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EMPLOYEE BENEFITS DEVELOPMENTS MARCH 2016

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Rulings, Opinions, Etc

IRS Provides Welcome Guidance on Mid-Year Changes to Safe Harbor 401 (k)/403(b) Plans. Previously, many advisors had been concerned that the Internal Revenue Service (IRS) regulations on safe harbor plan designs covering 401(k) and 403(b) plans may have severely limited the ability of plan sponsors to adopt amendments to their plans. This was because the IRS regulations indicated that a safe harbor design must be adopted before the start of the year and remain in effect for a 12-month plan year. This created a concern that amendments, even those that did not affect the safe harbor feature design of a plan, could be troublesome. The IRS regulations had permitted certain amendments and provided other exceptions in other published guidance which helped clarify that many amendments may be made without adversely affecting the qualification of a safe harbor plan feature. Under the new guidance in Notice 2016-16, amendments are generally permitted unless they are of a nature that modifies the safe harbor design in a prohibited manner. Under the Notice, the following changes are prohibited:

- A mid-year change to the vesting schedule which increases the number of years of service to obtain a fully vested account.
- A mid-year change in the type of safe harbor plan (a change from a traditional to a qualified automatic contribution arrangement).
- A mid-year change to exclude currently participating employees from the safe harbor contribution features (but prospective changes are permissible).
- Changes which modify the formula to determine a matching contribution or to permit additional discretionary matching contributions unless the change is made at least three months prior to the end of the plan year, the change is made retroactive, and an updated safe harbor notice is provided.

The Notice also provides that if a mid-year change will affect the information that must have been provided in the safe harbor notice, a new updated safe harbor notice described in the change must be provided within 30 days before the effective date of the change, or if not practical, as soon as possible but in no case, more than 30 days after the change. Following the provision of the updated sage harbor notice, all

employees must have an opportunity to make changes to their deferral elections. Under the Notice, changes were prohibited under the regulations continue to be prohibited including the adoption of the safe harbor design after the beginning of the plan year, a change to the plan year, or a reduction or suspension of safe harbor contributions. (IRS Notice 2016-16)

IRS Releases Guidance on Completing Compliance Questions for the 2015 Form 5500s. The Internal Revenue Service and Department of Labor recently announced that certain compliance questions added to the 2015 Form 5500 series returns should not be completed for the 2015 plan year.

For Form 5500 filers, Lines 4o-p and 6a-d on Schedules H and I should not be completed. These Lines include questions relating to unrelated business taxable income, in-service distributions, and certain trust information. In addition, new Part VII to Schedule R, which includes questions relating to nondiscrimination testing and plan document compliance, should not be completed in its entirety.

The 2015 Form 5500-SF includes similar questions. As with the Form 5500, these questions should be ignored in completing the 2015 Form 5500-SF. For Form 5500-SF filers, this includes Lines 10j; 14a-d, and New Part IX.

For both 2015 Forms 5500 and 5500-SF, the preparer's information at the bottom of the first page should not be completed.

CASES

Circuit Court Holds Claims Administrator's Claim Denial Not Entitled to Deferential Review. This case highlights the importance of having a well drafted plan document. Here, because the plan document did not clearly delegate discretionary authority to the claims administrator, the First Circuit Court of Appeals held that the claims administrator's decision to deny a claim should not have been afforded deferential review by the district court. This is important because claims that are subject to a more deferential standard are less likely to be overturned. The facts of this case are not unusual. Initially, the participant's claim (on behalf of her son) was partially denied by the claims administrator because the claim included expenses that, in the determination of the administrator, did not qualify as "medically necessary." After exhausting the plan's internal appeals process, the participant challenged the claim denial in district court. The district court, giving deference to the claim administrator's decision, upheld the denial on summary judgment. However on appeal, the circuit court ruled in favor of the participant by partially overturning the district court's decision based on the district court's erroneous use of a deferential standard of review. To increase the likelihood that a plan's claim decisions benefit from a deferential standard of review, plan sponsors should examine their plan documents to confirm that they clearly grant discretionary authority to claims administrators. *Stephanie C. v. Blue Cross Blue Shield of Mass. HMO Blue, Inc., (1st Cir. 2016).*

District Court Enforces Retroactive QDRO. A Michigan district court recently ruled that a pension plan must give retroactive effect to a domestic relations order prepared years after a deceased retiree's death. Under a divorce judgment issued in 1993, the plaintiff ex-wife in this case was awarded half of her husband's pension benefits accumulated under the plan during their marriage. Although the husband elected a single life annuity and began receiving retirement benefits in April 1994, the ex-wife did not submit the divorce judgment to the plan until December 1994. A plan representative determined that the judgment was not a qualified domestic relations order (QDRO) and arranged for a sample QDRO to be

mailed to her counsel. The plaintiff did not use the model form, but submitted the original divorce judgment again in early 2008, following the death of her ex-husband in late 2007. The plan denied her claim for benefits under the divorce judgment, stating that it was not a QDRO and that no benefit remained for assignment to her. The ex-wife unsuccessfully pursued benefits again in 2012.

In February, 2014, a county court entered a *nunc pro tunc,* or retroactive, domestic relations order, claiming marital property rights for the ex-wife as an alternate payee under the 1993 divorce judgment, and the ex-wife submitted it to the plan with a demand for benefits. The plan denied the claim because at the time of the participant-husband's benefit commencement, he chose a form of payment under which there is no survivor benefit. In 2015, the ex-wife filed suit, claiming benefits assigned to her under the divorce judgment and retroactive order.

To qualify as a QDRO that must be honored by an ERISA plan, a domestic relations order must satisfy a number of requirements, among them that the order must not require the plan to provide increased benefits (based on actuarial value) or to provide any type or form of benefit not otherwise provided under the plan. Because, in this case, the full amount of the participant's benefit was paid to him before he died, the plan argued that any benefits paid to the ex-wife under the order would represent an increase in the benefit. Also, because the order was issued after the commencement of the ex-husband's benefit, it would impermissibly change the form of his benefit from a single life annuity to a joint and survivor annuity with surviving spouse benefits. This would violate the plan's prohibition on a change in the form of benefits after the benefit commencement date.

The court concluded that the order could be qualified only if it is considered to be retroactive -- to date back to the 1993 divorce judgment. Noting that the courts are split on the validity of retroactive orders with respect to ERISA's qualification requirements, the court sided with "those authorities that give effect to a state court's invocation of the *nunc pro tunc* doctrine when evaluating the qualification" of a domestic relations order. Accordingly, the court held that the order in this case is considered entered as of 1993, and that the ex-wife is entitled to half of the late participant's benefits. Payment to the ex-wife now is thus regarded by the court not as an increase in benefits, but "instead a recognition that the money" the late participant received before his death included both his share and extra funds that the plan paid to him by mistake. *Patterson v. Chrysler Group* (E.D. Mich., 2016)

Stock Drop Case Update: District Court, On Remand, Rules Divestment of Stock Fund was Prudent. In the October 2014 issue of Employee Benefits Developments, we reported on a decision by the Court of Appeals for the Fourth Circuit in which the Fourth Circuit held that a district court erred in applying a "could have" standard in evaluating whether R.J. Reynolds Tobacco (RJR) had been objectively prudent in its decision to divest Nabisco stock funds from an individual account plan (i.e., whether a prudent fiduciary *could have* made the same decision to divest the stock funds). The Fourth Circuit remanded the case to federal district court for further proceedings consistent with evaluating whether RJR "met its burden of proving by a preponderance of the evidence that a prudent fiduciary *would have* made the same decision" (emphasis added) to divest the Nabisco stock funds.

On remand, after considering the testimony of several expert witnesses, the district court determined RJR was not liable, having concluded --

"…it is more likely than not that had a prudent fiduciary reviewed the information available to it at the time, including Plan documents, public disclosures, analysts' reports and associated research as to their significance, and newspaper articles, it would have decided to divest the Nabisco Funds at the time and in the manner as did RJR."

Whether the district court decision on remand will bring actual closure to this case remains unclear. The parties have been litigating this case for almost 14 years, and it seems quite possible this fight could continue in the form of another appeal to the Fourth Circuit. But, for now, this case serves as an ongoing reminder of the importance of plan fiduciaries adhering to a thoughtful and well-documented fiduciary process in deciding whether a particular investment or divestment decision is prudent and in the best interest of participants. In the face of an imperfect fiduciary process, RJR was able to meet the burden of proving that a prudent fiduciary would have made the same decision to divest and, for now, has avoided liability. *Tatum v. R.J. Reynolds Tobacco* (M.D.N.C. 2016).