Katten
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Compensation & Benefits IN FOCUS
Developments in executive compensation and employee benefits

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In This Issue

Health Reform Legislation Affects Large and Small Employers

On March 23, President Obama signed into law the Patient Protection and Affordable Care Act (the Act), legislation that is likely to have a dramatic impact on health insurance in the United States. The Act, as modified by the Health Care and Education Reconciliation Act of 2010—which was signed by President Obama on March 30—contains a variety of provisions that have directly affect the manner in which employers provide health insurance benefits, as well as certain related tax obligations.

The following summarizes several key terms of the Act that affect how employers currently supply health coverage to their employees, as well as some notable provisions about how employer-provided health insurance may change in the future.

Changes to Existing Plans for Next Year—Starting with the first plan year that begins after September 23, 2010, employer-provided health plans must meet the following requirements:

Coverage for Children until Age 26. Plans must offer coverage to the adult child of an employee until the child reaches the age of 26. Until 2014, such coverage must be provided only if the adult child is unable to obtain coverage under a plan maintained by the child's employer (for example, because the child's employer does not provide such coverage) or another employer-sponsored plan.

Lifetime Benefit Caps. Plans are not permitted to include annual or lifetime limits on benefits. The application of this requirement will be based on future interpretive guidance from the Department of Health and Human Services.

Recent Katten Client Advisories

Proposed Rules Address FBAR Reporting Requirements for Retirement Plans

The IRS issued proposed regulations about FBAR reporting. These regulations generally apply to U.S. retirement plan assets that are held offshore.

Read more

Banks May Use Their ESOPs to Improve Capital

Recent SEC filings reveal that certain banks that sponsor employee stock ownership plans may improve their capital positions by making adjustments to their plans.

Read more

The Pulse

More on the COBRA Subsidy

The COBRA subsidy eligibility period was extended until March 31, and the Department of Labor issued model notices related to the subsidy, as extended. Although both chambers of Congress introduced bills to further extend the subsidy, none were passed before Congress' spring recess. Further extension of the subsidy is anticipated when Congress reconvenes.

Read more

Request Deadline Looms for Pre-Approved Plans Determination Letters

April 30 is the deadline for employers that sponsor tax-qualified plans through non-standardized prototype plans or volume submitter plans to adopt updated plans and submit their applications for determination letters.

Read more

DOL Plans to Expand Definition of "Fiduciary"

The Department of Labor intends to issue proposed regulations that expand the definition of "fiduciary" to include persons such as certain consultants.

Read more

RiskMetrics Launches Tool to Measure Governance-Related Risks

To help investors gauge the level of corporate governance-related risks, RiskMetrics has introduced its Governance Risk Indicators (GRId). GRId replaces RiskMetrics' Corporate Governance Quotient (CGQ).

Read more

Auto-Enrollment for Large Employers. Employers with 200 or more full-time employees must, subject to applicable waiting periods, automatically enroll new full-time employees in health coverage. These employees must be given relevant notices about coverage and have the opportunity to opt out.

Flexible Spending Account Changes. Over-the-counter medications will no longer be eligible for reimbursement under flexible spending accounts, health savings accounts and other similar arrangements. In addition, effective in 2013, a new annual limit of $2,500 (as indexed in later years) on health flexible spending accounts will apply.

Reporting Obligations. The Act requires that employers report the aggregate cost of an employee's health coverage (medical, dental and vision) on that employee's annual Form W-2, beginning with the Form W-2 delivered in January 2012.

Key Changes with Later Effective Dates

Insurance Exchanges and Excise Taxes for Larger Employers. Beginning in 2014, a health insurance exchange must be established in each state. The exchanges will provide various levels of coverage and pricing that ignore preexisting conditions. These exchanges are expected to affect employers as follows:

- The employees of smaller employers (generally those with fewer than 50 employees) would be eligible to purchase insurance within the exchange (and possibly with a federal subsidy) without penalty to the employer.
- If a larger employer (generally one with 50 or more employees) does not offer full-time employees affordable coverage and such employees are forced to purchase insurance through the exchange, the employer may be subject to annual excise taxes that can reach as high as $3,000 per full-time employee.

Preexisting Conditions and Waiting Periods. Also beginning in 2014, employer health plans will be prohibited from imposing waiting periods in excess of 90 days and preexisting condition exclusions.

Reporting Obligations. Starting in 2014, employers with 50 or more employees will be required to report whether they offer coverage to full-time employees, the length of applicable waiting periods, the cost of coverage, the employer's share of total costs, and the number and names of full-time employees receiving coverage.

Excise Tax on "Cadillac Plans." Beginning in 2018, certain high-cost health insurance plans will be subject to a 40% excise tax on insurance companies (for policies sold in the group insurance market) and plan administrators (for self-funded plans). The tax would not apply to individual policies.

While the list above covers of some of the Act's key provisions that will affect employers, many other provisions will undoubtedly impact employers as the provisions of the Act become effective and the government issues regulations and other guidance.

The Patient Protection and Affordable Care Act can be found here.

The Reconciliation Act can be found here.

IRS 409A Audits Have Begun

The Internal Revenue Service announced that it would begin its first Employment Tax National Research Project since the 1980s. This Tax Project will include audits of 6,000 companies over the next three years, and is expected to focus review on (among other issues) executive compensation, including deferred compensation arrangements subject to Section 409A of the Internal Revenue Code of 1986, as amended.

In addition, employers are now reporting that the IRS has begun to audit deferred compensation plans for compliance under Section 409A. These audits are being conducted by the IRS as a separate audit project apart from the Tax Project. The IRS has been issuing "Information Document Requests" (IDRs) requiring disclosure of specific information on deferred compensation arrangements subject to Section 409A. These IDRs will be used to determine whether these arrangements are in compliance with Section 409A.

The potential to be audited and the new Section 409A correction program make now the ideal time for sponsors of deferred compensation plans to review their plans for documentary compliance. This is true even for plans that have already been amended for Section 409A, because practitioners' understanding of these rules has evolved over time based on information provided by the IRS. As explained in the article below, the correction program provides incentives to correct plans by December 31, 2011, and will be unavailable if the sponsor comes under audit before correction is made.

The correction program can be found **here**.

IRS Issues Correction Guidance for 409A Document Failures

The Internal Revenue Service has issued Notice 2010-6, which sets forth the method for correcting certain documentary failures that occur under Internal Revenue Code Section 409A. Documentary compliance with Section 409A was required on and after January 1, 2009. However, until issuance of Notice 2010-6, minor plan document violations could subject "service providers" (e.g., employees) to harsh tax consequences.

Section 409A contains strict rules related to the timing and form of payment of deferred compensation. Section 409A provides that payments of deferred compensation are only permissible upon certain events (including, but not limited to, a separation from service, change in control and a specified future date). If these rules are violated, the recipient of the deferred compensation is subject to immediate income inclusion of the deferred amounts (even if they have not been paid), as well as an additional 20% tax. Penalties and interest can also apply. An employer usually has a corresponding withholding and reporting obligation related to its promise to pay non-compliant deferred compensation.

One of the more frustrating issues arising under Section 409A was the idea that an unintentional technical violation in the plan document that continued to exist on and after January 1, 2009, would result in all amounts deferred under the plan being subject to adverse tax consequences. Fortunately, with the release of Notice 2010-6, many of these violations are now correctable. In addition, if the corrections are made on a timely basis, there may be little or no penalty involved with correction.

Over 15 types of violations may be corrected under Notice 2010-6. The notice contains detailed procedural requirements for each type of violation in order to ensure that full correction is made. Some of the correction procedures require the payment of penalty amounts by the income recipient (particularly in situations where correction is made less than one year prior to payment). As an example of one correction available under Notice 2010-6, Section 409A requires that amounts be paid within 90 days following a permissible payment event. If a deferred compensation plan permits payment within 180 days following an otherwise permissible payment event, Notice 2010-6 allows amendment of the plan to shorten the period to 90 days. In connection with such correction, no penalty payment would be required.

To be eligible to correct a Section 409A document failure under Notice 2010-6, certain eligibility criteria must be satisfied. For example, neither the payor (e.g., the company) nor the payee (e.g., the employee) may be under audit with respect to the relevant deferred compensation plan at the time correction is made. In addition, both the payor and the payee will be required to include certain information with the filing of their respective tax returns for the year in which correction occurs.

Finally, Notice 2010-6 contains transition provisions that allow even more favorable correction treatment for corrections made prior to 2011. The IRS has stated that the transition period is intended to allow employers an opportunity to voluntarily reexamine their deferred compensation plans and ensure that each of them is in full compliance with Section 409A.

Notice 2010-6 can be found **here**.

DOL Issues Safe Harbor Rule for Timely Deposit of Contributions to Small Plans

The Department of Labor recently published a final rule that allows employee benefit plans with fewer than 100 participants to comply with time limits for the segregation and deposit of participant contributions to employer-sponsored pension and welfare benefit plans. An employer's failure to promptly deposit contributions into a plan account is a prohibited transaction under the Employee Retirement Income Security Act of 1974 (ERISA) and certain provisions of the Internal Revenue Code (the Code), which potentially exposes the employer (or plan sponsor) to an excise tax and other liability. The final rule amends the existing regulation by establishing a safe harbor period to provide small plan sponsors a higher degree of certainty with respect to the required timing of such deposits.

The previous rule was issued by the DOL in 1988 and, for purposes of ERISA and the Code, defined "plan assets" as amounts withheld from or paid by a participant for contribution to an employee benefit plan. Under the 1988 rule, plan assets were required to be deposited "as of the earliest date on which such contributions can reasonably be segregated from the employer's general assets," but no later than 90 days from the date on which contribution amounts are received or withheld from a participant. The DOL amended the existing rule in 1996 to reduce the outer limit for deposit of participant pension plan contributions to the 15th business day of the month following the month in which such contributions are received or withheld from a participant. Under the 1996 amendment, participant contributions to welfare plans still became plan assets on the earliest date they could reasonably be segregated from the employer's assets, but the 90-day outer limit was retained.

The DOL tried to clarify that the 15-day (in the case of pension plan contributions) and 90-day (in the case of welfare plan contributions) maximum time periods were intended to apply in limited circumstances and were not safe harbors, but some plan administrators and employers remained uncertain and mistakenly applied the law and/or interpreted DOL guidance to mean that they had until the applicable 15th or 90th day to make such deposits. Last week's final rule mirrors a 2008 DOL proposed safe harbor, under which eligible employers with small plans would be considered to have made timely deposits within 7 business days. *Specifically, participant contributions to a pension plan will be treated as having been made to the plan in accordance with the general rule if contributions are deposited by the 7th business day following the day on which an amount is received by the employer (where the plan participant or beneficiary remits payments to the employer) or on the 7th business day following the day on which such amount would have been payable to the employee (where the employer withholds amounts from a participant's wages).* Contributions will be considered "deposited" upon remittance into any account of the plan without regard to allocation to specific participants or participant investments. The final rule does not apply to plans with more than 100 participants. As a result, contributions to such plans must still be made as soon as they can be segregated from the employer's general assets.

The final rule was published in the January 14 edition of the Federal Register and was immediately effective on the date of publication.

The final rule can be found **here**.

DOL Issues Proposed Rule Relating to Investment Advice in Individual Account Plans

On February 26, 2010, the Department of Labor's Employee Benefits Security Administration released a proposed rule relating to the provision of investment advice to participants and beneficiaries in individual account plans and retirement accounts (e.g., 401(k) plans). The proposed rule is intended to replace a final rule issued on January 21, 2009, but withdrawn later in the year after extensive criticism by commentators that it was inadequate to address issues of conflicts of interests and self-dealing by investment advisers. This new proposed rule has attempted to deal with these concerns by excluding an administrative class exemption that was the main reason for concern under the old rule. The remainder of the new proposed rule addresses the requirements for satisfying the statutory investment advice exemption, which was adopted as part of the Pension Protection Act of 2006.

The new proposed regulation provides that investment advice to plan participants is appropriate if either (1) a certified, non-biased computer model is used, such that the model is designed and operated to avoid investment recommendations that inappropriately distinguish among investment alternatives, or (2) the advice is provided by an investment adviser who is compensated on a "level-fee" basis (i.e., the fees do not vary based on investments selected by the participant).

The proposed rule contains many administrative and procedural requirements that must be satisfied in connection with the implementation and operation of an investment advice program under a 401(k) plan. The proposed regulations are expected to go into effect 60 days following the publication of final regulations. While the timing of such publication is unknown, comments on the proposed rule must be submitted on or before May 5.

The proposed rule may be found **here**.

Understanding and Monitoring Retirement Plan Investments Is Focus of Recent Case

A Tennessee district court recently ruled that a directed trustee may seek indemnification from a retirement plan's internal fiduciaries if that trustee is liable for alleged losses in investment funds it recommended. (See *FedEx Corp. v. The Northern Trust Co.*, 48 EBC 1769 (W.D. Tenn. 2010).)

In *FedEx*, internal fiduciaries (the Committee) of a FedEx-sponsored pension plan (the Plan) alleged that The Northern Trust Company (the Trustee) recommended two investment funds (the Funds) to the Committee that were contrary to the Plan's investment policy. The Trustee was also the manager of the Funds. The Committee decided to invest Plan assets in the Funds. FedEx filed a lawsuit against the Trustee to recover alleged Plan losses resulting from investing in the Funds.

The Trustee countered that FedEx would be required to indemnify the Trustee for any amounts the Trustee might be required to restore to the Plan. The Trustee alleged that the Committee (1) is responsible for selecting the Plan's investments, (2) failed to understand the Funds before investing Plan assets in them, and (3) did not monitor the appropriateness of continued investment by the Plan. If the Trustee were to prevail, FedEx might be required to restore any Plan losses resulting from any fiduciary breach.

The Trustee alleged that it had no discretionary authority to invest in the Funds. Although FedEx alleged that the Trustee's fiduciary role expanded because the Trustee recommended the Funds, the court rejected this characterization and found that the Trustee acted as a discretionary trustee and not an investment fiduciary. As a result, the court denied FedEx's motion to dismiss the counterclaim.

While it did not decide the substantive issue, the court's decision means that FedEx and the Committee could be found to be liable for the Plan losses if such losses were found to have resulted from the failure to understand the nature of the Funds.

This case is a good reminder to plan fiduciaries to (1) fully understand the nature and risks of investments that they approve for the Plan and (2) oversee and monitor the Plan's investment managers. Elements of these duties can include receiving training and updates on ERISA obligations, developing and applying a meaningful investment policy, using third-party investment consultants and scrutinizing the plan's investment managers and the investments they choose.

The district court's opinion can be found **here**.

Federal Agencies Release Guidance for Implementation of Mental Health Parity and Addiction Equity Act

The Internal Revenue Service, the Employee Benefits Security Administration and the Centers for Medicare & Medicaid Services together released on January 29, 2010, interim final regulations and proposed regulations under the Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act of 2008.

The Act, which became law on October 3, 2008, applies to insured health plans and group health plans sponsored by businesses with 50 or more employees that offer mental health and/or substance use disorder benefits; it does not require plans to offer such benefits. The Act requires covered plans to handle mental health and/or substance use disorder benefits in the same way that they handle medical and surgical benefits with respect to costs and access to care. The interim final regulations list six classifications of benefits that are subject to the parity and equity requirements, including: (1) inpatient, in-network; (2) inpatient, out-of-network; (3) outpatient, in-network; (4) outpatient, out-of-network; (5) emergency care; and (6) prescription drugs.

The interim final regulations provide that medical and surgical care and mental health and substance use disorder care must be treated equally for purposes of out-of-pocket costs, benefit limits and practices such as prior authorization and utilization review. For example, an insurance policy or a group health plan may not impose separate deductibles for medical/surgical services and mental health care, and it may not apply one out-of-pocket maximum to medical/surgical services and a different out-of-pocket maximum to mental health care. Any such deductible or maximum must encompass both types of care.

Under the regulations, new disclosure rules require covered group health plans to (1) make available to interested parties the criteria for medically necessary determinations for mental health or substance abuse disorder benefits and (2) provide, upon request, the reasons for any benefit denials.

The regulations apply for plan years beginning on or after July 1, 2010.

The text of the interim final regulations is available **here**.

The text of the proposed regulations is available **here**.

Please direct any questions, comments or suggestions regarding the newsletter to your Katten attorney or any of the following members of the firm's **Employee Benefits and Executive Compensation Practice**:

Shannon Skinner Anglin, Partner
312.902.5409 / shannon.anglin@kattenlaw.com

Gregory K. Brown, Partner
312.902.5404 / gregory.brown@kattenlaw.com

William B. Duff, Partner
212.940.8532 / william.duff@kattenlaw.com

Steven G. Eckhaus, Partner
212.940.8860 / steven.eckhaus@kattenlaw.com

Russell E. Greenblatt, Partner
312.902.5222 / russell.greenblatt@kattenlaw.com

Gary W. Howell, Partner
312.902.5610 / gary.howell@kattenlaw.com

Ann M. Kim, Partner
312.902.5589 / ann.kim@kattenlaw.com

Daniel B. Lange, Partner
312.902.5624 / daniel.lange@kattenlaw.com

William E. Mattingly, Partner
312.902.5266 / william.mattingly@kattenlaw.com

Edward J. Rayner, Partner
212.940.8515 / ed.rayner@kattenlaw.com

Kathleen Sheil Scheidt, Partner
312.902.5335 / kathleen.scheidt@kattenlaw.com

A. Victor Wray, Partner
704.444.2020 / victor.wray@kattenlaw.com

Andrew E. Bridgman, Associate
312.902.5509 / andrew.bridgman@kattenlaw.com

Michael R. Durnwald, Associate
312.902.5697 / michael.durnwald@kattenlaw.com

Katten

Katten Muchin Rosenman LLP

www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK WASHINGTON, DC

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