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EMPLOYEE BENEFITS DEVELOPMENTS
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Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

Final Regulations Issued on Fiduciary Investment Advice

The U.S. Department of Labor (DOL) has issued a final regulation under the statutory rules adopted in the Pension Protection Act of 2006, which created a new statutory exemption from the prohibited transaction rules to allow 401(k) and other pension plan fiduciaries to provide investment advice to participants. The statutory exemption permits participant investment advice to be provided 1) under a computer model, or 2) by an advisor who is compensated on a level-fee basis, meaning that fees do not vary based on the investments selected by the participants. Use of the exemption is optional, and no plan is required to arrange for participant investment advice. Under the regulations, a computer model must be certified as unbiased and must be based on generally accepted investment theories. The regulations also adopt methods for the certification of computer models by independent experts.

If these arrangements are to be used, the plan fiduciary, such as a plan committee, trustee, or plan administrator that is independent of the investment advisor, must authorize the advice arrangement. Recordkeeping requirements are imposed on the investment advisors relying on the exemption. The new rules include annual auditing requirements for the investment advice arrangements by independent auditors, and they require disclosures be made by the advisors to plan participants about the arrangements. Without these rules, the statute generally precludes any investment advisor from recommending a plan investment option if the advisor also receives fees from the underlying investment products.

Because these arrangements are now in their infancy, it is uncertain how widespread the use of participant investment advice arrangements will become. The DOL anticipates that as many as 16,000 investment advisor firms will provide investment advice pursuant to the statutory exemptions. With 401(k) plans maturing, and participants building larger account balances and relying on those accounts as a principal source of retirement income, it is likely that plan administrators will see

more and more of these investment advice arrangements offered to them as part of a 401(k) plan or other pension arrangement. (Department of Labor Regulation Section 2550.408g-1, October 2011)

U.S. Department of Labor Releases Final Rule Revising Procedures for Filing and Processing Prohibited Transaction Exemptions Under ERISA

The U.S. Department of Labor (DOL) has issued revised rules under which applicants may request an administrative exemption from the restrictions on prohibited transactions under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code. Under ERISA and the Code, a plan fiduciary is generally prohibited from causing a plan to engage in certain “prohibited transactions” with a party in interest (a “disqualified person,” under the Code). The term “party in interest” includes a fiduciary, service provider, sponsoring employer, union, and any other person who may be in a position to exert improper influence over a plan. The DOL is authorized to grant administrative exemptions from the prohibited transaction rules.

The revised rules are largely procedural, with many of the rules governing what information must be submitted with an application; however, there are several more substantive provisions that potential applicants should be aware of.

In certain circumstances, an application may be accompanied by a qualified independent appraisal report, or a qualified independent fiduciary may be required to represent the interests of the plan in a transaction. Whether an appraiser or fiduciary is independent of and unrelated to any party in interest (or their affiliate), is based on all the relevant facts and circumstances. In making this evaluation, unless the facts and circumstances indicate otherwise, a presumption of independence exists if the revenue an appraiser or fiduciary receives (or is projected to receive) in the current taxable year from a party in interest (or its affiliate) does not exceed two percent of the appraiser’s or fiduciary’s annual revenue from the prior taxable year. If the two percent threshold is exceeded, an appraiser or fiduciary may still be considered independent based on all the facts and circumstances, provided that the revenue it receives (or expects to receive) from a party in interest (or their affiliate) within the current taxable year does not exceed five percent of its annual revenue from the prior taxable year.

The definition of “affiliate” in the revised rules remains largely intact from the rules issued in 1990. The revised rules clarify that only an employee or officer of a person who possesses direct or indirect authority, responsibility, or control regarding the custody, management, or disposition of plan assets involved in the subject exemption transaction is an affiliate. The 1990 rules contained no explicit requirement that the plan assets must be those involved in the subject exemption transaction, allowing an employee or officer to be considered an affiliate if they possessed the requisite authority over any assets of the plan.

The revised rules also outline procedures for obtaining a retroactive exemption. As a general matter, the DOL will only consider granting a retroactive exemption if the safeguards necessary for a prospective exemption were in place at the time the transaction was consummated. In this regard, a retroactive exemption requires that the applicant provide evidence that it acted in good faith at the time of the transaction by taking reasonable and appropriate steps to protect the plan from abuse and unnecessary risk. The revised rules enumerate a non-exhaustive list of factors that will be considered in this inquiry, including the participation of a qualified independent fiduciary and the existence of a contemporaneous qualified

independent appraisal. The revised rules state that the DOL ordinarily will not favorably consider retroactive exemption requests where the plan has suffered a loss. (DOL Regulation Sections 2570.30 through 2570.52, effective December 27, 2011.)

IRS Further Delays Interest Crediting Rules Under Cash Balance/Hybrid Plans

A key piece of the Pension Protection Act of 2006 (PPA) relating to cash balance and other hybrid plans was a requirement that these plans may not provide for interest credits exceeding a market rate of interest. In late 2010, the Internal Revenue Service (IRS) issued proposed regulations regarding what qualifies as a market rate of interest. As originally envisioned, these rules would have become effective for plan years beginning in 2012. However, the IRS has not yet finalized these regulations, as certain complex issues have not been resolved. Because the regulations have not been finalized, the IRS has delayed the deadline to bring plans in compliance with these requirements until at least the last day of the 2012 plan year. IRS representatives have indicated that a final regulation on interest crediting and market rates of interest should be issued in the near future. (IRS Notice 2011-85)

IRS Issues List of Required Modifications

In connection with issuance of guidance on applications for opinion letters by sponsors of certain pre-approved plans (master and prototype plans) the Internal Revenue Service (IRS) has issued an updated listing of required modifications (LRMs), which reviewers use to determine whether the submitted documents comply with new law and regulation requirements. This language is not mandated to be utilized in a plan document; however, this language is helpful in preparing updated plan documents and helpful in obtaining speedy approval on an IRS determination letter request.

The Trade Adjustment Assistance Extension Act Extends Health Coverage Tax Credit

On October 11, 2011, the Trade Adjustment Assistance Extension Act was signed into law. Among its many provisions, this bill increases the amount of the Health Coverage Tax Credit (HCTC) available through the Trade Adjustment Assistance (TAA) program and extends available COBRA coverage to certain individuals. These provisions will be effective until January 1, 2014.

The HCTC was established in 2002 to help cover the cost of health insurance for workers who lose their jobs due to foreign trade and for certain individuals who receive their pension payments through the Pension Benefit Guaranty Corporation (PBGC). An individual is eligible for the HCTC if he or she meets the general requirements, is enrolled in a qualified health plan, and is either at least 55 years old and receiving pension payments from the PBGC, or receiving TAA benefits (including benefits under the Reemployment or Alternative TAA).

The HCTC pays a portion of qualified health insurance premiums for eligible individuals. Under the Trade Adjustment Assistance Extension Act, the amount of the HCTC increased from 65 percent of the qualified health insurance premiums to 72.5 percent.

Also under the new act, TAA recipients and individuals receiving pension payments from the PBGC whose maximum COBRA coverage period is due to expire on or after November 21, 2011 are eligible for COBRA coverage extensions through their former employer. TAA recipients are eligible for COBRA coverage extensions for as long as they have TAA eligibility, or until January 1, 2014. Individuals receiving pension payments from the PBGC are eligible for COBRA coverage extensions until January 1, 2014. If the PBGC payee dies, his or her surviving spouse or dependents are able to receive an additional 24 months of COBRA, or until January 1, 2014.

Additional Guidance on New IRS Settlement Program for Misclassified Workers

Employer misclassification of employees as independent contractors continues to attract the attention of the Internal Revenue Service (IRS) and the U.S. Department of Labor (DOL). In September 2011, the IRS announced a new Voluntary Classification Settlement Program (VCSP) that provides payroll tax relief for employers with past worker classification problems if they agree to voluntarily reclassify their workers as employees for future employment tax purposes (IRS Announcement 2011-64). The program is intended to encourage future tax compliance by employers through the offer of substantial payroll tax relief for their past misclassification of workers as nonemployees or independent contractors.

A set of frequently asked questions (FAQs) issued by the IRS in October 2011, provides additional guidance for the program. Eligible employers accepted into VCSP will pay 10 percent of the employment tax liability they may have owed on the compensation paid to the workers for the most recent tax year, calculated under the reduced rates of Section 3509 of the Internal Revenue Code. In addition, no interest or penalties will be due, and employers will not be audited for payroll tax purposes for the reclassified workers for prior years. However, for the first three years under the program, participating employers will be subject to a special six-year statute of limitations, rather than the usual three-year period that generally applies to payroll taxes. Although the IRS and the DOL signed a memorandum of understanding on September 19, 2011 to share information and collaborate on worker misclassification issues, A18 and A19 of the VCSP FAQs state that the IRS will not share information about VCSP applicants with either the DOL or the states.

Our Labor and Employment Practice Group has extensive experience with worker misclassification issues and, in conjunction with our Federal/International Tax Practice Group, is submitting questions to the IRS for clarification on a number of points related to the program. Stay tuned.

CASES

Stock Drop Case Update: Second Circuit Adopts Moench Presumption

Stock drop cases continue to be a hot area of litigation involving 401(k) plans, ESOPs, and other forms of individual account retirement plans. Stock drop cases are typically class action lawsuits started by groups of plan participants when plan assets are invested in employer stock and there has been a substantial decline in the stock price.

In a number of Circuit Courts of Appeal, the Moench presumption of prudence is frequently used as the basis for dismissing plaintiffs' stock drop claims that Employee Retirement Income Security Act of 1974 (ERISA) standards have been violated by plan fiduciaries. Under the Moench standard, there is a presumption that fiduciaries have not violated their ERISA fiduciary duties by allowing ongoing investments in employer stock as mandated by the terms of the plan documents, unless plaintiffs show the fiduciaries abused their discretion by continuing to invest in, or offering participants the opportunity to invest in, employer stock.

In two recent decisions (*Gray v. Citigroup, Inc*. 2nd Cir. 2011 and *Gearren v. McGraw-Hill Cos*. 2nd Cir. 2011), the Court of Appeals for the Second Circuit ruled on claims that fiduciaries acted imprudently by offering employer stock as investment options in the employers' plans despite the employers' exposure to risky subprime mortgages and the accompanying drop in stock value by 50 percent or more. In ruling in favor of the plan sponsor in both cases, the Second Circuit (which has jurisdiction in New York, Connecticut, and Vermont) now joins the Third, Fifth, Sixth, and Ninth Circuits in expressly adopting the Moench prudence presumption. In these two cases, employer stock was an investment option mandated by the plan, and the Second Circuit could find no abuse of discretion by the fiduciaries in continuing to offer employer stock as an investment option. The Second Circuit ruled that a fiduciary's failure to divest the plan of employer stock would be an abuse of discretion, and would be able to rebut the Moench presumption only under circumstances that place the employer in a "dire situation that was objectively foreseeable" to the plan sponsor. A downward trend in stock price alone, even if the drop is substantial, is not sufficient to rebut the Moench presumption.

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