HOT TOPICS IN EMPLOYEE BENEFITS

Randy McGeorge, Erin Randolph-Williams, Claire Bouffard, Lindsay Goodman, and Bill Marx

April 14, 2022

© 2022 Morgan, Lewis & Bockius LLP

Agenda

- US Department of Labor Regulatory Update
- Multiemployer Pension Plans: Transaction Considerations
- Mental Health Parity Compliance
- Plan Sponsor Considerations
- Equity Plan Proposals in 2022

US Department of Labor Regulatory Update

DOL Cryptocurrency Guidance

- In Compliance Assistance Release No. 2022-01, the DOL cautions plan fiduciaries about offering cryptocurrency exposure to plan participants.
- The DOL appears concerned about cryptocurrency being volatile, disclosure, custody and recordkeeping, valuation, and the evolving regulatory environment.
- EBSA expects to conduct investigations of 401(k) plans that offer investments in cryptocurrencies and related products.
- The DOL forewarns that plan fiduciaries that offer cryptocurrency investments under their 401(k) plans should brace themselves for potential DOL scrutiny of their fiduciary decision to offer these investments.
- Changing tides for self-directed brokerage?

DOL Statement on Private Equity in DC Plans

- The DOL's Supplemental Statement (the Statement) clarifies the DOL's position on the use of professionally managed asset-allocation funds with a private-equity component as an investment option in participant-directed 401(k) plans.
- Information Letter 06-03-2020 (the 2020 Letter) concluded that private equity is not per se imprudent.
- The Statement highlights concerns that the 2020 Letter may have misled market participants regarding private-equity risks and the level of sophistication required to properly assess private-equity risks.
- The DOL concludes that the 2020 Letter "did not endorse or recommend" investment options with private equity components and should not be read to mean that such investment options are "generally appropriate for a typical 401(k) plan."
- Size of the plan and the sophistication of the fiduciary may be relevant.

DOL ESG Request for Information (RFI)

- In February 2022, the DOL issued an RFI on "Possible Agency Actions to Protect Life Savings and Pensions from Threats of Climate-Related Financial Risk."
- The RFI follows up on the DOL's looming ESG regulation proposed in October 2021–while the DOL finalizes the regulation, it is simultaneously searching for additional information about other ways that climate change may impact the retirement industry.
- Amid an array of other questions, the DOL's two primary questions included:
  - How should EBSA act to "protect the lifesavings and pensions of US workers and families from the threats of climate-related financial risk"?
  - What are the most significant climate-related financial risks to retirement savings and why?

Multiemployer Pension Plans: Transaction Considerations

Morgan Lewis

Multiemployer Plan Basics

- Plan sponsored and maintained by a combination of an equal number of trustees appointed by a union and interested employers
- Collective bargaining agreement (CBA) between an employer and a union requires contributions to the plan
- Potential major issues:
  - Withdrawal liability
  - Controlled group liability
  - Escalating costs due to funding requirements

Controlled Group Issues & Structuring Consideration

- Under ERISA, liability for underfunded pension plans is "joint and several" among all "controlled group" members (i.e., generally all trades or businesses connected through an 80% or more ownership chain with a common parent)
  - Recent First Circuit Court of Appeals case held that a private-equity fund is a trade or business and therefore jointly and severally liable for underfunded pension liabilities of its portfolio companies
  - On remand, the lower court ignored the chosen corporate form (investment of 70% by Fund III and 30% by Fund IV) and deemed a partnership to exist among the related funds rather than the entity formed below them
    - Although such decision was overturned by the First Circuit Court of Appeals, the court applied a multifactor facts-and-circumstances test that leaves open the possibility that two private-equity funds could be deemed to create a partnership in fact subject to the controlled-group rules in a similar situation
- Buyers may want to consider partnering with unrelated minority investors or structuring their investments so that a target company with significant withdrawal liability exposure is not part of its or its other affiliated companies' controlled group

What is Withdrawal Liability and How Is It Triggered?

- An employer who ceases to contribute to a multiemployer pension plan must pay a proportionate share of the plan's unfunded vested liabilities even where the employer has paid all contributions required to be made by it under the applicable CBA
- "Complete" withdrawal occurs when an employer either:
  - permanently ceases to have an obligation to contribute (the CBA expires)
  - permanently ceases the activity that required its plan contributions (sale of a business in an asset deal)
- "Partial" withdrawal occurs when there is either:
  - 70% or more decline in contribution base units over a designated period
  - An employer ceases to have an obligation to contribute for fewer than all CBAs, but continues to work in the jurisdiction of the CBA or at the same facility, where the work is of the type for which contributions were previously required
- "Mass" withdrawal occurs when every employer leaves the plan

Does Withdrawal Liability Warrant a Purchase-Price Reduction?

- One of the issues that all buyers and sellers in transactions where underfunded multiemployer plans are involved should consider is whether the underfunding should warrant a deal price adjustment, funds being placed in escrow, and/or heightened indemnification protections
- Potential multiemployer pension plan liability in the event of withdrawal is not required to be disclosed in a company's financial statements by the FASB; therefore, buyers often overlook the amount of such potential liability in setting the purchase price at the bid stage
- Valuation firms, such as Moody's, have put out guidance indicating that they treat withdrawal liability exposure as a debt-like item that negatively affects the valuation of a company
  - Buyers follow suit and argue that withdrawal liability is a debt-like item, no different than the underfunding associated with a single-employer pension plan, that could affect marketability and valuation on subsequent sales
  - Sellers counter that the liability is only triggered if and when an employer "leaves" the plan, and therefore "mythical" for a going concern, and should not affect price

Quantification of the Financial Exposure – Generally

- A plan's publicly filed funding information and due diligence disclosures are generally not sufficient to enable anyone to determine an employer's actual withdrawal exposure with precision
- ERISA requires a plan to provide a contributing employer with a withdrawal liability estimate at least once per year upon request, but these usually take up to six months to satisfy so this rule is often only useful where a seller has requested an estimate in advance of sale/auction
  - Sellers sometimes argue that they haven't/won't request an estimate because it would "signal" the union that they are being sold; we generally view this as flawed reasoning because it is common practice for employers to make routine annual requests as a matter of good financial risk assessment
- Absent timely withdrawal liability reports, "back of the envelope" estimates must be done with applicable caveats (we do these routinely)

Factors Affecting the Quantification of Withdrawal Liability Exposure

- There are multiple permissible methods for a plan to calculate withdrawal liability (e.g., total shortfall times the quotient of an employer's contributions to all employers' contributions over the last five years, pooling an employer's share of +/- in funding on an annual basis, allocation base on employer's employees)
  - Such methods may produce widely different results
- Mitigating considerations
  - If the buyer intends to operate the business, liability won't be triggered immediately so discounting may be appropriate
  - Not payable in a lump sum, so discounting may be appropriate
    - Annual payment cap based on employer's historical base units (e.g., hours worked) multiplied by the highest rate of contributions (e.g., dollars per hour)
    - 20-year cap on payments (unless part of a mass withdrawal)
  - Payments are tax-deductible

Successor Liability in Asset Sales

- Asset sale will generally trigger withdrawal liability because the “company” will cease to have an obligation to contribute to the multiemployer plan even if the buyer continues to contribute to the plan at the exact level for the exact same employees postclosing
- The Third, Sixth, Seventh, and Ninth Circuit Courts of Appeals have all held that successor liability can attach to an asset purchaser if it had actual or constructive notice of the withdrawal liability before acquiring the seller’s assets and there was a substantial continuity in the operation of the business

Sale of Assets Exception

- An asset seller can avoid triggering withdrawal liability upon a sale of assets if the buyer and seller agree to, and follow, the requirements of Section 4204 of ERISA, which requires the following:
  - A bona fide arm's-length transaction between unrelated parties
  - Buyer assumes obligation to contribute for substantially the same number of contribution base units as the seller was obligated to contribute to the plan
  - Buyer timely posts a bond for a period of five years based the seller's historical annual contributions, unless an exception applies
  - Buyer must pick up the last five years of contribution history of seller (for purposes of determining liability of buyer upon buyer's subsequent withdrawal)
  - Seller must agree in the purchase agreement to be secondarily liable for the amount of the liability it would have otherwise incurred, but for Section 4204, if the buyer withdraws within five years and does not pay its withdrawal liability
  - If seller liquidates all or substantially all of its assets within five years, it must post a bond based on the amount of withdrawal liability it would have otherwise incurred

Potential Pricing Issues in Addition to Withdrawal Liability

- Plans that are determined to be "critical" (65% or less funded) or "endangered" (less than 80% funded) must adopt a rehabilitation or funding improvement plan that may require increased contributions and surcharges to improve plan funding
  - As part of the diligence process, a buyer should determine and assess the cost of pre-established future increases in contribution rates to underfunded multiemployer pension plans
- A plan's failure to satisfy its statutory minimum funding requirements could result in excise taxes and other hidden costs to contributing employers
  - At least one fund has language buried in its rehabilitation plan indicating that, upon withdrawal, in addition to statutory withdrawal liability, the withdrawing employer will, as a matter of contract, owe an amount equal to its share of the minimum funding shortfall

Mental Health Parity Compliance

Morgan Lewis

Mental Health Parity Compliance: NQTL Comparative Analysis

- Background on Mental Health Parity and Addiction Equity Act (Mental Health Parity) requirements
- Refresher on Consolidated Appropriations Act's (CAA) requirement to create and maintain comparative analyses of nonquantitative treatment limitations (NQTLs)
  - An NQTL is any process, strategy, evidentiary standard, or other criteria that limits the scope or duration of benefits under a group health plan
  - Examples of NQTLs include:
    - Medical management standards
    - Formulary designs for prescription drugs
    - Fail-first or step-therapy protocols
    - Provider licensing standards
    - Determination of usual and customary charges
    - Conditioning benefits on completion of a course of treatment

Mental Health Parity Compliance: NQTL Comparative Analysis

- Comparative analysis requirement
  - Must make NQTL comparative analysis available to a state authority or the Secretaries of the DOL, HHS or Treasury upon request (generally 10-14 days)
- Comparative analysis must include:
  - The specific plan or coverage terms or other relevant terms regarding NQTLs and a description of all mental health or substance use disorder (MH/SUD) and medical or surgical (M/S) benefits to which each such term applies in each respective benefit classification
  - The factors and evidentiary standards used to determine that the NQTLs will apply to MH/SUD benefits and M/S benefits
  - The comparative analyses demonstrating that the processes, strategies, evidentiary standards, and other factors used to apply the NQTLs to MH/SUD benefits, as written and in operation, are comparable to, and applied no more stringently than, the processes, strategies, evidentiary standards, and other factors used to apply the NQTLs to M/S benefits in the benefits classification
  - The specific findings and conclusions reached by the group health plan or health insurance issuer with respect to the health insurance coverage that indicates the group health plan is or is not in compliance

Mental Health Parity Compliance: 2022 Report to Congress

- Latest report to Congress issued on January 25, 2022
  - Provides an update on the enforcement action undertaken by the Departments to ensure compliance with Mental Health Parity
  - Overall, **NONE** of the comparative analyses initially reviewed to date have been sufficient (156 letters were issued, 134 of which were self-insured plans)
  - All self-insured health plans currently under DOL audit were asked to provide a comparative analysis
    - Many plans were unprepared to provide an analysis
  - Makes certain recommendations, including implementing civil monetary penalties for parity violations, to amend ERISA to allow EBSA to directly pursue TPAs that violate Mental Health Parity and amend ERISA to allow participants and beneficiaries to recover amounts for Mental Health Parity violations
  - Provides examples of deficiencies

Mental Health Parity Compliance: 2022 Report to Congress

- Sufficient comparative analysis must include:
  - A detailed, written, and reasoned explanation of the specific plan terms and practices at issue
  - Bases for the conclusions that the NQTL complies with Mental Health Parity
  - Be up to date
  - Must analyze **ALL** NQTLs imposed
- Examples of insufficient comparative analysis:
  - General statements of compliance or conclusory references to broadly stated processes, strategies, evidentiary standards, or other factors
  - Generic comparative analysis not specific to plan at issue
  - Production of a large volume of documents without a clear explanation of how and why each document is relevant to the NQTL comparative analysis
  - Identification of processes, strategies, sources, and factors without the required or clear and detailed NQTL comparative analysis
  - Identification of factors, evidentiary standards, and strategies without a clear explanation of how they were defined and applied in practice
  - Lack of meaningful comparison or meaningful analysis
- Hoping for additional guidance in the next few months

Mental Health Parity Compliance: 2022 Report to Congress

- What should plans be doing?
  - Ensure comparative analysis is underway or complete
    - Work closely with TPAs/consultants/brokers
    - Review prepared comparative analysis carefully to flag potential deficiencies

Plan Sponsor Considerations

Proposed Required Minimum Distribution Regulations

- Stated purpose to update the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) and certain other law changes
- Changes formatting of regulations from Q&A to standard regulations format
- Revises the Internal Revenue Code (Code) Section 401(a)(9) regulations, as well as certain sections of the rollover and 403(b) regulations
- Generally effective January 1, 2022

SECURE Act RMD Clarifications

- Reflect the change in the age component of participant required beginning date from 70½ to 72 (defined contribution and defined benefit)
- Clarify that actuarial adjustment for participants in defined benefit plans applies from April 1 following the year the participant reaches age 70½ and this is not increased to age 72
- Changing the minimum incidental death-benefit rules to reflect that adjustments apply from age 72
- Reflect the "ten-year rule" that applies to designated beneficiaries who are not "eligible designated beneficiaries" in defined contribution plans, including those that provide annuity contracts, and clarify that acceleration for this purpose does not violate the minimum incidental death-benefit rules
- Provide that the age of majority is 21

Other Changes/Clarifications

- Section 436 restrictions trump the five-year rule, but remaining benefits must be paid in a single lump sum after the restrictions are lifted
- Clarify the rollover rules regarding the portion of any distribution to be treated as a required minimum distribution (depending on whether life expectancy, five-year, or 10-year rule applies)
- Rules regarding disability determinations
- Application of rules where there are multiple beneficiaries and where the beneficiary is a trust
- Provide exceptions/extensions for 60-day rollovers (including clarification related to qualified plan loan offsets due to termination of employment)

Lifetime Income Disclosure

- The SECURE Act required benefit statements to include, at least annually:
  - an estimate of the monthly income that a participant could receive if the participant were to take regular, equal withdrawals from his or her account in form of a single life annuity and 100% joint and survivor annuity
- For participant-directed plans, the first lifetime income disclosure must be provided on a quarterly benefit statement no later than the last calendar quarter ending within 12 months after the September 18, 2021 effective date — i.e., for quarterly statements delivered in **July 2022**
- For non–participant-directed plans, the first lifetime income disclosure must be provided on the annual statement for the first plan year ending on or after September 19, 2021

Lifetime Income Disclosures

- The DOL provided certain model language explaining the illustrations that must be provided and the assumptions used to create the illustrations.
- The regulations provide safe-harbor relief from fiduciary liability for providing allegedly inaccurate lifetime income disclosures, conditioned on use of DOL model language.
- Model language contemplates distribution options and plan features that may not apply to every plan — it includes disclaimers to that effect but could generate participant questions.

Bonus Topic – SECURE Act 2.0

- Mandatory automatic enrollment of at least 3%, with 1% automatic escalator up to 10% with permissive withdrawals (EACA), with exception for existing plans, small or new businesses, and governmental and church plans
- Increasing the age for participants to receive required minimum distributions to a maximum of 75
- Allowing additional catch-up contributions for participants between ages 62 and 65
- Treating student loan payments as deferrals for purposes of receiving match and providing nondiscrimination relief
- QLACs and life annuity contract modifications
- Allows for matching contributions to be made on a pretax or Roth basis, on participant's election

Bonus Topic – SECURE Act 2.0

- Further reducing the service requirements for long-term, part-time employees from three consecutive years of 500 or more hours of service to two
- Reducing the excise tax on RMDs from 50% to 25% (or sometimes lower)
- Creation of retirement savings lost and found
- Expanding EPCRS and codifying certain corrections.
- Providing three-year time limit on repayment of qualified birth or adoption distributions
- Providing ability to rely on employee certification for hardship withdrawal circumstances
- Withdrawals for victims of domestic abuse
- And more…
- Many similarities, but also some differences between House and Senate versions of legislation

2022 Equity Plan Proposals

Equity Plan Proposals

- Shareholder perspectives and guidelines
- Proxy advisor guidelines
- Equity needs
- Evolving case law and statutory changes

Institutional Shareholder Services (ISS)

- ISS supports shareholder approval of equity plans based on whether the plan achieves the requisite number of points under the ISS analysis (Equity Plan Scorecard) and has no overriding factors
  - Plan needs 57, 55 or 53 (depending on type of company) out of 100 points for ISS approval
  - Number of points dictates number of shares available for new grants
- Overriding factors:
  - Liberal change-in-control definition
  - Repricing/cash buyout of underwater options without shareholder approval
  - Plan is a vehicle for problematic pay practices or pay-for-performance misalignment; problematic pay practices include:
    - Tax gross-ups
    - Excessive change-in-control severance/voluntary termination severance trigger
  - Plan is estimated to be excessively dilutive to shareholders (ranging from 20% to 25%)
  - Plan includes an evergreen feature
  - Other plan features detrimental to shareholder interests

Institutional Shareholder Services

- Points are awarded based on a range of factors under three "pillars":
  1. **Plan Cost**
     - Dilution
     - Overhang
  2. **Grant Practices**
     - Burn rate relative to peers
     - Vesting schedule and performance measurement period for the CEO's most recent equity grants during the prior three years
     - Proportion of CEO awards that are performance-based
     - Estimated plan duration
     - Clawback policy that includes equity grants
     - Post-exercise/post-vesting shareholding requirements

Institutional Shareholder Services

3. **Plan Features**
   - Disclosure around vesting upon a change in control
   - Liberal share counting
   - Minimum one-year vesting period
     - 5% carve-out
     - Must apply to all types of awards
   - Dividends payable only upon vesting (performance- or time-vested)
   - Discretion to accelerate vesting

- Factors within each pillar are not weighted equally

Lessons from 2022 Proxy Season

- Consider tailoring language to shareholder and proxy advisor guidelines
  - Clawback language specifically refers to clawback policy authorizing recoupment
  - No dividends or dividend equivalents paid until equity is vested
- Confirm numbers in the proxy are consistent with previously disclosed numbers
- ISS data verification
  - ISS provides data verification report to an issuer only if a proxy is filed more than 40 days prior to the meeting
  - Issuer has 48 hours to review and correct
- Steps to take if ISS or Glass Lewis does not recommend approval
  - Make plan changes and make a supplemental SEC filing
  - Supplemental SEC filing urging shareholders to vote for the plan
  - Meet with largest shareholders who follow ISS or Glass Lewis

Questions?

Biography

Randall (Randy) McGeorge
Pittsburgh
+1.412.560.7410
randy.mcgeorge@morganlewis.com

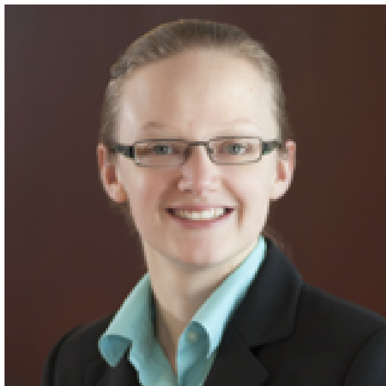
Randy counsels clients on executive compensation and employee benefits concerns, including the design and implementation of qualified and nonqualified retirement plans, equity incentive plans, executive compensation arrangements, and health and welfare plans. Representing corporations and individuals, he negotiates and drafts employment and severance agreements. He also represents clients before the US Internal Revenue Service (IRS), Department of Labor (DOL), and Pension Benefit Guaranty Corp. regarding the qualification and operation of employee benefit plans.

Biography

Erin Randolph-Williams
Philadelphia
+1.215.963.5982
erin.randolph-williams@morganlewis.com

Erin is part of a team that helps clients find solutions to their employee benefits–related problems. She counsels clients on employee benefits matters, including design, implementation, and administration of cash or deferred compensation arrangements, nonqualified deferred compensation plans, and executive and equity compensation arrangements. Erin negotiates employment agreements and severance arrangements for senior executives, and advises clients on all employee benefits and compensation-related aspects of mergers, acquisitions, sales and spin-offs.

Biography



Claire E. Bouffard
Pittsburgh
+1.412.560.7421
claire.bouffard@morganlewis.com

Claire counsels clients on employee benefits and executive compensation. She drafts and assists with design of tax-qualified pension and profit-sharing plans, cash or deferred arrangements, health and welfare arrangements, deferred compensation plans, and employment agreements. In addition, Claire reviews and edits plan documents and amendments to ensure compliance with applicable law; drafts communications materials and notices to plan participants; and files voluntary correction program submissions. Claire assists with benefit plans in every stage of their lives—from inception or acquisition to termination or divestiture.

Biography

Lindsay M. Goodman
Chicago
+1.312.324.1176
lindsay.goodman@morganlewis.com

Lindsay has experience with many aspects of the firm's comprehensive employee benefits practice. She handles a wide range of projects, including health and welfare plan issues, qualified and nonqualified retirement plan issues, HIPAA and COBRA matters, employee benefits due diligence with respect to mergers and acquisitions, and Department of Labor and Internal Revenue Service audits.

Biography

William (Bill) Marx
Philadelphia
+1.215.963.1744
william.marx@morganlewis.com

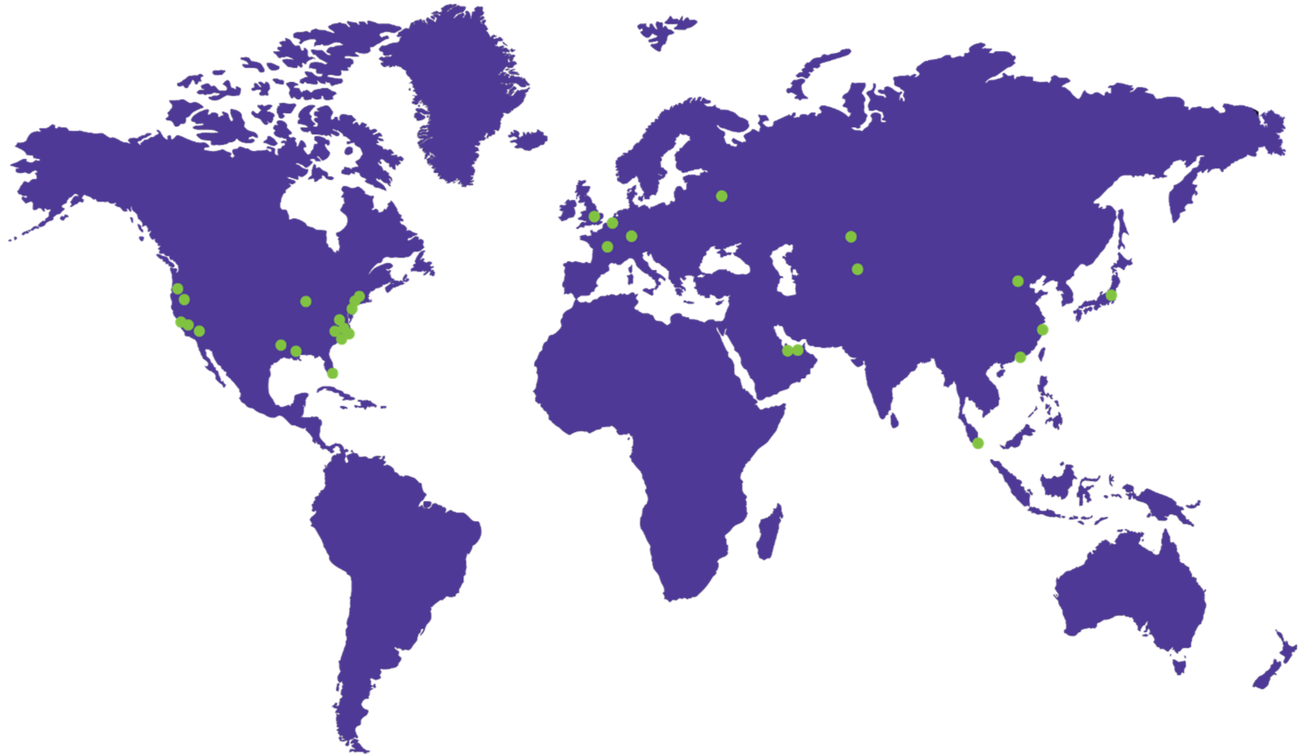
Bill helps employee benefit plan sponsors and financial service providers with a range of matters related to employee benefits. His focus includes advising clients on qualified and nonqualified retirement plan issues, and the fiduciary and prohibited transaction rules under ERISA. William has several years of business experience in the retirement plan industry, including consulting plan sponsors on plan design, employee education, and investments among other business decisions.

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Abu Dhabi
Almaty
Beijing*
Boston
Brussels
Century City
Chicago
Dallas
Dubai
Frankfurt
Hartford
Hong Kong*
Houston
London
Los Angeles
Miami
Moscow
New York
Nur-Sultan
Orange County
Paris
Philadelphia
Pittsburgh
Princeton
San Francisco
Shanghai*
Silicon Valley
Singapore*
Tokyo
Washington, DC
Wilmington



Morgan Lewis

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan, Lewis & Bockius is a separate Hong Kong general partnership registered with The Law Society of Hong Kong. Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

THANK YOU

© 2022 Morgan, Lewis & Bockius LLP
© 2022 Morgan Lewis Stamford LLC
© 2022 Morgan, Lewis & Bockius UK LLP

Morgan, Lewis & Bockius UK LLP is a limited liability partnership registered in England and Wales under number OC378797 and is a law firm authorised and regulated by the Solicitors Regulation Authority. The SRA authorisation number is 615176.

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan, Lewis & Bockius is a separate Hong Kong general partnership registered with The Law Society of Hong Kong. Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

This material is provided for your convenience and does not constitute legal advice or create an attorney-client relationship. Prior results do not guarantee similar outcomes. Attorney Advertising.