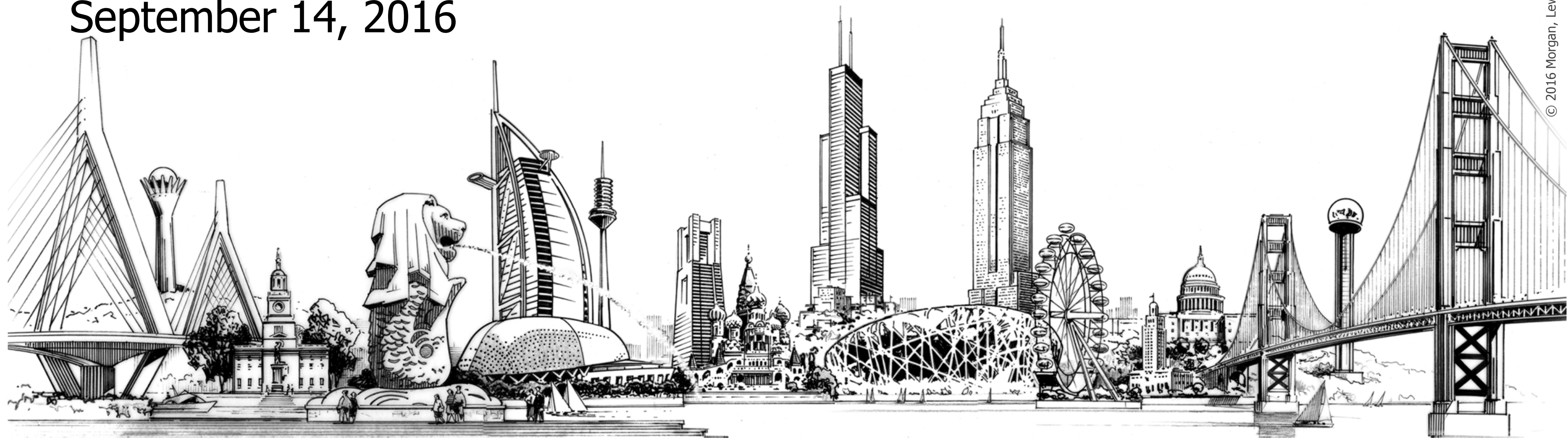
Morgan Lewis

# HOT TOPICS IN EMPLOYEE BENEFITS: WHAT WE'RE SEEING

Presenters: Craig Bitman (moderator), Andy Anderson, Jeremy Blumenfeld, Randall McGeorge, Mark Simons, Julie Stapel, and David Zelikoff

September 14, 2016



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# Agenda

- Health and Welfare
- Fiduciary Considerations
- Plan Sponsor Considerations
- ERISA Litigation
- Executive Compensation
- Multiemployer Plans

PRESENTER: ANDY ANDERSON

# HEALTH AND WELFARE

# Nondiscrimination Rule

- ACA Section 1557:
  - Prohibits discrimination on the basis of race, color, national origin, sex, age, or disability in certain health programs and activities
  - Final rule released May 18, 2016
  - Applies, generally, July 18, 2016
    - Exception for design changes effective plan years beginning on or after Jan. 1, 2017
    - Exception for printed stocks of communication material
  - Applies directly to insurers, certain TPAs, and certain self-insured plans that receive Federal financial assistance (FFA)
    - FFA is defined as $ received from HHS (including Exchange subsidies and retiree drug subsidies)

# Nondiscrimination Rule

- Applies, indirectly, to all plans (discussed later) the Rule "clarifies existing obligations under existing authorities" such as:
  - Title VI of the Civil Rights Act
  - Title IX of the Education Amendments of 1972
  - Age Discrimination Act of 1975
  - Section 504 of the Rehabilitation Act of 1973

# Nondiscrimination Rule

- Final Rule Requires:
  - Foreign language taglines
  - Translation services
  - Enhanced accessibility to websites
  - Nondiscrimination notice
  - Grievance procedure
  - Potential design changes to:
    - Prevent impermissible discrimination
    - Prohibit absolute bar on gender transition benefits

# Nondiscrimination Rule

- Final Rule Next Steps:
- Are you, your TPA, or your insurer covered by the final rule?
  - Remember, enforcement will be broader and referrals made to other agencies if you are not directly regulated
- Who will comply with the rule requirements?
- Does your TPA agreement address the final rule?
- If only the TPA and/or insurer are covered, will you need to:
  - Revise 2017 OE material?
  - Distribute notice?
  - Appoint a Section 1557 Coordinator?
- What if all 3 entities are covered?
- Upcoming webinar: "ACA Nondiscrimination Rule and EEOC Wellness Requirements" | Sept. 28 at 1:00–2:00 pm ET

PRESENTER: JULIE STAPEL

# FIDUCIARY CONSIDERATIONS

# DOL Fiduciary Rule

- The DOL's new fiduciary rule has now been out for five months, but many questions still remain.
- Quick recap
  - Expanded definition of fiduciary investment advice under ERISA
  - Will have the effect of making many more parties fiduciaries, especially brokers
  - Also included two new prohibited transaction exemptions to help preserve certain common forms of compensation
  - Expected to have the most significant impact on the IRA market
  - Key effective dates are April 10, 2017 (general effective date) and January 1, 2018 (key date for the "best interest contract exemption")

# Best Interest Contract Exemption

- Many of the questions revolve around the "best interest contract" exemption (the BIC)
- Allows fiduciary advisors to employee benefit plans to receive compensation otherwise prohibited by ERISA and the Code, namely:
  - Compensation that varies based on advice
  - Compensation from third parties
- Covers nondiscretionary advice to sponsors/fiduciaries of small plans, plan participants, and IRA account owners
- Impartial Conduct Standards
  - advice that is in the "best interest" of the investor at the time of the recommendation or advice;
  - reasonable compensation; and
  - no misleading statements
- Requires written acknowledgment of fiduciary status; policies and procedures; extensive disclosures

# Questions Under the BIC Exemption

- To BIC or Not to BIC?
  - Financial services firms evaluating whether to rely on the BIC exemption, or look for other ways to avoid prohibited transactions in providing investment advice. Possibilities include:
    - Moving clients to fee-based rather than commission-based accounts
    - Going to a directed model for those clients without fee-based accounts (in other words, no recommendations—just put in the trades the clients tell you to)
- Grandfathering Provisions of the BIC
  - BIC allows compensation streams established before April 10, 2017 to stay in place without having to follow the BIC, but significant limitations:
    - No more recommendations after April 10, 2017 (the Applicability Date) (other than recommendations regarding exchange or rebalance rights as long as such recommendation does not increase compensation)
    - No additions to the investment/new purchases after the Applicability Date other than as part of a systematic purchase program established before the Applicability Date

# Other Questions About the Fiduciary Rule

- When (or maybe even if) the DOL will issue the anticipated "frequently asked questions" about the fiduciary rule
- Fate of pending litigation in US District Courts in Texas and the District of Columbia challenging the DOL's authority to adopt the rule
  - Hearing during the week of August 22 in DC case with judge appearing sympathetic to plaintiffs' claims
- Impact of announcements by some large brokerage firms

# Fiduciary Rule – Next Steps and Takeaways

- Financial Services Providers
  - Generally well underway with implementation but relatively few "final answers" yet

- Plan Sponsors
  - Discussions with recordkeepers (because plan sponsors' participants may become recordkeepers' customers after taking distributions)
  - Discussions with advice providers
  - Evaluating role of plan sponsor employees in providing advice

- Stay Tuned
  - While most in the industry do not expect a Hail Mary pass at this point, there will still be a lot to develop

PRESENTER: MARK SIMONS

# PLAN SPONSOR CONSIDERATIONS

# Rev. Proc. 2016-37

## OVERVIEW OF CHANGES EFFECTIVE JANUARY 1, 2017

- Elimination of staggered 5-year filing cycle
  - IDPs that have a determination letter (DL) may no longer submit restated plans to the IRS for qualification
    - Note: Cycle A3 is the last IDP cycle (current cycle ending January 31, 2017 for EIN's ending in "1" or "6" or new controlled group members (or ASG) with a Cycle A election by January 31, 2012)

# Rev. Proc. 2016-37

## OVERVIEW OF CHANGES EFFECTIVE JANUARY 1, 2017

- In 2017 and later, IDPs can *only* be submitted to request a DL for:
  - Initial plan qualification
  - Qualification upon plan termination
  - After 2017, under certain other circumstances to be specified annually by the IRS
    - Note: Additional situations in which DLs may be requested will be published in the Internal Revenue Bulletin (IRB)

# Rev. Proc. 2016-37

## OVERVIEW OF CHANGES EFFECTIVE JANUARY 1, 2017

- New IRS Publications (plan compliance assistance)
  - Required Amendments List (RA List):
    - lists changes in requirements that must be adopted to retain the plan's qualified status
    - generally, items on the RA List will appear after guidance is published
    - IRS may include items if no guidance is anticipated
    - establishes the date the remedial amendment period (RAP) expires for items on the RA List (generally, the end of the second calendar year after the RA List is published)
    - issued annually after October 1 and based on the calendar year

# Rev. Proc. 2016-37

## OVERVIEW OF CHANGES EFFECTIVE JANUARY 1, 2017

- New IRS Publications (plan compliance assistance) (cont'd.)
  - Operational Compliance List (OC List):
    - lists changes in qualification requirements that affect the plan's operational compliance
    - a plan must be operated in compliance with a change in qualification requirements from the effective date of the change
    - expected to be issued annually and based on the calendar year

# Rev. Proc. 2016-37

## OVERVIEW OF CHANGES EFFECTIVE JANUARY 1, 2017

- New RAP for IDPs
  - New extended RAP established under Rev. Proc. 2016-37 (the extended 401(b) RAP under Rev. Proc. 2007-44 will expire on December 31, 2016)
  - RAP Transition Rule – limited RAP extension to December 31, 2017 for IDPs with disqualifying provisions (as of January 1, 2017) where the RAP under Rev. Proc. 2007-44 has not expired
  - Extended RAP for amendment of disqualifying provision in:
    - a new IDP is the later of the 15th day of the 10th calendar month after the end of the plan's initial plan year, or the "modified §401(b) expiration date" (based on the tax-exempt status of the employer)
    - an existing IDP is the end of the second calendar year following the calendar year in which the amendment is adopted or effective, whichever is later

# Rev. Proc. 2016-37

## OVERVIEW OF CHANGES EFFECTIVE JANUARY 1, 2017

- IDP sponsors will no longer be required to adopt interim amendments
  - However:
  - Interim amendment requirement continues to apply for amendments having an adoption deadline prior to January 1, 2017
  - No change to the adoption of discretionary amendments (end of the plan year in which the amendment is operationally effective)

# Rev. Proc. 2016-37

1. Is the amendment either (i) a required (law change) amendment to an existing plan, or (ii) a defective (i.e., disqualifying) amendment to an existing plan that is not related to a law change, or (iii) a defective, or impermissibly overlooked, amendment to a new plan?

   **YES** – Go to 3 and 4.

   **NO** – Go to 2.

2. The amendment is, by default, a nondisqualifying (i.e., fully compliant) discretionary amendment. Thus, (i) the concept of a remedial amendment period is irrelevant (there is no defect to remedy), and (ii) the deadline for adopting the amendment is the last day of the plan year in which it is operationally put into effect.

3. Both the remedial amendment period and the amendment adoption deadline are the same, and are as follows:

   A. In the case of a new plan maintained by only one employer, the RAP/deadline is the later of (i) the 15th day of the 10th calendar month after the end of the plan's initial plan year, or (ii) the extended tax filing deadline for the employer's tax year related to the date on which the plan was put into effect. In the case of a new plan maintained by more than one employer, the RAP/deadline is the 15th day of the 10th calendar month after the end of the plan's initial plan year. These deadlines apply to a for-profit entity.

   B. In the case of a required law change to an existing plan, the RAP/deadline is the end of the second calendar year after issuance of the related Required Amendments List in which the change in qualification requirement appears.

# Rev. Proc. 2016-37

C. In the case of a disqualifying discretionary amendment to an existing plan, the RAP/deadline is the second calendar year after the calendar year in which the amendment was adopted or made effective, whichever is later.

NOTE: A sponsor is unlikely to know that a discretionary amendment is defective (i.e., disqualifying) until some point well after its adoption. Thus, the sponsor should assume the amendment is *not* disqualifying, and is subject to the earlier adoption deadline described in Item 2, above.

D. Plan sponsors should institute a practice of reviewing plan amendments as the RAP for a given amendment approaches, to confirm that it does not include any disqualifying defects.

4. If the amendment (i) was adopted after the plan's most recent (timely) 5-year remedial amendment period, and (ii) does not appear on the IRS's 2016 Required Amendments List (or any subsequent list), the RAP ends on December 31, 2017. Plan sponsors should, as December 31, 2017 approaches, review all amendments described above to confirm that they do not include any disqualifying defects. If they do, they should correct them before that date.

# Rev. Proc. 2016-37

## OVERVIEW OF CHANGES EFFECTIVE JANUARY 1, 2017

- Scope of IRS Reviews
  - During calendar year 2017, initial qualification IDPs will be reviewed based on the 2015 Cumulative List
  - After January 1, 2017, new IDPs will be reviewed based on the RA List that was issued during the second calendar year preceding the submission of the DL application including all previously issued RA Lists (and Cumulative Lists prior to 2016)
  - Terminating IDPs will be reviewed for amendments required to be adopted in connection with the plan termination

# Rev. Proc. 2016-37

## CHALLENGES FOR IDP SPONSORS

1. Principles of reliance
   - Per Rev. Proc. 2016-6, effective January 4, 2016, DLs will no longer contain expiration dates
   - Rev. Proc. 2007-44 to be modified to provide that expiration dates are no longer operative
   - IDP sponsors may *not* continue to rely on the plan's DL for post-DL plan amendments or changes in law
   - IDP sponsors may continue to rely on the plan's DL if it is not amended or affected by a law change
2. Qualification uncertainty/proving plan qualification
3. Increases the risk of disputes with the IRS on plan audit/need for audit CAP relief with potential sanctions; no 7805(b) relief
4. Complicates business transactions (mergers, acquisitions, etc.)
5. **Complicates practices around plan audits**

# Effect of Brexit on Qualified Plans

- The June 23, 2016 decision by British voters to leave the European Union had an immediate and adverse effect on the financial markets
- The effect varied as between DB plans and DC plans
  - In the case of DB plans, investment matters are the responsibility of the plan fiduciary
  - In the case of DC plans, investment matters typically are the responsibility of participants and beneficiaries

# Brexit – Effect on DB Plans

- Brexit triggered a (further) decline in interest rates
- This affects DB plans, since market interest rates underlie:
  - Funding calculations
  - Lump-sum payment calculations
  - PBGC premium calculations
  - Financial accounting calculations

# Brexit – Funding Calculations

- For funding purposes, liabilities (i.e., the present value of benefits) are determined based on corporate bond rates
- Lower bond/interest rates mean higher liabilities
  - However, employers can use a 25-year average of rates, which "smooths out" transient dips and spikes
  - Nonetheless, Brexit accelerated (at least temporarily) the general trend of declining rates

# Brexit – Lump Sums

- The calculation of lump sums also depends on corporate bond rates
- However, there is no "smoothing" over 25 years (a one-month average is used)
  - On the other hand, most plans use a look-back benchmark date, which delays the effect of real-time changes in interest rates

# Brexit – PBGC Premiums

- Corporate bond rates also underlie the calculation of PBGC premiums
  - The variable rate is based on the level of underfunding, which (in turn) requires a calculation of the present value of liabilities
  - The present value for this purpose is calculated using the same basis as for lump sums, but without the look-back option

# Brexit – Financial Accounting

- Financial accounting uses spot fixed income rates to determine liabilities

- This use of “real time” rates could trigger an increase in reportable plan liabilities

# Brexit – DC Plans

- The decrease in interest rates and adverse effect on stock prices, triggered by Brexit, may have resulted in more conservative investment strategies by participants

- Plan sponsors may want to provide (nonfiduciary) investment education to enhance a long-term outlook by participants

# Determination Letter Amendment/Information Requests

- Requests that:
  - A plan be amended to confirm no investment in employer securities
  - The sponsor indicate whether approval for a Notice 2015-49 risk transfer is being sought
  - Proof be provided that the accrual rules are met in the case of a cash balance plan
  - More expansive Code Section 436 amendment
  - A plan be amended to describe procedures for locating missing participants

PRESENTER: JEREMY BLUMENFELD

# ERISA LITIGATION

# ERISA Litigation

- Discussion on recently filed “excessive fee cases” against colleges and universities

PRESENTER: DAVID ZELIKOFF

# EXECUTIVE COMPENSATION

# Share Withholding

- Current rule: In order to maintain favorable equity classification treatment for a share-based award, cash settlement of a share-based award for tax-withholding purposes may not exceed the *minimum* statutory withholding requirement
- Earlier this year, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update relating to share-based compensation under US GAAP
- Among the changes in the Update is that it will be permissible to provide for cash settlement of a share-based award for tax withholding up to the *maximum* statutory tax rate in the applicable jurisdiction

# Share Withholding

- Effective date:
  - Public companies – annual reporting periods beginning after December 15, 2016, and interim periods within those annual periods
  - Nonpublic companies – annual reporting periods beginning after December 15, 2017, and interim periods within those annual periods
  - Companies may elect to adopt the new standards early, but must adopt all of the Update

# Share Withholding

- Considerations – Pros/Cons:
  - Gives employees added flexibility for tax planning
  - May be useful if awards are made outside of the United States, given the difficulty in determining the "minimum" tax rate applicable to such equity awards
  - Cash flow effect
  - Administrative complexity in calculating share withholding
  - Securities law implications
- Consider whether plan amendment is required

# Share Withholding

- Is shareholder approval required for the amendment?
  - The NYSE rules require shareholder approval of any “material revision” to an equity plan
    - Updated NYSE FAQs to provide that an amendment to increase share withholding based on the recipient’s maximum tax obligation is not a material revision if the shares withheld were never issued, even if the shares withheld are added back to the plan
  - Nasdaq has a similar shareholder approval requirement and, to date, has not commented on this issue

# Share Withholding

- For more information, please refer to our ML BeneBits blog posts at:

- http://blogs.morganlewis.com/mlbenebits/04/21/2016/new-fasb-rules-on-equity-compensation-withholding-summary/

- http://blogs.morganlewis.com/mlbenebits/04/22/2016/new-fasb-rules-on-equity-compensation-withholding-issues/

PRESENTER: RANDALL MCGEORGE

# MULTIEMPLOYER PLANS

# Multiemployer Pension Reform Act of 2014 *Proposed* Merger and Transfer Regulations

**Overview**

- Pre-MPRA Mergers and Transfers
- MPRA Facilitated Mergers
- Proposed Regulations on MPRA Mergers/Transfers

# Pre-MPRA Mergers and Transfers

- Under ERISA § 4231(b), multiemployer plan mergers or asset and liability transfers must comply with 4 requirements:
  - Plan sponsor must notify PBGC at least 120 days before the effective date of the merger or transfer;
  - Participant/beneficiary accrued benefit may not be lower immediately after the merger or transfer than immediately before;
  - Participant/beneficiary benefits must not be reasonably expected to be subject to suspension as a result of plan insolvency; and
  - An actuarial valuation of the assets and liabilities of each of the affected plans must have been performed during the plan year preceding the effective date of the merger or transfer, based upon the most recent data available as of the day before the start of that plan year.
- These rules still apply.
- PBGC has authority to vary above requirements.

# Pre-MPRA Facilitated Mergers

- PBGC may provide financial assistance in the form of a loan to plans that are or will be insolvent, i.e., unable to pay benefits when due during the plan year. ERISA § 4261.
  - No formal financial assistance rules.
  - The loan is usually sufficient to pay guaranteed benefits to participants and beneficiaries.
- Pre-MPRA, PBGC provided financial assistance to facilitate the merger of a soon-to-be insolvent plan into a larger, more financially secure plan, which assumed responsibility for benefits under the failing plan.
  - The loan covered the cost of guaranteed benefits under the failing plan.
    - The loan was generally less than PBGC's valuation of the present value of future financial assistance to the failing plan.
  - PBGC facilitated only a few financial assistance mergers before MPRA.

# MPRA Facilitated Merger Generally

- MPRA amended ERISA § 4231 to add a new section for PBGC facilitated mergers. ERISA § 4231(e).
- PBGC may facilitate a merger with another plan if:
  - The PBGC determines that the merger is in the interests of the participants and beneficiaries of at least one of the plans; and
  - The merger is not reasonably expected to be adverse to the overall interests of the participants and beneficiaries of any of the plans.
- PBGC may provide *facilitation* assistance such as training, technical assistance, mediation, communication with stakeholders, and support with related requests to other governmental agencies.

# MPRA Facilitated Mergers – *Financial Assistance*

- PBGC may also provide financial assistance to facilitate a merger if:
  - One or more of the plans is in "critical and declining" status (plan will generally become insolvent in next 15 years);
  - PBGC reasonably expects that financial assistance will reduce its expected long-term loss with respect to the plans involved;
  - PBGC reasonably expects that the financial assistance is necessary for the merged plan to become or remain solvent;
  - PBGC certifies its ability to meet existing financial obligations will not be impaired by providing the financial assistance; and
  - The assistance is paid from the PBGC's Multiemployer Program fund. ERISA § 4231(e)(2).

# Proposed Merger and Transfer Regulations

- On May 25, 2016, the PBGC released **proposed regulations** on the merger/transfer provisions under section 4231 of ERISA, including the facilitated merger provisions added by MPRA.
- **Effective Date:** Plans can apply for mergers or transfers or facilitation under the proposed regulations, but may have to modify their submissions later when there are final regulations.
- PBGC urges plans considering a facilitated merger requiring financial assistance to discuss the proposed merger with PBGC before making a formal submission.
- **Two parts to the regulations:**
  - **Part A →** amended the pre-MPRA merger and transfer regulations. ERISA §§ 4231(a)-(d).
  - **Part B →** interpret the MPRA facilitated merger rules. ERISA § 4231(e).

# Part A – General Merger and Transfer Regulations

- Adds some new definitions for terms: critical and declining status, *de minimis* merger and transfer, facilitated merger, financial assistance merger, etc.
- Expands the definition of "significantly affected plan" to include endangered and critical status plans.
  - Significantly affected plan: 1) transfers assets equal or > 15% of its assets before transfer; 2) is created from spin-off; 3) receives a transfer of unfunded accrued benefits that equal or > 15% of assets before transfer; 4) engages in merger/transfer either after such plan terminated by mass withdrawal or with another terminated plan; **or 5) is either critical or endangered and engages in a transfer.**
- Plan sponsors may engage PBGC informally to discuss proposed mergers and transfers.
- Amends some of the filing requirements, i.e., timing and method.
- Clarifies some of the actuarial valuation requirements.
- Must request compliance determination at time of filing notice.

# Part A – General Merger and Transfer Regulations

- Amends "plan solvency" tests for "nonsignificantly affected plans" – a plan will satisfy the plan solvency requirement if:
  - in each of the first 10 years (no longer 5) beginning after the proposed effective date of the merger/transfer, the plan's expected contributions and investment earnings equal or exceed expected expenses and benefit payments for the plan year, or
  - the plan's expected fair market value of assets immediately after the merger/transfer equals or exceeds 10 times the benefit payments for the last plan year ending before the proposed effective date of the merger/transfer.
- Amends the plan solvency requirements for "significantly affected plans":
  - Expected contributions must be equal to or exceed the estimated amount necessary to satisfy the minimum funding requirements under IRC 431 for 10 plan years (previously 5 years).
  - Changes amortization period from 25 to 15 years to reflect the period generally applicable to funding of multi plans under the PPA.
  - Expected contributions after merger/transfer must itemize expected withdrawal liability payments separately from contributions.

# Part B – Facilitated Merger Regulations

- Regulations under ERISA § 4231(e).
- **Written Request:** Plans must submit a formal written request (and notice) to PBGC.
  - Submission must include a notice of merger, certain plan information, and a detailed narrative description with supporting documentation that merger is in best interest of participants and beneficiaries of at least one plan and not reasonably expected to be adverse to interest of participants and beneficiaries of both plans.
- **The facilitation can include:** training, technical assistance, mediation, communication with stakeholders, support with governmental agencies, and most importantly, $$$$$ assistance.
- Must satisfy ERISA §§ 4231(b) (general merger rules) and (e) (new merger rules).
- PBGC may approve or deny the request at its discretion; will notify the plans in writing (with reasons supporting decision).

# Part B – *Financial* Facilitated Merger Regs

- Financial assistance merger request **also must include**:
  - Information for both plans, i.e., trusts, plan documents, SPDs, and Forms 5500,
  - Actuarial and financial information,
  - Participant census data, and
  - Detailed description of the merger.
    - The narrative and documentation must consider the effect of financial assistance in making the above demonstrations.
- If request is approved, PBGC sets the terms of the financial assistance in a written agreement (similar to ERISA § 4261 assistance) and retains jurisdiction over merged plan and agreement.

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# QUESTIONS?

**Register for the next webinar in this series:**
December 8, 2016

https://morganlewisevents.webex.com

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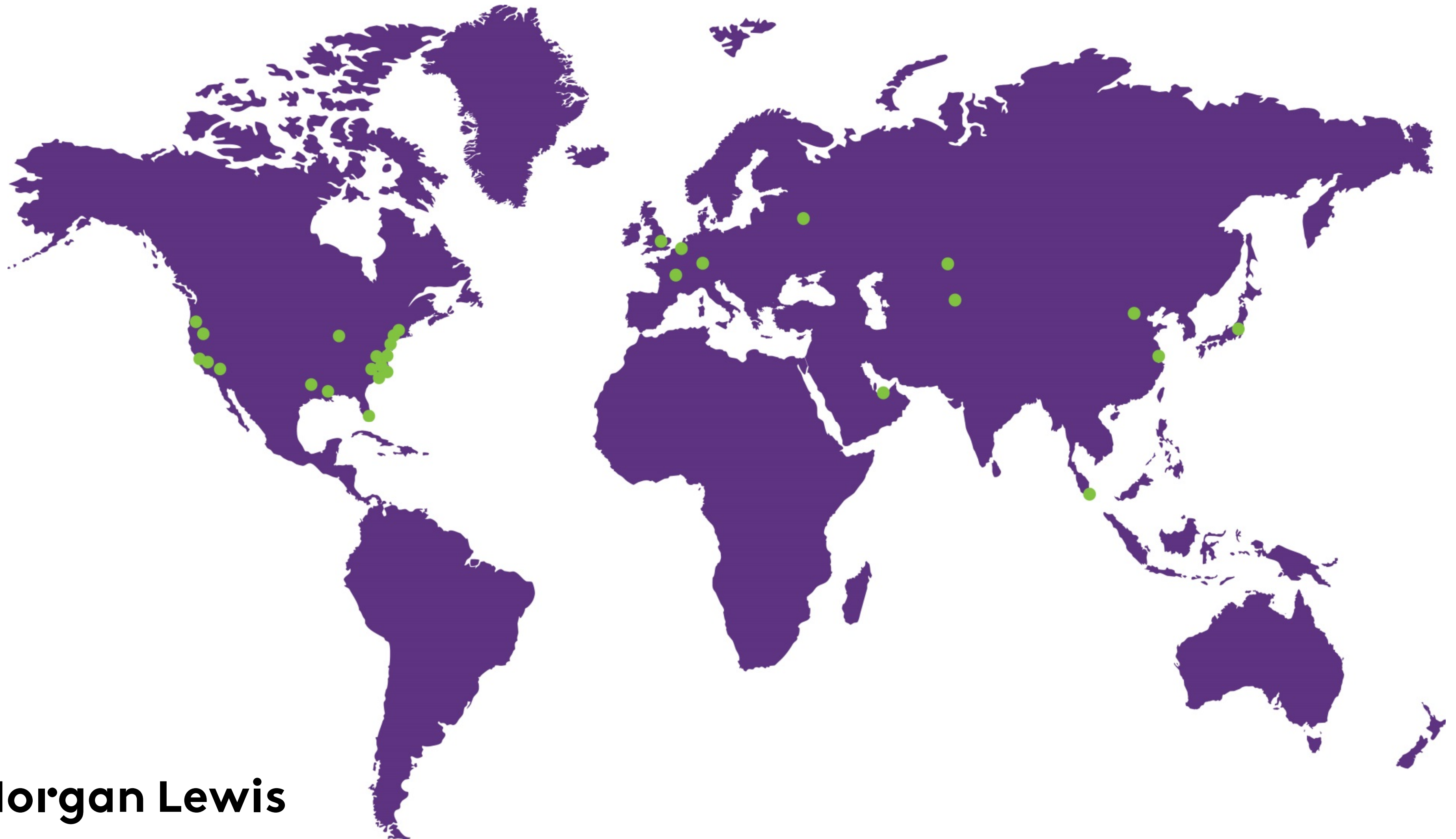

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