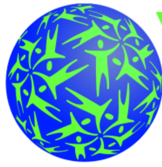

WEB Worldwide Employee Benefits Network

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WEB's ***Benefits Insider*** is a bi-monthly member exclusive publication providing the latest developments from Washington, DC, on matters of interest to employee benefits professionals. The content of this newsletter is being provided through a partnership with the American Benefits Council, a premier benefits advocacy organization. To inquire about membership with the Council, contact Deanna Johnson at (202) 289-6700 or djohnson@abcstaff.org.

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RECENT LEGISLATIVE ACTIVITY

Senate Committee Examines Retirement Security

On January 28, the U.S. Senate Finance Committee held a hearing on Helping Americans Prepare for Retirement: Increasing Access, Participation and Coverage in Retirement Savings Plans, focusing on the recommendations of the committee's bipartisan working group on Savings and Investment.

In a media advisory announcing the hearing, Committee Chairman Orrin Hatch (R-UT) observed that "Employer-sponsored plans are an important source of retirement savings for American workers. As such, we should be doing all we can to empower job creators to offer and improve access to retirement savings plans for their workers." He echoed this principle in his opening statement, identifying "open" multiple employer plans (MEPs) as one particular area of promise.

Senator Ron Wyden (D-OR), the committee's ranking Democrat, was critical of the federal tax incentives supporting employer-sponsored retirement plans in his opening statement, calling them "skewed toward people who need the assistance the least." He also touted Oregon's automatic payroll-deduction IRA program for those without employer-based coverage. Wyden also announced that he would soon be introducing a bill to "strengthen the saver's tax credit so that it does more for the people who need the most help."

The Finance Committee hearing featured testimony from the following witnesses:

- Alicia Munnell, director of the Center for Retirement Research at Boston College, argued that "the private pension system is not working well … and people simply do not save if they do not have an employer-provided plan." Munnell was supportive of the working group proposals, particularly open MEPs, but advocated for "bold changes" including mandatory automatic enrollment in 401(k) plans.

- John J. Kalamarides, head of Institutional Investment Solutions for Prudential Financial, identified the three barriers to employer adoption of retirement plans: cost, administrative hassle and fiduciary liability. He, too, supported elimination of the "nexus" requirement for open MEPs as well as the "one bad apple" rule (under which one employer's failure to meet the criteria necessary to maintain a tax-preferred retirement plan can result in potential disqualification of the entire MEP) and called for development of a "model MEP" that eliminates discrimination testing.

- Thomas Barthold, chief of staff for the Joint Committee on Taxation, offered a detailed review of present law related to employer-sponsored retirement plans and individual retirement arrangements, economic issues relating to retirement plans, data relating to retirement savings and summaries of selected legislative proposals relating to tax-favored retirement savings.

During the question-and-answer period, Wyden observed that ERISA has failed keep pace with the modern economy, particularly those with irregular work patterns. Kalamarides suggested that expanding open MEPs and programs for “long-time, part-time” workers would help employees in the “gig” economy. On this same topic, Senator Mark Warner (D-VA) noted that contingent workers have made up a growing share of the working population for many years.

Numerous lawmakers raised the specter of retirement plan “leakage,” the term for assets being depleted from an account prior to retirement through plan loans or hardship distributions. Senator Charles Grassley (R-IA) asked the panel for insights on possible approaches to limit leakage, in light of the fact that these plan features are useful in encouraging people to participate in the plan. Barthold acknowledged that it was a challenging trade-off, but said there is no empirical evidence that suggests that the plan design rules should be tightened.

Hatch noted that the committee would be examining multiemployer plans in a subsequent hearing.

RECENT REGULATORY ACTIVITY

Obama Budget Proposal to Include New Retirement Policy Initiatives

While President Obama’s Fiscal Year 2017 federal budget proposal will not be formally issued until February 9, on January 26 the White House announced the proposal would include a series of new and continuing initiatives designed to expand retirement plan coverage and make accumulated savings more portable.

The most notable new proposal would make it easier for small private employers to enter into “open” multiple employer plans (MEPs) by eliminating the requirement that employers share a nexus or “common bond” other than maintaining the same plan.

Additionally, echoing the President’s remarks in his most recent State of the Union Address in which he called for increased portability of retirement benefits, the budget proposal will devote demonstration funding for nonprofits and states to develop and pilot models that are portable across employers and can accommodate intermittent contributions or contributions from multiple employers for an individual worker. As part of this effort, the U.S. Department of Labor (DOL) will be directed to “evaluate existing portable benefits models and examine the feasibility of greater change.”

In November 2016, a group of 11 Senate Democrats (including the ranking Democrat on the Senate Finance Committee, Ron Wyden (D-OR) and the ranking Democrat on the Senate Health, Education, Labor and Pensions (HELP) Committee, Patty Murray (D-WA)) sent a letter to DOL Secretary Thomas Perez asking the department to encourage the use of a retirement “clearinghouse” for rollovers.

The January 26 announcement also indicates that the FY 2017 budget proposal will include a number of other ideas that have formed the centerpiece of the Obama Administration's retirement policy agenda, including:

- Mandatory automatic enrollment of workers without access to a workplace retirement plan in an Individual Retirement Account (IRA): Employers that have been in business for at least two years and have more than 10 employees, and do not currently offer a retirement plan, would be required to automatically enroll employees in an IRA. This proposal is described in more detail on Page 135 of the 2015 Treasury "Green Book."

- Tax credits for auto-IRA adoption and for small businesses that choose to offer employer plans or switch to auto-enrollment: Employers with 100 or fewer employees could claim a temporary non-refundable tax credit of up to $1,000 per year for three years, with an additional non-refundable credit of $25 per enrolled employee up to $250 per year for six years. Additionally, the current "start-up" credit would be increased to $1,500 per year for three years (and up to a fourth year under certain circumstances). Small employers who already offer a plan and add auto-enrollment would be eligible for an additional $1,500 tax credit.

- Expanding employee access to workplace retirement plans among part-time workers: the proposal would require employers who offer retirement plans to allow employees who have worked at least 500 hours per year for three years or more to make voluntary contributions to the plan. Employers would not be required to offer matching contributions.

As a reminder, the president's previous budgets also included a number of troubling retirement policy provisions, including additional Pension Benefit Guaranty Corporation (PBGC) authority and premium increases, a limit on the total accumulation of benefits in tax-preferred retirement plans and IRAs, and prohibitions on so-called "stretch IRAs" (meaning that non-spouse beneficiaries of deceased IRA owners and retirement plan participants generally would be required to take inherited distributions over no more than five years). Although these provisions were not mentioned in the White House announcement, they could be included in the President's budget proposal.

It is important to note that while the president's annual budget proposal describes how much money should be spent on various governmental activities, including substantive programmatic changes as those noted above, it is only the starting point for negotiations with Congress. Undoubtedly, the Republican-controlled Congress has its own ideas and many proposals from President Obama (as with all presidents) have not been adopted in the past. However, budget items – because their revenue impact has already been calculated – are occasionally considered separately as federal revenue offsets for other non-budget legislation. Outside of the budget process, the January 26 announcement cites several other retirement-related regulatory items that are already underway within the Obama Administration:

- The PBGC will be issuing a proposal to expand its existing Missing Participants Program – which connects participants who could not be located when their defined benefit plan terminated with their unclaimed pension benefits – to help missing participants in terminating defined contribution plans as well.

- In June, the federal government's retirement plan – the Thrift Savings Plan (TSP) – will issue a request for proposals to, among other things, facilitate rollovers to the TSP by making the service provider, not the participant, responsible for shepherding rollovers. This raises questions regarding what new responsibilities may be placed on service providers and whether these could eventually be extended to other contexts not involving the TSP.

- The Obama Administration is still eager to finalize the DOL's proposed regulations to broadly change the definition of "fiduciary investment advice" by extending fiduciary status to a wide array of advice relationships. (See next story below.)

DOL Inches Closer to Finalization of Fiduciary Definition Rule

The U.S. Department of Labor reportedly sent a final version of its proposal to change the definition of "fiduciary investment advice" to the White House Office of Management and Budget (OMB) on January 28. OMB review is generally limited to 90 days, though the review period could be shortened to as few as 50 or 60 days. Under current law, the OMB director is permitted to extend it once for up to 30 days and the head of a rulemaking agency can extend it indefinitely.

The DOL proposal seeks to extend fiduciary status to a wide array of advice relationships. Congressional lawmakers have urged DOL to proceed deliberately and obtain as much input as possible before issuing a final rule. Prior to the end of 2015, policymakers floated a measure to limit the DOL budget in such a way that it would be prevented from finalizing the rule before the end of the 2016 fiscal year. Ultimately, this measure was not included in the December 2015 spending bill.

Nevertheless, two measures designed to address concerns with the DOL proposal have been introduced: the Strengthening Access to Valuable Education and Retirement Support (SAVERS) Act (H.R. 4294) and the Affordable Retirement Advice Protection (ARAP) Act (H.R. 4293). Both measures would require an affirmative vote by Congress before the DOL final rule is permitted to go into effect. If Congress fails to approve the department's regulatory proposal, a new fiduciary standard contained in the legislation would take effect. The U.S. House of Representatives Education and the Workforce Committee has scheduled a "markup" session on February 2 to review the legislation, with the House Ways and Means Committee to follow on February 3.

IRS Proposes New Rules for Applying Nondiscrimination Rules to Frozen Pension Plans

The Internal Revenue Service (IRS) released new **proposed rules** on January 28 addressing the imposition of certain nondiscrimination rules on closed (soft frozen) defined benefit pension plans.

The increasingly necessary practice of defined benefit plan sponsors "soft freezing" their plans (closing them to new entrants) has created new challenges for employers. These plan sponsors have various approaches to assist older employees with this transition, such as grandfathering existing participants. However, over time, some of these transition approaches can become technically inconsistent with current regulations prohibiting discrimination in favor of highly compensated employees due to turnover among lower compensated employees and movement of some of those employees to highly compensated status over time.

Plan sponsors are currently operating under temporary relief provided under IRS Notice 2014-5, issued in December 2013 and extended through 2016 by Notice 2015-28. This guidance allows plans to be tested together (or "aggregated") on a benefits basis for plan years beginning before January 1, 2017, if (1) the plans qualified for aggregate testing in 2013, based on meeting the "primarily defined benefit in character" rule or "broadly available" in the plan year beginning in 2013, or (2) the defined benefit (DB) plan passed nondiscrimination on its own in 2013. This allows plans that did not already have a problem to aggregate the defined benefit and defined contribution plans for testing purposes in their 2014 and 2015 (and now 2016) plan years, even if they would not have met the aggregate test in those plan years.

To qualify for the temporary relief, the "soft freeze" amendment had to be in place by December 13, 2013. Absent this relief, closed plans were subject to rigid testing every year, which would result in failing discrimination testing at some point due to the turnover and movement among lower compensated employees previously discussed. This relief does not address the inadvertent effects of ERISA's nondiscrimination rules on plans that attempt to grandfather participants from changes in a defined benefit plan.

The new proposed regulations provide modifications to the testing rules that would allow some closed plans more flexibility to pass nondiscrimination testing if they meet certain look-back and look-forward rules (generally, lack of significant modifications to the plan for five years before and after the closing, except for the closing event itself). Essentially, this changes the current yearly test to a five-year (point-in-time) test using current nondiscrimination testing and ongoing tests after that with the modified testing requirements. The proposal also contains two new rules applicable to any defined benefit plan (not just closed plans). Many of the new rules can be relied upon before the regulation becomes effective for plan years beginning on or after January 1, 2014.

The IRS is soliciting written comments on the proposal through April 28 and will hold a hearing to discuss these matters on May 19.

In the previous session of Congress, Senators Benjamin Cardin (D-MD) and Rob Portman (R-OH) of the U.S. Senate Finance Committee, and Representatives Pat Tiberi (R-OH) and Richard Neal (D-MA) of the U.S. House of Representatives Ways and Means Subcommittee on Select Revenue Measures, introduced legislation (the Retirement Security Preservation Act (S. 2855)/H.R. 5381) that would have affirmed that a defined benefit plan does not fail the nondiscrimination rules, or the minimum participation requirement, provided the composition of the closed class of participants in the plan meets certain requirements. Further legislation has not been introduced in the current congressional session, primarily in anticipation of proposed guidance from the IRS. However, legislation could still be introduced to resolve remaining issues or to respond to concerns raised by restrictions included in the new rules.

IRS Issues Guidance on Mid-Year Changes to Safe Harbor Plans and Safe Harbor Notices

In Notice 2016-16, issued on January 29, the Internal Revenue Service (IRS) provided guidance on mid-year changes to safe harbor 401(k) plans and how they must be treated under the Internal Revenue Code nondiscrimination rules.

The notice provides that a mid-year change, either to a safe harbor plan or to a plan's safe harbor notice, does not violate the prevailing safe harbor rules merely because it is a mid-year change, provided that applicable notice and election opportunity conditions are satisfied and the mid-year change is not a prohibited mid-year change, as described in the notice.

The IRS is soliciting comments on additional guidance that may be needed, particularly with respect to mid-year changes to safe harbor plans in cases in which a plan sponsor is involved in a merger or acquisition or to plans that include an eligible automatic contribution arrangement. Written comments are due no later than April 28, 2016.

IRS Advisory Committee Seeks Input on Determination Letter Policy

The Employee Plans subgroup of the Internal Revenue Service (IRS) Advisory Committee on Tax Exempt and Government Entities has launched a survey of retirement plan practitioners and service providers to collect feedback on its decision to eliminate most determination letters for individually designed plans (those that are *not* operating under a pre-approved vendor-sponsored master and prototype or volume submitter plan document).

Click here to take the survey. The deadline for responses is February 1. Responses are voluntary, confidential and will be sent only to the advisory committee, not the IRS itself. The committee is particularly interested in learning what choices plan sponsors are likely to make and how the IRS can minimize the impact of the changes to the determination letter program.

In anticipation of the forthcoming changes, the IRS recently issued Internal Revenue Bulletin 2016-1 and Notice 2016-3 establishing the new process for obtaining determination letters.

FASB Proposes New Defined Benefit Plan Disclosures, Benefit Cost Guidelines

In a series of exposure drafts issued on January 26, the Federal Accounting Standards Board – the independent organization tasked with establishing generally accepted accounting principles (GAAP) within the United States – proposed changes to both the defined benefit plan disclosure rules and the presentation of pension benefit costs.

In **Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20)**, FASB seeks to modify the disclosure requirements for employers that sponsor defined benefit pension or other post-retirement plans by removing seven current requirements and adding five new requirements.
Very generally, the proposal eliminates certain number-based disclosures in favor of "material," more descriptive disclosures. These more descriptive disclosures include such requirements as "a narrative description of the reasons for significant gains and losses affecting the benefit obligation or plan assets." Although financial statement users have indicated that current disclosures are sufficient, FASB believes they can make incremental improvements.

In **Compensation—Retirement Benefits (Topic 715)**, FASB seeks to improve the presentation of "net periodic pension cost" and "net periodic postretirement benefit cost" on financial statements.

Generally, the effect of the proposed amendments would be to disaggregate the service cost component from the other components of net benefit cost. The proposed amendments also would provide explicit guidance on how to present the service cost component and other components of net benefit cost in the income statement and would allow only the service cost component of net benefit cost to be eligible for capitalization.

RECENT JUDICIAL ACTIVITY

Supreme Court Affirms High Standard for Stock Drop Cases

In a collective and unanimous January 25 opinion, the U.S. Supreme Court maintained that so-called "stock drop" lawsuits – based on a plan fiduciary's alleged failure to divest of an investment (such as company stock) that subsequently drops in value – must clear a high standard to be considered valid.

In *Harris et al. v. Amgen et al.,* the plaintiffs (current and former employees of Amgen and AML), participated in two retirement plans that qualified as "eligible individual account plans" under ERISA. When the value of Amgen common stock fell, the plaintiffs alleged that the employers breached their fiduciary duties. The U.S. Court of Appeals

for the Ninth Circuit has consistently sided with the plaintiffs in their allegations of breach of fiduciary duty.

This is the second time the high court had ruled on the case, after having vacated a prior ruling by the Ninth Circuit and sending the case back for further consideration in light of the high court's decision in *Fifth Third Bancorp v. Dudenhoeffer*. In that landmark precedent, the court indicated that"[t]o state a claim for breach of the duty of prudence on the basis of inside information, a plaintiff must plausibly allege an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary would not have viewed as more likely to harm the fund than to help it."

In remanding the case back to the Ninth Circuit Court of Appeals once again, the Supreme Court stated that "The Ninth Circuit … failed to assess whether the complaint in its current form 'has plausibly alleged' that a prudent fiduciary in the same position 'could not have concluded' that the alternative action 'would do more harm than good.' … Having examined the complaint, the Court has not found sufficient facts and allegations to state a claim for breach of the duty of prudence."

The high court's ruling sends a powerful message that "stock drop" plaintiffs must fully satisfy the requirement that they "plausibly allege an alternative action that the defendant could have taken" before the lawsuit can proceed.

Supreme Court Limits Health Plan's Ability to Recover Funds in Subrogation Claims

The U.S. Supreme Court ruled on January 20, in the case of *Montanile v. Board of Trustees of the National Elevator Industry Health Benefit Plan*, that employers pursuing subrogation claims can only recover third-party settlement funds if they have not yet been spent.

Under the subrogation rights provided by ERISA, an employer plan or insurer is entitled to "equitable relief" in the form of amounts it paid for the cost of benefits it provided for a claimant, and for which a third party has been found liable.

Under the facts of this case, an ERISA plan paid medical bills arising out of an automobile accident in which the participant in a health plan sustained injuries. When the participant received a settlement of $500,000, the plan sought repayment of $121,000 in expenses it had paid on his behalf. Because the participant had already spent the proceeds on legal expenses and medical care, the fiduciary sought an equitable lien against petitioner's general assets.

The U.S. District Court for the Southern District of Florida ruled that the lien was enforceable, a ruling upheld by the U.S. Court of Appeals for the Eleventh Circuit (aligning with the First, Second, Third, Sixth and Seventh Circuits, with the Eighth and

Ninth circuits in opposition). The Supreme Court took up the case to resolve the circuit court conflict.

In an 8-to-1 decision, the high court reversed the appellate court decision. Writing the majority opinion, Justice Clarence Thomas clarified that the "equitable relief" available under ERISA Section 502(a)(3) is limited to "specifically identified funds that remain in the defendant's possession or against traceable items" purchased with those funds. The Supreme Court's decision is significant, not only because it imposes pressure on employers to pursue subrogation claims as swiftly as possible, but also because it has similar implications for other actions brought under ERISA's "equitable relief" provisions, such as recovery of retirement plan overpayments. The court's ruling could also affect actions filed by participants against plan fiduciaries.

District Court to Review Vesting of Benefits in Light of Supreme Court Decision

Additional fact-finding in a landmark retiree health benefits case will take place at the district court level, it was announced on January 21.

The U.S. District Court for the Southern District of Ohio will reviewthe case of *Tackett, et al. v. M&G Polymers USA, et al.*, in which the U.S. Supreme Court previously struck down a special inference that retiree health care benefits are "vested for life" and should continue indefinitely in the absence of specific language to the contrary in a plan document or collective bargaining agreement. The high court remanded the case to the Second Circuit Court of Appeals, which then remanded the case to the district court. The Supreme Court decision effectively invalidated what is known as the "Yard-Man inference," a judicial inference previously applied by the U.S. Court of Appeals for the Sixth Circuit under which parties to a collective bargaining agreement are assumed to vest retirees with lifetime health benefits in the absence of a specific contractual provision or extrinsic evidence to the contrary. Since the initial fact-finding was influenced by this prevailing inference, the appellate court said, the district court must reexamine the facts of the case.