered very similar investment choices and expense ratios and the funds were available on the open market for the same fee. The Loomis opinion also reinforced that no statute or regulation requires the specific disclosure to participants of revenue-sharing arrangements. Instead, the total fee paid by participants is the "critical figure."

The Loomis court found that the complaint was still not factually distinguishable from the allegations in Hecker even after the plaintiffs amended the complaint in light of the Hecker ruling. In rejecting the amended complaint, the court, as in Hecker, emphasized that nothing in the law requires plan fiduciaries to use institutional or "wholesale" funds as opposed to retail funds. The amended complaint removed all allegations that would implicate the ERISA section 404(c) safe harbor provision, and therefore the opinion did not address 404(c) issues.

Appeals Court Opinion Favors Participant in 401(k) Fee Lawsuit

On November 25, the U.S. Court of Appeals for the Eighth Circuit issued an opinion in the case of Jeremy Braden, et al. v. Wal-Mart Stores, Inc., et al., a class-action lawsuit regarding fee arrangements in 401(k) plans, generally targeting revenue sharing arrangements. The appeals court opinion vacates (cancels) a lower court decision in favor of the employer, denying the arguments of plan sponsors, and sends the case back to the district court level for further proceedings.

Specifically, the case involves allegations of breach of fiduciary duty for imprudently choosing investment options with excessive fees and failing to disclose material information. The plaintiff claimed that the following aspects of the available investment options increased the expenses: (1) retail class shares were used instead of institutional class shares, (2) the investment funds are predominantly actively-managed rather than passively-managed, (3) most of the funds charge 12b-1 fees, and (4) the funds also include a revenue sharing fee.

The appeals court's ruling vacates the ruling of the U.S. District Court for the Western District of Missouri, which had decided in favor of the defendant plan sponsor in November 2008, stating that the suit contained little more than "conclusory allegations, without any factual support." The Court had also ruled that "Wal-Mart and the (Retirement Plans Committee) could have chosen funds with higher fees for any number of reasons, including potential for higher return, lower financial risk, more services offered, or greater management flexibility. Plaintiff's dissatisfaction with fees or earnings does nothing to establish a colorable claim that Wal-Mart and the (committee) did not properly investigate available options before making a decision."

This is an unfortunate setback for sponsors of defined contribution plans and further confuses precedent on this subject. This case is similar to the case of Hecker et al v. Deere & Company/Fidelity, in which the U.S. Court of Appeals for the Seventh Circuit recently affirmed a district court decision and denied an appeal for rehearing, confirming that the plaintiffs failed to state a claim against the defendants.