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WEB's ***Benefits Insider*** is a member exclusive publication providing the latest developments from the Nation's Capital on matters of interest to benefits professionals. The content of this newsletter is being provided as a result of a partnership with the American Benefits Council, a premier benefits advocacy organization, which provides its core content, and is edited by Christopher M. Smith, Employee Benefits attorney and Principal of Flexible Benefits Systems, Inc., csmith@fbsi.com.

Articles in this Edition

RECENT LEGISLATIVE ACTIVITY

Lawmakers Introduce Bill to Eliminate FSA 'Use-or-Lose' Rule

On April 18, a bipartisan group of lawmakers in the U.S. House of Representatives introduced the Medical FSA Improvement Act (H.R. 1634), legislation to eliminate the "use-it-or-lose-it" rule governing flexible spending accounts (FSAs).

The measure would generally allow employers to distribute unused FSA funds from the previous year (until the seventh month after the close of the plan year) to employees as taxable compensation. If enacted, H.R. 1634 would apply to plan years beginning after December 31, 2014.

Representative Charles Boustany Jr. (R-LA), the lead sponsor of the bill, said in a statement that "This bipartisan legislation lowers costs associated with medical care by making it easier for Americans to plan and save for their health-care needs using FSAs." Reps. Rodney Davis (R-IL), John B. Larson (D-CT) and Aaron Schock (R-IL) have also signed on as original cosponsors of the measure. H.R. 1634 has been referred to the House Ways and Means Committee, where Boustany, Larson and Schock all serve as members.

The U.S. Treasury Department and the Internal Revenue Service (IRS) is also considering possible modifications to the FSA "use-it-or-lose-it" rule, having requested comments on potential modifications to the rule in IRS Notice 2012-40.

GAO Issues Full Report on Multiemployer Pension Plans

The Government Accountability Office (GAO) formally issued its report, PRIVATE PENSIONS: Timely Action Needed to Address Impending Multiemployer Plan Insolvencies, on March 28. Charles Jeszeck, director of GAO's Education, Workforce, and Income Security division previewed the report at a March 4 hearing of the U.S. House of Representatives Education and the Workforce Committee's Health, Employment, Labor, and Pensions (HELP) Subcommittee.

The multiemployer pension funding provisions of the Pension Protection Act of 2006 (PPA) are scheduled to expire after 2014 and many multiemployer plans are reportedly significantly underfunded. According to the Pension Benefit Guaranty Corporation (PBGC), which insures defined benefit pensions, the multiemployer insurance fund is projected to be exhausted by 2023.

GAO's report finds that "while most plans aimed to eventually emerge from critical status, a significant number reported that they do not and instead project eventual insolvency ... Consequently, a substantial, and in some cases catastrophic, loss of income in old age looms as a real possibility for the hundreds of thousands of workers and retirees depending on these plans." Ultimately, GAO recommends congressional action on the matter, with options including (1) the enactment of legislation permitting plans to reduce accrued benefits of both working participants and retirees or (2) giving PBGC additional authority and resources to assist the most severely underfunded plans, although GAO notes that these and other options would themselves have serious consequences.

HELP Subcommittee Chairman Phil Roe (R-TN) has held a number of hearings on the topic of multiemployer pension plans and has said repeatedly that his subcommittee and the full committee will continue to be very active on this issue, perhaps including development of

legislation to address these issues. Senate staff has also indicated interest in considering multiemployer plan legislation this year. The Retirement Security Review Commission of the National Coordinating Committee for Multiemployer Plans (NCCMP) issued the report Solutions not Bailouts on February 19, offering recommendations for strengthening the multiemployer pension system.

The legislative and regulatory treatment of multiemployer plans is significant because they face similar pressures as the single-employer plan system. Though the two systems are subject to different rules, measures addressing one system can affect the other and legislation focused on multiemployer plans may also include have provisions targeted to single-employer plans. The multiemployer plan crisis also raises the profile of the Pension Benefit Guaranty Corporation (PBGC) and its deficit, which has frequently been invoked as a rationale for further defined benefit plan premium increases.

GAO Issues Report on Defined Contribution Plan Rollovers

In a recent report issued the Government Accountability Office (GAO) posed a number of recommendations to the U.S. Department of Labor (DOL) and the Internal Revenue Service (IRS) regarding plan-to-plan rollovers.

The report, 401(K) PLANS: Labor and IRS Could Improve the Rollover Process for Participants, "reviewed relevant federal laws and regulations, interviewed federal officials and industry experts, conducted a survey of plan sponsors, and made undercover calls to 401(k) plan service providers" to identify challenges that plan participants may face when they exit a plan and must choose between distribution and rollover options.

GAO asserted that "The current rollover process favors distributions to individual retirement accounts (IRAs)" rather than plan-to-plan rollovers, citing "waiting periods to roll into a new employer plan, complex verification procedures to ensure savings are tax-qualified, wide divergences in plans' paperwork, and inefficient practices for processing rollovers" as factors that make rollovers to IRAs easier and faster than plan-to-plan rollovers. Though it was only discussed in a small portion of the report, GAO suggests that participants may be encouraged to roll over their assets into an IRA without fully understanding their distribution options.

The report makes several recommendations to DOL and IRS to encourage participants to stay in the 401(k) plan environment and give departing participants clearer information to use when choosing among distribution options. Specifically, GAO suggests:

- DOL should finalize the "definition of fiduciary" regulations and, in doing so, require service providers that assist participants with distribution options to clearly disclose any financial interests they may have in the outcome of their decisions and the conditions under which they are subject to any regulatory standards (such as ERISA fiduciary standards and SEC standards) and what those standards mean for the participant. DOL is expected to re-propose these regulations before the end of the year.

- DOL should develop a concise written summary explaining a participant's four distribution options (leave assets in the plan, roll to an IRA, roll to new employer plan or cash out), listing "key factors" a participant should consider when comparing possible investments. DOL should require plan sponsors to provide the summary to terminating participants.

- IRS and DOL should review policies that might present obstacles to participants that leave assets in the former employer's plan or move them to a new employer's plan. IRS should revise rules that allow plans to send direct-rollover distribution checks to individuals rather than the receiving entities.

- DOL and IRS should work together to communicate to plan sponsors IRS's guidance on the relief from tax disqualification that could be imposed on plans that accept rollovers that are later determined to have come from a plan that was not tax qualified.

- DOL and IRS should review the lack of standardization of sponsor practices relating to keeping savings in the 401(k) plan environment. This could include, for example, sponsors that decline to accept rollovers from other plans, restrictions on participants' control over savings once they separate from the employer or the charging of different fees for inactive participants.

The initial request to GAO was made by Senator Tom Harkin (D-IA), chairman of the Senate Committee on Health, Education, Labor and Pensions, Senator Bill Nelson (D-FL), chairman of the Senate Special Committee on Aging, and Representative George Miller (D-CA), ranking Democrat on the House of Representatives Education and the Workforce Committee. The three lawmakers responded to the report with a letter focusing on the criticism of IRA providers and calling on DOL and IRS to modify previous guidance to protect workers against "biased marketing and conflicted advice."

RECENT REGULATORY ACTIVITY

Obama FY 2014 Budget Analysis: Health and Retirement Plan Proposals, Including Retirement Savings Cap, PBGC Premiums, Auto-IRA Proposal

President Obama released his Fiscal Year 2014 budget proposal on April 10, requesting $3.8 trillion for the government's operation and setting forth a number of policy priorities for the next year, including numerous employee benefits measures. The White House Office of Management and Budget (OMB) released the detailed budget estimates by agency; historical tables, which illustrates budget data over the last century; and Analytical Perspectives, which provides a detailed discussion of certain budget concepts and Administration policies.

Most significant in the Analytical Perspectives document is the calculation of projected federal "tax expenditures" over the next five years (Page 254), ranked by estimated revenue effect. According to this table, the largest expenditure is the "exclusion of employer contributions for medical insurance premiums and medical care," accounting for more than $1.2 trillion of foregone tax revenue over the next five years. If we combine the tax deferrals for 401(k) plans and the tax exclusion for employer-provided pension contributions and earnings, the total foregone tax revenue is more than $786 billion over the next five years, which would be No. 2 on the list. The significant revenue effects of these tax preferences could make the tax incentives for employer-sponsored benefits a lucrative target for tax reform as part of a larger budget or deficit reduction deal.

The thrust of the President's proposal consists of continued investment in manufacturing, infrastructure and research and development, coupled with tax reform largely aimed at eliminating "loopholes" and minimizing deductions for high-income individuals. As in the prior year's budget proposal, the FY 2014 budget proposes reductions in the value of itemized deductions and other

tax preferences (including employer-sponsored health insurance and employee retirement contributions) to 28 percent. The proposal would also implement the "Buffett Rule," requiring that households with incomes over $1 million pay at least 30 percent of their income (after charitable giving) in taxes, and would tax carried interest at regular income tax rates rather than capital gains tax rates.

The proposal specifically provides for $1.8 trillion in deficit reduction identical to what has previously been referred to as the "grand bargain" floated between the President and congressional Republicans. The measure would replace the "sequester" spending cuts triggered earlier this year. One controversial element of the President's budget proposal is the implementation of a "chained Consumer Price Index (CPI)" calculation that would replace the current methodology for calculating cost-of-living adjustments. The proposal estimates that the change would generate additional revenue by slowing the growth rate of Social Security payouts and accelerating the applicability of higher tax brackets to individuals. This change is estimated to raise $230 billion over ten years.

The budget also addresses a number of health and retirement benefit initiatives:

Retirement Savings

- The budget proposes a cap on "an individual's total balance across tax preferred accounts to an amount sufficient to finance an annuity of not more than $205,000 per year in retirement." The budget's Analytical Perspectives document and an excerpt from the U.S. Treasury Department's "green book" provides some additional detail on this extremely complex proposal, revealing that:
    - The limit applies to deductions and exclusions for contributions to, and accruals in, defined contribution plans, defined benefit plans or individual retirement accounts (IRAs).
    - The annuity amount is pegged to the "maximum allowable defined benefit plan benefit," payable in the form of a joint and 100 percent survivor benefit commencing at age 62 ($205,000 in 2013). It would be indexed to inflation.
    - This limitation would be determined at the end of each calendar year and would apply to contributions or accruals for the following calendar year.
    - Plan sponsors and IRA trustees would have to report account balances the end of each calendar year. This amount would then be converted to an annuity.
    - If an individual's "annuity" account balance exceeds the annuity limitation, no further accruals or contributions would be permitted, though the account would be permitted to grow through investment earnings and gains.
    - Excess contributions would be treated as excess deferrals under current law.

- The budget proposes raising $25 billion over ten years by giving the Board of Directors of the Pension Benefit Guaranty Corporation (PBGC) the authority to raise premiums charged to defined benefit pension plans. Specifically, the proposal directs PBGC to "take into account the risks that different sponsors pose to their retirees and to PBGC" after a study and public comment period. It is unclear how the $25 billion would be divided between single-employer and multi-employer plans, or between flat-rate and variable-rate premiums.

  These premium increases would be applied on top of the $9 billion in increases previously enacted as part of Moving Ahead for Progress in the 21st Century (MAP-21) Act of 2012.

The 2014 budget proposal clearly indicates an interest in deriving additional revenue from PBGC premium increases.

- As in prior budget proposals, citing "78 million working Americans … lack[ing] workplace retirement plans," the president proposes an "automatic workplace pensions" initiative. Under the proposal, employers who do not currently offer a retirement plan will be required to enroll their employees in a direct-deposit IRA account that is compatible with existing direct-deposit payroll systems. Employees would be permitted to opt-out if they choose. Small employers (ten employees or fewer) would be exempt, though they would also be entitled to an additional credit of $25 per participating employee — up to a total of $250 per year — for six years.

- The 2013 budget proposal also includes familiar initiatives to double the small employer pension plan startup credit. Under current law, small employers are eligible for a tax credit equal to 50 percent (up to a maximum of $500 a year for three years) of the start-up expenses of establishing or administering a new qualified retirement or SIMPLE plan. To encourage small employers to offer pensions to their workers in connection with the automatic workplace pensions proposal, the budget would increase the maximum credit from $500 a year to $1,000 per year for up to four years under certain circumstances.

- The President's budget also includes a number of initiatives that are not included in the budget proposal document but are described in the Analytical Perspectives document, including:
    - Non-spouse beneficiaries of IRA owners and retirement plan participants would be required take inherited distributions over no more than five years. Very generally, under current law, if an IRA owner dies, the beneficiary is permitted to draw down the IRA over the beneficiary's life expectancy, but this proposal would do away with such "stretch" IRAs. Exceptions would be provided for disabled beneficiaries and beneficiaries within 10 years of age of the deceased IRA owner or plan participant, and there would be an exception for minor children until they reach the age of majority.
    - Individuals would be exempted from minimum required distribution requirements if the aggregate value of the individual's IRA and tax-favored retirement plan accumulations does not exceed $75,000 at the beginning of the year in which the individual turns 70½ or, if earlier, the year in which the individual dies.
    - A 60-day rollover opportunity would be available for amounts distributed from a qualified plan or IRA to non-spouse beneficiaries (who presently may only do a direct rollover in the case of inherited plan assets and only a trustee-to-trustee transfer in the case of inherited IRA assets). This proposal appeared in the president's 2012 and 2013 budget proposals.
    - As in the 2012 and 2013 budget proposals, the 2014 budget proposes to give the IRS the authority to require certain employee benefit plan tax information to be filed electronically as part of the annual Form 5500.
    - The deduction for dividends or distributions paid with respect to stock held by an ESOP that is sponsored by a C corporation (subject to an exception for C corporations with annual receipts of $5 million or less) would be repealed. The current law rules allowing for immediate payment or use of an applicable dividend would remain intact, without a deduction, and be moved to a different section of the tax code.

Health Care

- The 2014 budget proposal aims to "drive down health care costs by implementing the Patient Protection and Affordable Care Act (PPACA)" by $401 billion over ten years (largely through Medicare, Medicaid and other federal programs) through reforms that develop innovative payment methods, improve health care quality, develop interoperable health information technology and eliminate waste, fraud and abuse. The proposal appears to reaffirm that the establishment of PPACA health insurance exchanges is still proceeding according to schedule, noting that "the reforms effective in 2014 will implement some of the most important pieces of the legislation, providing every American access to affordable, comprehensive coverage through Health Insurance Marketplaces, also known as Affordable Insurance Exchanges."

- The budget specifically expresses support for initiatives that would move up the date when states will be eligible to apply for waivers from PPACA to develop their own health reform standards, from 2017 to 2014. Currently, states may apply for five-year "State Innovation Waivers" from certain coverage requirements beginning in 2017, as long as the state program covers provides the same amount of coverage without increasing the federal deficit. A White House fact sheet supporting state innovation was prepared in February 2011.

- The proposal includes a number of reforms to Medicare and Medicaid policies, including a $50 billion proposal to restructure income-related premiums under Medicare Parts B and D by increasing the lowest income-related premium five percentage points (from 35 percent to 40 percent) and also increasing other income brackets until capping the highest tier at 90 percent. The proposal would also impose premium increases for beneficiaries in Medicare Parts B and D with "higher incomes" and a surcharge on Medicare Part B premiums for new beneficiaries and those that purchase near or full first-dollar Medigap coverage.

- The budget proposes a program to establish payment amounts for Employer Group Waiver Plans (EGWPs) based on the average Medicare Advantage plan bid in each individual market, beginning in 2015. This proposal is estimated to save $4 billion over 10 years.

- The U.S. Department of Labor (DOL) budget request specifically notes that Employee Benefits Security Administration (EBSA) "expects to continue implementation of regulations and compliance related programs that significantly enhance the Department's enforcement authority relating to Multiple Employer Welfare Arrangements (MEWAs)," with planned increases in interpretative and other technical assistance projects involving MEWA registration and Mental Health Parity and Addiction Equity Act (MHPAEA) compliance efforts.

Other Issues

- As in the previous year's budget proposal, the president recommends a program to penalize and eliminate misclassification of employees as "independent contractors." The budget proposal specifically includes $14 million to combat misclassification (identical to the prior year's budget), including $10 million for grants to states to identify misclassification and recover unpaid taxes and $4 million for personnel at the U.S. Department of Labor (DOL) Wage and Hour Division to investigate misclassification.

- With regard to family leave issues, the budget also again proposes a $5 million "State Paid Leave Fund" within DOL to provide competitive grants that would help states cover the start-up costs of launching paid-leave programs. This initiative was proposed in last year's budget at a level of $23 million. The budget proposal also earmarks an additional $3.4 million for the DOL Wage and Hour Division for increased enforcement of rules addressing wages, overtime and family and medical leave.

Since the U.S. Senate and House of Representatives have each already passed deeply contrasting budget resolutions, a bipartisan budget deal incorporating the Obama Administration's proposals is extremely doubtful. However, these proposals may lay the groundwork for regulatory activity or future consideration of more comprehensive tax reform measures in the coming months.

PBGC Re-Proposes Reportable Events Rule

On April 2, the Pension Benefit Guaranty Corporation (PBGC) issued proposed regulations on defined benefit plan reportable events — events that indicate potential problems and may signal the possible future underfunded termination of a plan — under ERISA Section 4043. The new regulations, which replace a previous proposal from November 2009, are intended to reflect changes resulting from the Pension Protection Act of 2006 (PPA). The 2009 proposal eliminated most automatic waivers and filing extensions provided under the pre-2009 reportable events regulations. The proposed rules are also consistent with a long-stated desire by the PBGC to more closely link employer obligations to the agency based upon a plan sponsor's creditworthiness.

The newly proposed regulations waive reporting for five specific "events" currently covered by funding-based waivers under the pre-2009 regulations (which generally require 80 percent funding) if one of two criteria is met: if (1) a plan sponsor comes within a financial soundness safe harbor based on five criteria (including a "credit report" test), or (2) the plan is either fully funded on a termination basis or 120 percent funded on a premium basis (the calculation performed to determine whether the plan owes variable rate premiums).

Reportable events covered by the new financial soundness or plan funding safe harbors include (1) extraordinary dividend or stock redemption, (2) change in contributing sponsor or controlled group, (3) active participant reduction, (4) transfer of benefit liabilities and (5) distribution to a substantial owner.

Events with limited or no safe harbors under the new proposal include (1) bankruptcy/insolvency, (2) liquidation, (3) loan default, (4) failure to make required contributions, (5) application for a Funding Waiver and (6) inability to pay benefits when due.

Within the proposed regulations is a chart that summarizes waiver and safe harbor provisions for reportable events for which post-event reporting is required. According to the preamble, "[T]he proposal would also generally provide more small-plan waivers and preserve foreign entity and de minimis waivers but eliminate most other waivers." In addition, the "PBGC also proposes to eliminate the automatic extensions under the existing regulation."

According to the regulations' preamble, "The credit report test [for the financial soundness safe harbor] would require that the business have a credit report score from a commercial credit reporting company that is commonly used in the business community and that the score indicate

a low likelihood that the company would default on its obligations." The other criteria for the financial soundness safe harbor in the proposed regulations include (1) positive net income, (2) no secured debt (with some exceptions, such as purchase-money mortgages and leases), (3) no loan defaults or similar issues, and (4) no missed pension plan contributions (with some exceptions).

The preamble further states that the proposal "targets requirements to the minority of companies and plans that are at substantial risk of default." PBGC estimates that the revised proposal "will exempt more than 90 percent of plans and sponsors from many reporting requirements" and provides "a blueprint for a new reportable events waiver structure that is more closely focused on risk than the current waiver structure".

In addition, the newly proposed regulations:

- Institute new legal requirements enacted through PPA, including the test that determines whether advance reporting of certain reportable events is required.
- Clarify the descriptions of several reportable events and make some event descriptions narrower, "aimed at tying reporting burden to risk."
- Mandate electronic filing of reportable events notices.

The regulations, when finalized, will supersede Technical Update 13-1, guidance addressing (1) funding-related determinations for purposes of waivers, extensions, and the advance reporting threshold test; and (2) missed quarterly contributions.

FAQ Guidance Issued on PPACA Summary of Benefits and Coverage Requirements, Including Updated Templates

The U.S. departments of Labor (DOL), HHS and Treasury jointly issued Frequently Asked Questions (FAQs) About Affordable Care Act Implementation (Part XIV) on April 23, providing seven new questions and answers covering the implementation of the Summary of Benefits and Coverage (SBC) requirements under the Patient Protection and Affordable Care Act (PPACA). The SBC is intended to provide consumers with consistent and comparable information regarding health plan benefits and coverage. The departments issued final regulations on the SBC requirements in February 2012.

Along with the FAQs, the departments issued updated versions of the official template and completed sample, authorized for the second year of applicability of the SBC requirements (coverage beginning on or after January 1, 2014, and before January 1, 2015). The only change to the SBC template and sample completed SBC is the addition of data elements indicating whether the plan or coverage provides minimum essential coverage (MEC) and whether the plan or coverage meets the minimum value (MV) requirements.

The guidance also provides relief to plans that are already in the process of preparing its SBC for the second year of applicability and for whom it would be an administrative burden to add the new data element. In such cases, the departments "will not take any enforcement action against a plan or issuer for using the template authorized for the first year of applicability, provided that the SBC is furnished with a cover letter or similar disclosure stating whether the plan or coverage does or does not provide MEC and whether the plan's or coverage's share of the total allowed costs of

benefits provided under the plan or coverage does or does not meet the MV requirement under the Affordable Care Act."

The FAQs also:

- clarify that additional coverage examples are not required for 2014;
- extend existing safe harbors and enforcement relief related to the requirement to provide an SBC and uniform glossary to apply to the second year of applicability;
- extend the safe harbor and enforcement relief for plans and issuers with respect to insurance products that are no longer being offered for purchase; and
- extend the "anti-duplication" rule to student health insurance coverage.

New PPACA FAQ Guidance on Clinical Trial Coverage; Expiration of Annual Limit Waivers

On April 29, the U.S. departments of Treasury, Labor (DOL) and Health and Human Services (HHS) released the 15th set of Frequently Asked Questions (FAQs) to assist with required compliance with the Patient Protection and Affordable Care Act (PPACA). FAQ Part XV includes four questions related to annual limit waiver expiration dates, provider nondiscrimination rules, coverage for those in clinical trials, and transparency reporting.

The FAQs clarify that recipients of annual limit waivers who change their plan or policy years will not extend the expiration date of their waivers. For example, if a waiver approval letter states that a waiver is granted for an April 1, 2013, plan or policy year, the waiver will expire on March 31, 2014, regardless of whether the plan or issuer later amends its plan or policy year. The FAQs also state that the provider nondiscrimination and clinical trial coverage statutory requirements are self-implementing and the Departments do not expect to issue regulations in the near future. Until any further guidance is issued, group health plans and health insurance issuers offering group or individual coverage are expected to implement these requirements using a good faith, reasonable interpretation of the law. These statutory requirements apply to non-grandfathered group health plans and health insurance issuers offering group or individual health insurance coverage for plan years (in the individual market, policy years) beginning on or after January 1, 2014.

The FAQs also clarify when plans and issuers will have to comply with certain transparency in coverage reporting provisions under section 1311(e)(3) of PPACA and extended under Public Health Service Act section 2715A to non-grandfathered group health plans and health insurance issuers offering group or individual coverage.

SEC Considers Target Date Fund Recommendations

The Investor Advisory Committee of the Securities and Exchange Commission (SEC), in an April 11 meeting, generally approved a set of recommendations set forth for the regulation of target date funds (TDFs). These funds are commonly used as investment options in 401(k) and similar participant-directed individual account plans, occasionally as default investments under automatic enrollment.

The SEC previously proposed regulations specifically addressing marketing and advertising disclosure requirements for TDFs and continues to deliberate additional changes. The U.S. Department of Labor (DOL) Employee Benefits Security Administration (EBSA) is also conducting a separate, ongoing project on TDFs; proposed regulations were issued in November 2010, requiring more specific disclosure requirements for TDFs. EBSA issued a Target Date Retirement Funds — Tips for ERISA Plan Fiduciaries document on February 28. Among other things, SEC's proposal would require a target date fund with a date in its name to disclose the asset allocation of the fund and include a table, chart, or graph that clearly depicts the asset allocations among types of investments over the entire life of the fund (known as the "glide path").

The Investor Advisory Committee was established under the Dodd-Frank Act to advise the SEC on regulatory priorities and submit findings and recommendations for review and consideration. The recommendations, prepared by the Investor as Purchaser Subcommittee, are non-binding but may indicate the current thinking of the committee as it finalizes the new regulations. The following recommendations were adopted by the committee:

- The [SEC] should develop a glide path illustration for target date funds that is based on a standardized measure of fund risk as either a replacement for or supplement to its proposed asset allocation glide path illustration.

- The [SEC] should adopt a standard methodology or methodologies to be used in both the risk-based and asset allocation glide path illustrations.

- The [SEC] should require target date fund prospectuses to disclose and clearly explain the policies and assumptions used to design and manage the target date offerings to attain the target risk level over the life of the fund. (The SEC indicated during discussion that this proposal focuses on marketing materials only, though the same anti-fraud/liability laws generally apply to both marketing materials and prospectuses.)

- The Committee strongly supports the Commission's proposal to require target date fund marketing materials to include a warning that the fund is not guaranteed and that losses are possible, including at or after the target date. The Commission should consider testing various approaches to providing this disclosure to determine the most effective approach and then mandate that approach in the final rule.

- The Commission should [amend] the fee disclosure requirements for target date funds to provide better information about the likely impact of fund fees on total accumulations over the [expected holding period] of the investment.

Though discussion was limited at the meeting, Subcommittee Chair Barbara Roper (director of investor protection at the Consumer Federation of America) indicated that the group has discussed fee disclosure and may want to look at the issue more broadly sometime in the future.

IRS Provides Anti-Cutback Relief for ESOP Amendments

In Notice 2013-17, issued April 18, the Internal Revenue Service (IRS) formally provided anti-cutback relief to employee stock ownership plan (ESOP) amendments that eliminate a distribution option offered under previously required diversification options.

The Internal Revenue Code's "anti-cutback" rules generally provide that a tax-qualified plan may not decrease previously accrued benefits of participants by plan amendment, including distribution options. The relief provided by this notice allows an ESOP sponsor to amend the plan to eliminate all in-service distribution options previously used to satisfy the diversification requirements of Internal Revenue Code Section 401(a)(28)(B)(i) without running afoul of the anti-cutback rules. The relief applies to amendments that are both adopted and put into effect under a plan by the last day of the first plan year beginning on or after January 1, 2013, or by the time the plan must be amended to satisfy the Pension Protection Act diversification requirements of Code Section 401(a)(35), if later. A plan that is subject to the PPA diversification requirements may be subject to other diversification requirements with respect to investments in employer securities, and these requirements cannot be satisfied by distributing a portion of the participant's account.

In cases in which (1) an ESOP has been amended in time to satisfy Code Section 401(a)(35) and (2) the remedial amendment period with respect to that amendment expires before the ending date of the anti-cutback relief, this notice also extends the remedial amendment period to the last day of the first plan year beginning on or after January 1, 2013, to permit the adoption of an amendment to the ESOP eliminating the distribution options that were previously required but now may be prohibited.

IRS Releases Final Report on 401(k) Compliance Check Questionnaire

The Internal Revenue Service (IRS) has published its **final report** on data collected through the 401(k) Compliance Check Questionnaire Project, nearly three years after first conducting a comprehensive survey of 401(k) plan sponsors.

The final report, released on March 29, is based on the responses of 1,200 plan sponsors to a 46-page questionnaire in 2010. The respondents were randomly selected from the population of Form 5500 filers for the 2007 plan year and the data reflects plan and participant behavior from the 2008 plan year.

The report includes detailed information on elective deferrals, employer contribution levels, nondiscrimination actions, safe harbor contributions, automatic contributions, distribution options, hardship distributions and loans, composition of trust assets, determination letters and use of the Employee Plans Compliance Resolution System (EPCRS). Much of the data compares changes in experience between 2006 and 2008 and is stratified by plan size. Highlights of the report are posted on the IRS questionnaire website.

IRS Also released a Frequently Asked Questions (FAQ) document describing some of the methodology and purpose of the study. According to the FAQ, IRS intends to use the questionnaire's findings to:

- modify and improve our 401(k) plan compliance tools,
- produce outreach materials,
- improve voluntary compliance programs,
- assess the need for additional guidance, and
- define upcoming projects and enforcement activities.

IRS Proposes Regulations Governing PPACA Executive Compensation Deduction Limit

The Internal Revenue Service (IRS) released a notice of proposed rulemaking on April 1, clarifying the application of the $500,000 deduction limit on the compensation of some individuals by certain Covered Health Insurance Providers (CHIPs). The limitation, contained in Internal Revenue Code Section 162(m)(6), as added by the Patient Protection and Affordable Care Act (PPACA), imposes a $500,000 per year limit on the deduction that a CHIP may claim with respect to the compensation paid to its officers, directors, employees and certain other service providers. Compensation, for purposes of applying the limitation in a given year, can include deferred compensation not actually paid or otherwise deductible until a later year.

The proposed regulations largely affirm guidance previously issued by the IRS in the form of Notice 2011-02.

Comments on the proposed regulations, as well as any requests for hearing on the topic, are due by July 1, 2013.

DOL Releases PPACA Study on Self-Insured Health Plans

On April 1, the U.S. Department of Labor sent to Congress the third annual report on self-insured employee health benefit plans, as required under the Patient Protection and Affordable Care Act (PPACA). The report contains general information on self-insured employee health benefit plans and financial information on the employers that sponsor them.

The report estimates that 20,000 health plans filing a Form 5500 Annual Return/Report of Employee Benefit Plan for 2010 were self-insured and 4,000 mixed self-insurance with insurance. These plans respectively covered 30 million and 26 million participants. Many self-insured health plans do not meet the filing requirements and therefore do not file the Form 5500. Therefore, it is likely that the report underestimates the total number of self-insured plans.

The report includes two appendices: Appendix A provides aggregate information on self-insured and mixed health benefit plans that are required to file a Form 5500 Annual Return/Report of Employee Benefit Plan (plans covering 100 or more participants or holding assets in trust). Appendix B presents a study that surveys the academic literature on self-insured health plans, explores statistical issues associated with Form 5500 data, and analyzes available financial data for the employers that sponsor group health plans filing the Form 5500.

CMS Issues Termination Schedule for ERRP

On April 23, the Centers for Medicare and Medicaid Services (CMS) issued a notice describing the process for winding down the Early Retiree Reinsurance Program (ERRP) in anticipation of the program's January 1, 2014, sunset date.

The ERRP, which allows employer health plan sponsors to apply and qualify for reimbursement of early retiree health care expenses, was enacted under Section 1102 of the Patient Protection and Affordable Care Act (PPACA). The temporary $5 billion program was designed to end on the earlier of January 1, 2014 (when the state-based health insurance exchanges are scheduled to

be operational) or when program funds were exhausted. Requests for reimbursement had already exceeded the $5 billion in appropriated funding by early 2012.

The April 23 notice describes how five operational processes will be impacted by the sunset date, including:

- Reporting changes to information in ERRP applications;
- reporting change of ownership;
- submitting reimbursement requests;
- reporting and submitting corrections to data inaccuracies; and
- requesting the Secretary to reopen and revise an adverse reimbursement determination.

Informal EEOC Letter Addresses Wellness Plans, Reasonable Accommodations under ADA

The Equal Employment Opportunity Commission (EEOC) recently released an informal letter indicating that if a wellness program is voluntary and an employer requires participants to meet certain health outcomes or to engage in certain activities in order to remain in the program or to obtain rewards, the program must provide reasonable accommodation to individuals unable to meet the outcomes or engage in specific activities.

The January 18, 2013, letter from EEOC legal counsel Peggy Mastroianni responds to an inquiry submitted to the Nashville-area EEOC office about "a plan, offered to eligible employees (e.g. employees with diabetes) on a voluntary basis, which waives the plan's annual deductible if the employee meets certain requirements, such as enrollment in a disease management program or adherence to a doctor's exercise and medication recommendations."

The letter expresses the EEOC's view that such a program would be considered a wellness program, saying "we assume that a condition of participation is that employees disclose that they have qualifying health conditions, which would be a disability-related inquiry, and that other disability-related inquiries or medical examinations would be required to determine continued eligibility for any incentive offered." Such inquiries by employers are strictly limited under Title I of the ADA and EEOC enforcement guidance.

The letter also explains that (1) disability-related inquiries and medical examinations are permitted as part of a voluntary wellness program and (2) a wellness program is voluntary as long as an employer neither requires participation nor penalizes employees who do not participate. Although the EEOC indicates that the plan, as described, provides a reward for participation (waiver of the annual deductible), it does not address whether the wellness program is "voluntary" for purposes of the Americans with Disabilities Act (ADA), an ongoing area of regulatory uncertainty. As stated in the letter, "The EEOC has not taken a position on whether and to what extent a reward constitutes a requirement to participate, or whether withholding of the reward from non-participants constitutes a penalty, thus rendering the program involuntary."

Although the letter is "an informal discussion of the issues" and does not constitute an official opinion of the EEOC, it provides additional insight with regard to the EEOC's views on wellness programs.

RECENT JUDICIAL ACTIVITY

Federal Court Decision Upholds IRS Interpretation of Stock Options under 409A

A recent federal claims court case has confirmed that Internal Revenue Code 409A (which governs nonqualified deferred and "executive" compensation) applies to discounted stock options, even if the options were granted before 409A was enacted as part of the American Jobs Creation Act of 2004.

Under IRS Notice 2005-1 and subsequent regulatory guidance, the IRS established that if a stock option is granted with an exercise price of less than the fair market value on the grant date, the option is considered "deferred compensation" subject to 409A.

In the case of *Sutardja v. United States*, the Court of Federal Claims ruled in favor of the United States on a number of issues related to nonqualified deferred compensation, thereby generally affirming the IRS view.

U.S. Supreme Court Decides for Employers in Subrogation Case

The U.S. Supreme Court handed down a unanimous decision on April 17 in McCutchen v. U.S. Airways, Inc., ruling that equitable defenses do not override clear contract language and cannot be used to re-write terms of an ERISA-governed plan.

McCutchen v. U.S. Airways, Inc. involves Section 502(a)(3) of ERISA. Under this provision, when an employer-sponsored plan files suit against a participant seeking to enforce the plan's terms the available relief is limited to an injunction or "other appropriate equitable relief." The Supreme Court has twice applied Section 502(a)(3) in the context of benefit plan reimbursement provisions, including "subrogation" provisions that require an employee to reimburse the plan for monies paid to cover his or her health costs if the employee subsequently recovers from a third party. In these prior cases, the Court held that (1) under Section 502(a)(3), any recovery a plan seeks from a participant must be equitable in nature; and (2) an action to enforce a reimbursement provision against a participant who holds identifiable funds is allowed under ERISA.

These prior Supreme Court decisions, however, left open whether employees should be allowed to raise typical equitable defenses, including "unjust enrichment," as argued in McCutchen. Prior to the ruling in *McCutchen* by the U.S. Court of Appeals for the Third Circuit, at least five courts of appeals considered that question. They unanimously concluded that clearly worded reimbursement provisions should be enforced as written. They reasoned that "[a]pplying federal common law" doctrines of insurance equity to override the plan's controlling language, which expressly provides for reimbursement, would frustrate ERISA's purpose to protect contractually defined benefits.

Justice Elena Kagan, writing the court's majority opinion to reverse the Third Circuit decision with respect to the reimbursement provision, stated that "… in an action brought under Section 502(a)(3) based on an equitable lien by agreement, the terms of the ERISA plan govern. Neither general principles of unjust enrichment nor specific doctrines reflecting those principles—such as the double-recovery or common-fund rules—can override the applicable contract." The decision also held that although the equitable rules cannot trump the plan's reimbursement provision, it could be used to properly construe it. Since the US Airways plan was silent on the allocation of attorneys' fees and said nothing specific about how to pay the costs of recovery, the Court concluded that the common-fund doctrine could be used to bridge that contractual gap.

The decision represents an important win for employers in the enforcement of reimbursement provisions of ERISA-governed plans.