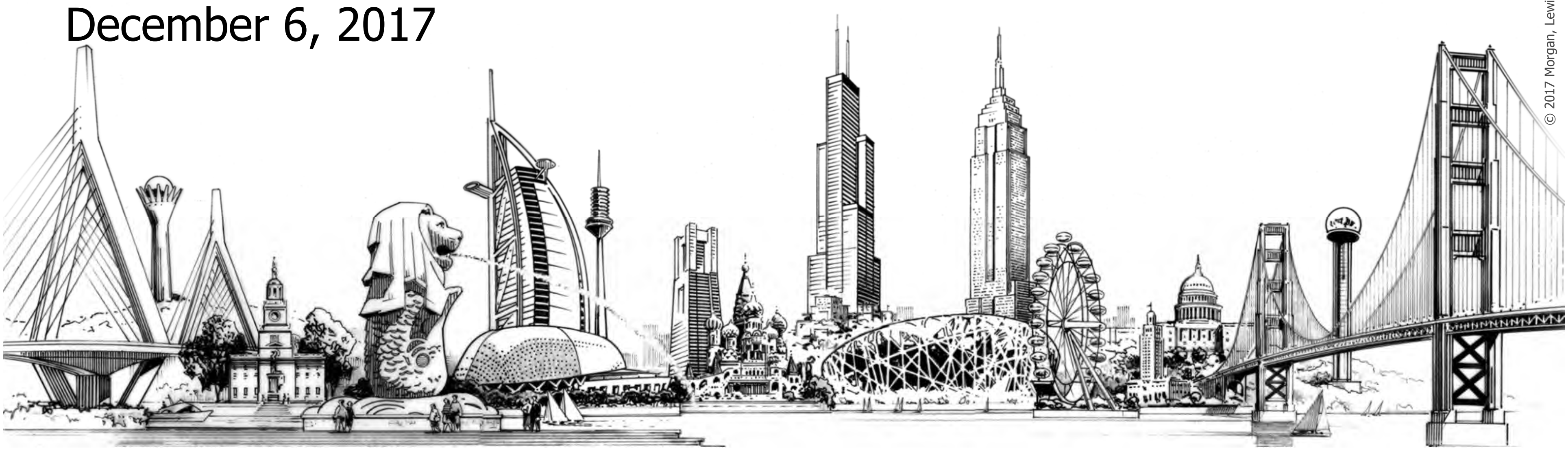
Morgan Lewis

HOT TOPICS IN EMPLOYEE BENEFITS: WHAT WE'RE SEEING

Presenters: Julie Stapel (moderator and presenter), Andy Anderson, Brian Hector, Randy Tracht, and Jonathan Zimmerman

December 6, 2017



Agenda

- Fiduciary Considerations
- Health and Welfare
- Plan Sponsor Considerations
- Executive Compensation
- Employee Stock Ownership Plans (ESOPs)

PRESENTER: JULIE STAPEL

FIDUCIARY CONSIDERATIONS

The Fate of the Fiduciary Rule

- After years and years of ups and downs, the Department of Labor (DOL) has granted an 18-month extension on certain key pieces of the DOL fiduciary rule.
- Brief Background
  - DOL has revised a 33-year-old regulation defining when a person is considered a fiduciary when providing investment advice.
  - The overall effect of the rule will be to broaden the investment advice that is considered fiduciary and the parties who will be considered fiduciaries.
  - The rule became applicable on June 9, 2017.
  - Two new prohibited transaction exemptions were adopted along with the rule—one called the Best Interest Contract Exemption and the other called the Principal Transaction Exemption. In addition, an exemption applicable to annuity sales (PTE 84-24) was amended. (We'll refer to these together as "the exemptions.")
  - Certain conditions of the exemptions are already in effect, but others were subject to a transition period scheduled to end on January 1, 2018.

The Fate of the Fiduciary Rule

- In the most recent development in this long and winding road, the DOL published a notice in the *Federal Register* on November 29 announcing that the transition period will be extended to **July 1, 2019.**
- What the extended transition period does—
  - Gives additional time for investment advice fiduciaries to comply with *certain* aspects of the exemptions. These conditions include, among other things:
    - The requirement to have a written contract meeting certain standards, including a prohibition on waivers on the right to participate in a class action
    - Transaction-based disclosures
    - Disclosures on publicly accessible websites
  - Extends the period of temporary enforcement relief
    - The DOL issued a Field Assistance Bulletin in May that provides that the DOL will not pursue claims against investment advice fiduciaries who are "working diligently and in good faith to comply with their fiduciary duties and to meet the conditions" of the rule and the exemptions.
    - The IRS issued parallel enforcement relief.

The Fate of the Fiduciary Rule

- What the extended transition period does not do—
  - Make the rule inapplicable or ineffective
    - One common misunderstanding is that this somehow delays applicability of the rule. That's not so.
    - The rule is effective right now; only certain conditions of the exemptions are the subject of the transition.
  - Provide a complete pass from the conditions of the exemptions
    - The "Impartial Conduct Standards," a key component to each of the exemptions, is currently in effect.
    - The Impartial Conduct Standards are:
      - Acting in the client's best interest
      - Charging no more than reasonable fees
      - Avoiding any materially misleading statements
    - The Impartial Conduct Standards require compliance efforts outside of those subject to the transition period (but subject to the temporary enforcement relief).

The Fate of the Fiduciary Rule

- What Can We Expect the DOL to Do Now?
  - The DOL still needs to consider the criteria set forth in the Presidential Memorandum issued on February 3, 2017.
  - The DOL has said it will consider possible changes and alternatives to the exemptions in light of the current comment record (which includes many thousands of comments from the numerous instances in which comments were sought from the public).
  - The DOL also mentions involvement of the Securities and Exchange Commission (SEC) and state insurance commissioners. Lack of coordination with the SEC, which regulates investment advisers as well, has been a common criticism of the rule.
  - Also, the President has nominated a new head of the Employee Benefit Security Administration, the branch of the DOL responsible for this rule. It is Preston Rutledge, a veteran tax policy expert with experience both at the IRS and on Capitol Hill. Thus, Mr. Rutledge's views on the rule may be expected to have an impact as well.

The Fate of the Fiduciary Rule

- What Can We Expect Financial Services Providers to Do Now?
  - Generally, stand down, at least temporarily, to see in what direction the rule may be going.
  - After a while, though, we might expect firms to resume compliance efforts. While 18 months is a long time in many respects, it is not long in light of major system overhauls required by the rule for some providers (especially if some months are used to evaluate what's going to happen next).
  - But really it will depend on what appears to be happening in the early part of the extended transition period.
- What Can We Expect Plan Sponsors to Do Now?
  - Of all the stakeholders in this rule, this development likely affects plan sponsors the least because service providers to plan sponsors may have been relying on exemptions other than the exemptions affected by the transition.
  - Thus, plan sponsors should consider carefully any changes proposed by service providers in light of the extension of the transition period.

The Fate of the Fiduciary Rule

- Is Congress Going to Do Anything?
  – Rep. Ann Wagner, a Republican from Missouri, introduced a bill in September to stop implementation of the rule and impose a different standard.
  – There has not been significant movement on the bill, and Congress's attention has turned to tax reform.
- Are the Courts Going to Do Anything?
  – On November 3, a US District Court in Minnesota issued a preliminary injunction against the rule, but also granted a stay in the case involving Thrivent Financial for Lutherans.
  – There were other lawsuits brought by those opposing the rule seeking to stop its implementation but, until the *Thrivent* case, the DOL had generally been successful in upholding the rule.
  – There is now also the possibility of litigation by supporters of the rule challenging the permissibility of the 18-month delay under the Administrative Procedures Act or other grounds.

PRESENTER: ANDY ANDERSON

HEALTH AND WELFARE

THE AFFORDABLE CARE ACT—TAX REFORM IMPLICATIONS

Tax Reform

- "Tax Cut and Jobs Act" passed House November 16 on basically a party line vote 227-205 (13 Republicans voted against)
- Passed Senate December 2 on another party line vote 51-49 (1 Republican voted against)
- Both House and Senate used budget reconciliation processes to permit bare majority passage
- Bill language now goes to reconciliation in conference committee, and is expected to return to House and Senate for a final vote before Christmas
  - Narrow margins in both house and Senate will lead to difficult conference, with Senate terms (perhaps) mainly winning the day

Tax Reform

- Numerous employee and fringe benefit provisions (and differences), with key health and welfare provisions:
  - Zeroes out penalty for ACA individual mandate beginning for months after 12.31.2018 (S)
  - Adds employer credit of 12.5% to 25% for up to 12 weeks of paid family or medical leave starting 1.1.2018 and terminating after 2019 (S)
    - Does not apply to state or local mandated leave
    - Does not appear to strengthen ERISA preemption
  - Ends dependent care spending accounts 2023 (H)
  - Loss of employer deduction for transportation fringe benefits for tax years after 12.31.2017 (H, S)
    - Will deduction loss also end or disfavor qualified transportation fringe?

Tax Reform

- End of adoption assistance programs (H)
- End of section 132 employer provided education assistance effective 2018 (H)
- End of itemized deduction for medical expenses (H); but Senate dropped to 7.5% threshold for 2017 and 2018 and then returns to current 10%
  - Still requires itemization, which is raised by Senate bill
  - Key concession for key Senator

Tax Reform

- No changes to:
  - ACA employer mandate
  - Tax-free nature of employer group health benefits
  - ACA taxes:
    - Cadillac tax
    - Health insurance tax
    - Device tax
    - FSA contributions
    - OTC drugs
    - HSA distributions
  - HSA rules
- Senate vote linked to support for Collins-Nelson "Lower Premiums Through Reinsurance Act" and Alexander-Murray "Market Stabilization" legislation

Tax Reform

- Conference committee now key battleground
- Narrower Senate vote margin—will Senate (primarily) prevail?
- Expect signed bill by end of 2017

ACA Employer Mandate Activity

- Letter 226Js are on the street!
  - Limited sampling shows:
    - Gross errors (on the part of IRS and vendors)
    - High 4980(a) penalties
    - Difficult to work through what went wrong without data files from vendors
  - Above all---**note 30 days response deadline!**
    - Use Form 14764 (ESRP Response) to state disagreement (and why), changes required on 1094-C and 1095-C reporting, changes to Employee PTC Listing, and authorizing contact to discuss ESRP issue

PRESENTER: RANDALL TRACHT

PLAN SPONSOR CONSIDERATIONS

IRS Missing Participants Guidance

- The Internal Revenue Service (IRS) issued a memorandum to address missing participants and "required minimum distribution" (RMD) issues
- Background:
  - Both the IRS and the Department of Labor (DOL) are very focused on missing participants in exams and audits
  - There is uncertainty and no clear guidance about what plan sponsors/fiduciaries must do to locate missing participants in certain situations
- The IRS memorandum provides that examiners should not challenge a retirement plan for failing to timely commence RMDs to missing participants so long as the plan has:
  - Searched plan records, other plan sponsor records, and publicly available records;
  - Used any of the following search methods: (1) a commercial locator service, (2) a credit reporting agency, or (3) a proprietary internet search tool; and
  - Attempted contact via US certified mail to the last known address of a missing participant and other appropriate means for any other known addresses or forms of contact (e.g., email, telephone number)

2018 IRS Mortality Table

- The IRS issued a new mortality table effective for plan years beginning on and after January 1, 2018
- The mortality table is effective for plan-funding purposes and lump-sum determinations
- The IRS guidance provides limited ability to delay the effective date of the mortality table for funding purposes (but not lump sums) for one year if it would be administratively impracticable to implement the table and have more than a *de minimis* impact on the plan sponsor's business
- Plan sponsors should consult with their actuaries and also consider administrative implications of the new table (e.g., using the new table to prepare lump-sum distribution election packages as of 1/1/18)
- Depending on the plan's drafting approach, an amendment to adopt the new mortality table may not be necessary

Year-end Amendments

- Limited circumstances in which year-end compliance amendments may be required
- IRS required amendment list issued in late 2016 does not identify any required amendments (2017 list will be issued shortly)
- Amendments are potentially necessary to implement 2016 disaster relief for hardships and loans (amendments for 2017 disaster relief are not required until the end of 2018)
- Defined benefit plans with bifurcated distribution options may need to be amended by 12/31/17
- Possible amendment to permit a plan to use forfeitures of QNECs/QMACs
- Possible amendment to implement the new IRS mortality table

PRESENTER: JONATHAN ZIMMERMAN

EXECUTIVE COMPENSATION

Tax Reform – Legislative Overview

- House bill passed on November 16.
- Senate bill passed on December 1.
- Conference committee will reconcile the bills.
- In order to pass the Senate through the budget reconciliation process (which means 51 votes needed to pass instead of 60):
  - Total cost may not exceed $1.5 trillion over 10 years.
  - May not increase the deficit after the end of the same 10-year period.
- Sections 409A and 409B changes are not part of either current bill
  - Could be restored later as a revenue raiser, but such changes do not raise significant revenue.

Tax Reform – Section 162(m)

- Eliminates the performance-pay exception.
- CFO again becomes a covered employee.
- Once a covered employee, always a covered employee.
- Will apply to companies that have publicly traded debt, even if they do not have publicly traded stock.
- Tax-exempt employers will be subject to Section 162(m) through a 20% excise tax.
- Effective January 1, 2018, so companies may push to accelerate performance plan deductions into 2017 and/or encourage exercise of stock options.
- Grandfather rule in Senate bill would shield “contracts” in effect on November 2, 2017 that are not materially modified.

Tax Reform – Fringe Benefits

- Eliminates employer deductions for many fringe benefits
  - Entertainment activities, including business entertainment
  - Transportation fringe benefits
    - Includes transit passes, pool cars, and parking.
  - Moving expenses
  - On-site athletic facilities (House bill only)
  - Company cafeterias (Senate bill only; effective in 2026)
  - Can avoid disallowance by treating benefits as compensation to the employee
- Eliminates employee exclusion for other benefits
  - Qualified tuition or educational assistance (House bill only)
  - Adoption assistance benefits (House bill only)
  - Employee achievement awards (House bill only)
  - Moving expenses
  - Dependent Care FSAs (House bill only; effective in 2023)

Tax Reform – What to Do Next?

- Consider accelerating bonus deductions to 2017 while the corporate tax rate is 35%.
- Communicate to employees that changes in the law may affect the tax treatment of 2018 awards and programs.
- Monitor the legislation for additional changes.
- Be prepared to take action in late December!

PRESENTER: BRIAN HECTOR

EMPLOYEE STOCK OWNERSHIP PLANS (ESOPS)

Two New DOL Settlement Agreements Provide Additional ESOP Transaction Guidance

- Two recent settlement agreements were entered into stemming from two lawsuits brought by the DOL against independent outside ESOP trustees, with one case filed in 2012 against First Bankers Trust Services (FBTS), and the other filed in 2015 against James F. Joyner III (Joyner).
- Each settlement agreement requires the trustee to abide by a fiduciary process in future ESOP transactions.
- These two agreements provide guidance that may be useful to other fiduciaries involved with ESOPs, and expand on prior guidance from the DOL in its 2014 Fiduciary Process Agreement with GreatBanc Trust Company.

Two New DOL Settlement Agreements Provide Additional ESOP Transaction Guidance

- Substantially all of the content of the FBTS and Joyner agreements is essentially the same as the GreatBanc agreement.
- The main differences between these recent agreements and the earlier GreatBanc agreement elaborate on trustee responsibility to ensure that the valuation advisor is independent, and that financial information and projections used in the transaction valuation are reliable.
- The FBTS agreement adds some new requirements relating to loans from executives and/or sellers to the ESOP, as well as potential clawbacks if there are misrepresentations.

Two New DOL Settlement Agreements Provide Additional ESOP Transaction Guidance

FBTS Agreement

- The FBTS agreement results from the case *Perez v. First Bankers Trust Services, Inc.* (S.D.N.Y. No. 1:12-cv-08648-GBD), relating to the Maran Inc. ESOP's purchase of 49% of Maran stock for $70 million in 2006.
- In 2009, Walmart, Maran's main customer, stopped buying from Maran and the stock value dropped to zero. Walmart later renewed the contract, and the stock was valued at $8.3 million.
- The DOL was concerned that (i) the valuation firm had worked for the company before, (ii) FBTS did not get information about a prior offer to sell the company, and (iii) the engagement agreement between FBTS and the appraiser stipulated that the appraiser could rely on the projections of a Maran officer.
- The DOL also alleged that FBTS failed to properly negotiate the offer.

Two New DOL Settlement Agreements Provide Additional ESOP Transaction Guidance

FBTS Agreement (cont.)

- The FBTS agreement with the DOL expands on the GreatBanc process agreement by adding a number of requirements in regard to:
  - Determining the independence of the appraiser
  - Assessing the reliability of earnings projections
  - Assessing any prior valuations and/or offers
  - Ensuring that any relinquishment of control by the ESOP is adequately compensated (or document why this is not necessary)
  - The agreement further requires that FBTS document not just what steps it took to ensure that the valuation was properly vetted, but also who at the firm took such steps

Two New DOL Settlement Agreements Provide Additional ESOP Transaction Guidance

FBTS Agreement (cont.)

- The FBTS agreement also adds requirements that the trustee make sure the appraiser has properly considered a variety of issues, including:
  - Any prior defaults within the last five years by the ESOP
  - Any management letters provided to the ESOP sponsor by its accountants within the last five years
  - Information from any employee who has participated in decisions about the transaction
  - Information from any employee who participated in the transaction who believes that the report’s conclusions are not indicative of the true value

Two New DOL Settlement Agreements Provide Additional ESOP Transaction Guidance

Joyner Agreement

- The Joyner agreement flows out of the case *Acosta v. Bat Masonry Company* (W.D. Va. No. 6:15-00028-EKD), in which the DOL claimed overvaluation of shares purchased by the ESOP. Joyner served as trustee for the transaction. The Joyner settlement required him to enter into an agreement that very closely tracks the GreatBanc process agreement.
- The Joyner agreement has only a few elements that are different from the GreatBanc process agreement:
  - The trustee's vetting of the appraiser must be repeated every 24 months rather than every 15 months.
  - It contains restrictive language concerning when it is appropriate to use unaudited statements.
  - It adds a requirement that the trustee obtain fiduciary insurance or be a named fiduciary under the sponsor's policy. (Joyner worked as an individual outside trustee; institutional trustees would have their own insurance.)

QUESTIONS?

Biography

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Julie K. Stapel helps employee benefit plan sponsors and financial service providers with the investment, and management of employee benefit plan assets. She advises clients on ERISA fiduciary and prohibited transaction rules, and their impact on investment products and services, and helps those clients use investment documentation and other tools to manage potential fiduciary risks while providing top-quality benefits and services. She also works with plan sponsors and financial service providers to address ERISA–related compliance issues.

Biography

Andy Anderson
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Leader of Morgan Lewis's health and welfare task force, Andy R. Anderson is often recognized for his work in counseling clients on employer, individual, and insurer issues created by the Affordable Care Act, and regulatory compliance issues in relation to the Internal Revenue Code, ERISA, COBRA, HIPAA, and Mental Health Parity. Tax-exempt organizations and Fortune 500 companies turn to Andy for handling their benefit plans, and legal review surrounding welfare benefit plans, government self-correction programs, cafeteria plans, and VEBAs.

Biography

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Brian D. Hector counsels clients on Employee Retirement Income Security Act (ERISA) and employee benefits issues, including employee stock ownership plans (ESOPs), qualified benefits plans, executive compensation, fiduciary liability, and related securities matters. As head of Morgan Lewis's ESOP Task Force, he advises public and private ESOP clients on corporate governance, succession planning strategies, ownership transition issues, and liquidity transactions. He also represents enterprises before the US Internal Revenue Service (IRS) and Department of Labor (DOL) in a range of ESOP and employee benefits matters.

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Randall "Randy" Tracht advises clients on a broad range of employee benefits and executive compensation issues involving clients' tax-qualified pension and 401(k) plans, health and retiree medical plans, non-qualified deferred compensation plans, equity incentive plans and other executive compensation arrangements, employment agreements, and fringe benefit plans. Randy represents and counsels a wide range of corporate and tax-exempt clients across the United States, including clients in the higher education, healthcare, retail, and energy sectors. His work includes counseling clients on fiduciary issues under the Employee Retirement Income Security Act (ERISA), tax-qualification requirements and other issues under the Internal Revenue Code, the employee benefits aspects of corporate transactions, and other matters.

Biography

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Jonathan Zimmerman helps clients design and maintain all types of employee benefit plans and programs. His practice focuses on Internal Revenue Code and Employee Retirement Income Security Act (ERISA) compliance for retirement, health and welfare, and executive compensation plans. He has particular experience with Code Sections 409A, 162(m), and 280G, and with taxes and fees arising under the Affordable Care Act (ACA). Jonathan also devotes a large part of his practice to payroll, withholding, and fringe benefits matters. He works with clients of all sizes and routinely handles matters ranging from large transactions to day-to-day administrative questions.

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

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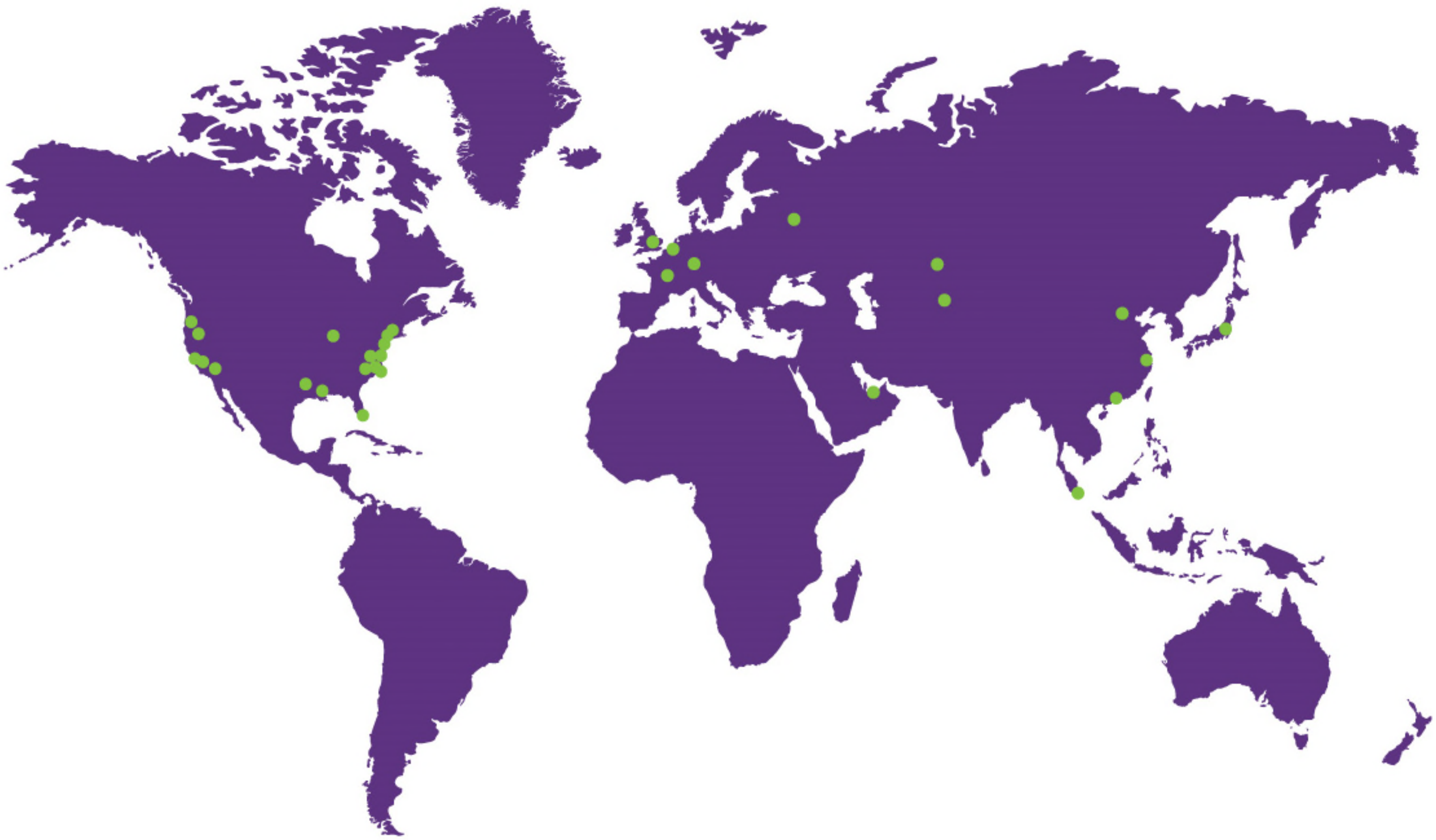

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