Morgan Lewis

Employee Benefits and Executive Compensation
Hot Sheet[1] | Winter 2014

Fiduciary Issues (Craig Bitman, Dan Kleinman, Marla Kreindler, Donald Myers, Julie Stapel)	
Issue: In his January 28, 2014 State of the Union address, President Obama announced a new no fee, workplace-based retirement savings program called the myRA (My Retirement Account) for employees who either do not have access to an employer-sponsored retirement savings plan or are looking to supplement a current plan. Employers may make myRAs available to employees but will not be required to do so. Employers who elect to participate in the program and make myRAs available to their employees will not contribute or administer the myRAs, apart from payroll deductions. Employees of participating employers will be able to open a myRA with as little as $25, and elect to have a portion – as little as $5 – directly deposited into their myRAs automatically. Account balances will never go down and will earn interest at the same variable rate as the Government Securities Investment Fund in the Thrift Savings Plan for federal employees. The myRAs will be structured as Roth IRAs. Accordingly, myRAs will be subject to Roth IRA annual contribution and income limits. Employee contributions will be made on an after-tax basis and can be withdrawn tax-free at any time. Investment earnings can be withdrawn tax-free after age 59-1/2. Contributions to myRAs will not be limited to one employer to account for job changes, and may be rolled over to a Roth IRA at any time. A rollover is mandatory, however, once the account reaches $15,000 or has been in place for 30 years.	**Action:** According to the Treasury, the myRA program will offer two key advantages for employers: 1) a benefit to help employers attract and retain employees – at little or no cost to the employers; and 2) an easy way to help their employees improve their financial stability by saving for retirement. Initially, myRAs will be offered through a pilot program to employees of employers who choose to participate in the program by the end of 2014. The Treasury expects to roll out myRAs, along with guidance, later this year. In the meantime, employers who wish to participate in the program should consider the cost and payroll system changes that may be required to distribute information about the myRAs to their employees and implement payroll deductions to the myRAs. (*See* 3/19/2014 webinar, "Hot Topics in Employee Benefits – What We're Seeing.")
Issue: As assets held in IRA accounts continue to represent an increasing percentage of all U.S. retirement assets and currently exceed those held in employer-sponsored 401(k) plans (and other similar plans) and traditional pension plans, perceived issues with the IRA rollover process have become an increasing concern. In 2013, the U.S. Government Accounting Office (GAO) published a report[2] urging the U.S. Department of Labor (DOL) and the Internal Revenue Service (IRS) to take action to improve the rollover process for plan participants. The GAO report was particularly critical of the information and disclosures that financial services firms provide to plan participants when counseling them on options relating to distribution from their employer-sponsored retirement plans. Specifically, the GAO report	**Action:** Issuance of FINRA Notice 13-45 and the inclusion of IRA rollovers as FINRA and SEC examination priorities, along with the 2013 GAO report, are consistent with the trend toward increasing scrutiny of the IRA market. IRA rollovers are also receiving attention from the DOL, which indicated in its comments to the 2013 GAO report that its pending project to revise its regulation on the definition of a "fiduciary" may address many of the GAO's concerns. Because IRA rollovers will likely increase as more Americans reach retirement age, we can expect further regulatory activity in this area – including possibly from the IRS. Plan sponsors are currently required to provide plan participants with a special tax notice that describes the rules and tax consequences of rolling over all or a portion of their

[1] This Hot Sheet is intended for informational purposes about recent legal developments of interest to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship.

[2] View the report at http://www.gao.gov/assets/660/652881.pdf.

concluded that financial services firms generally encouraged IRA rollovers without fully explaining the options available and without making sound determinations that an IRA rollover is in a particular investor's best interests.

Sharing the GAO's concerns that investors may be misled about the benefits of rolling over assets to an IRA, the Financial Industry Regulatory Authority (FINRA) issued FINRA Notice 13-45[3] on December 30, 2013 to remind broker-dealer firms of their responsibilities when recommending rollovers to IRAs and marketing IRAs and associated services. As a general matter, broker-dealer firms will need to (i) ensure their IRA rollover recommendations reflect consideration of various factors related to a particular investor's individual needs and circumstances, (ii) review their retirement services activities to assess conflicts of interest in recommending IRA rollovers, and (iii) ensure their recommendations and educational materials regarding IRA rollovers do not violate FINRA's suitability rule and are fair and balanced.

On January 2 and 9, 2014, respectively, FINRA and the U.S. Securities and Exchange Commission (SEC) announced in their 2014 examination priorities[4] that each respective agency will focus on broker-dealer and investment advisory firms' marketing materials and practices with respect to IRA rollovers. Officials from both FINRA and the SEC have indicated that they may focus on those firms or representatives within a particular firm that have been particularly successful at encouraging clients to roll over assets to IRAs.

employer-sponsored retirement plans to an IRA. The special tax notice is intended to help plan participants decide whether to do such a rollover.

Plan sponsors who are concerned about the rollover information their plan participants are receiving outside of the special tax notice may wish to provide their plan participants with additional information or education regarding their distribution options to ensure that their plan participants are receiving comprehensive and balanced information with which to make an informed decision.

(*See* 3/19/2014 webinar, "Hot Topics in Employee Benefits – What We're Seeing.")

Executive Compensation Issues (Mims Zabriskie, Dan Hogans)

Issue: The SEC has recently proposed rules implementing the provision in the Dodd-Frank Act that requires each public company to disclose the ratio of its CEO's total compensation to the total compensation of the remainder of its workforce. The Dodd-Frank provision is highly controversial, with a number of its critics questioning its purpose and efficacy. The recent SEC proposal was approved 3-2 along party lines, with Republican SEC commissioners objecting strenuously. The SEC proposal makes an effort to provide companies with ways to reduce the cost of implementation of the statute by using statistical samples, and generally signals an interest in working with reporting companies to reduce the regulatory burden resulting from the rule. Nevertheless, the rule requires significant data collection efforts, especially from companies with international operations and geographically diverse operations. The proposal envisions the development of a statistical median employee whose compensation would be compared to the CEO's compensation using the SEC's total compensation methodology.

Action: If finalized as proposed, for a calendar-year firm, this proposal would be effective for the 2016 proxy season, using 2015 compensation data. While that effective date provision allows some time to see that the company's data systems meet the proposal's requirements, it is not too early to begin the process of determining what steps need to be implemented to meet the requirements. Companies that identify material data or methodology impediments stemming from the proposal may want to consider filing comments to the SEC proposal or joining in industry group comments.

(Please notify us at oto@morganlewis.com if a webinar on this topic would be of interest to you.)

[3] View Notice 13-45 at https://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p418695.pdf.

[4] View FINRA's examination priorities at http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p419710.pdf. View the SEC's examination priorities at http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf

Issue: Many employers are encountering administrative issues and questions with legacy or maturing split-dollar life insurance arrangements. These types of arrangements are generally characterized by an agreement between an employer and an employee (insured) under which the employer will pay premiums on a whole or universal life insurance policy, subject to repayment of the premiums paid by the employer from policy proceeds. Often adopted many years ago, these arrangements may be reaching maturity (e.g., where employer premiums may be repaid) or be under financial performance review as part of an effort to rationalize long-term and deferred compensation for affected participants. The variety of split-dollar life insurance structures and income tax rules, including some ambiguities in those rules, pose challenges for employers in ongoing administration and planning, wind-up or rollout of policies covered under split-dollar life insurance arrangements. Where employer premiums are to be recovered from policy cash value, and there is cash value in excess of premiums paid, issues may arise regarding the potential taxation of excess policy cash value.

The federal income tax treatment of split-dollar life insurance arrangements changed substantially with the implementation of final Treasury Regulations effective September 17, 2003. Under the final Treasury Regulations, and subject to transition relief described in IRS Notice 2002-8, split-dollar life insurance was transitioned from an old guidance regime under which covered employees generally were taxed currently on the term value of life insurance coverage benefits to a new regime where, depending on the structure, the arrangement either would be taxed as a loan of the premiums (potentially subject to imputed interest income to the employee), or under an "economic benefit" regime, where the employee would be subject to tax on the value of life insurance coverage plus any vested interest in the policy cash value. The final Treasury Regulations allowed for grandfather treatment of old split-dollar arrangements and many of these arrangements still exist. Because the grandfather rules of the final split-dollar Treasury Regulations are very restrictive, and split-dollar arrangements also may be subject to deferred compensation restrictions under section 409A of the Internal Revenue Code, great care should be taken in administration of, or potential changes to, such arrangements.

Action: Employers should indentify and categorize any existing split-dollar life insurance arrangements (e.g., endorsement or collateral assignment, split-dollar grandfathered or not, section 409A grandfathered or not) and ensure that the policies are being properly administered from a federal income tax standpoint (including ongoing income tax reporting of coverage value or imputed interest, etc.). Employers should also analyze and plan for any potential tax issues that may arise in connection with the termination or rollout of a split-dollar policy including any potential reporting and withholding issues.

(*See* 3/19/2014 webinar, "Hot Topics in Employee Benefits – What We're Seeing.")

Plan Sponsor Issues (Randy Tracht, Lisa Barton, Brian Dougherty)

Issue: The Supreme Court has recently provided strong endorsement for the enforceability of plan-based limitations periods for bringing judicial actions for benefits claims. The Court barred a claim for LTD benefits based on a plan provision requiring commencement of any legal action within three years after "proof of loss" is due. The Court characterized the provision as a contractual, or agreed-upon, limitations period that was enforceable if it was of reasonable length and not subject to a contrary controlling statute. In this case the claimant had approximately a year to bring suit after exhausting the administrative claims procedure. The Court found that to be reasonable.

Action: Plan sponsors should examine their retirement plans, and perhaps their welfare plans, as well, to determine whether they should take advantage of this judicial support for plan-based limitations periods. Consideration should be given to plan provisions limiting the periods for bringing both administrative claims and judicial actions, including, in the latter case, claims for fiduciary breach.

(*See* 3/19/2014 webinar, "Hot Topics in Employee Benefits – What We're Seeing.")

Issue: An increasing number of plan sponsors have closed, or are considering closing, their defined benefit plans to new participants, while allowing existing participants to continue to accrue benefits. New employees are often covered by enhanced employer contributions to a defined contribution plan. Over time, the population covered by the closed defined benefit plan becomes increasingly highly compensated, making it difficult or impossible for the closed plan to continue to satisfy nondiscrimination requirements. One alternative is to freeze accruals for highly compensated employees under the frozen plan. The IRS has now provided another alternative in the form of temporary relief that facilitates aggregation and cross testing of the closed defined benefit plan with a defined contribution plan that covers newer employees.	**Action:** Plan sponsors with closed defined benefit plans, that may have been advised of impending nondiscrimination failure this year or next (the current relief expires with the plan year beginning in 2015), should examine whether this new guidance will afford a reprieve, however temporary. (*See* 3/19/2014 webinar, "Hot Topics in Employee Benefits – What We're Seeing.")
Issue: 2012 legislation expanded the availability of in-plan Roth conversions to include amounts not currently eligible for distribution under applicable plan qualification rules. But the law itself left many unanswered questions, which caused many plan sponsors to fail to embrace this new opportunity. The IRS has now answered a number – but not all – of these questions.	**Action:** 401(k) plan sponsors should consider whether this new guidance offers the comfort they need to extend to participants this expanded opportunity for in-plan Roth conversions. But be cautioned. We have learned recently that certain highly visible 401(k) recordkeepers are not yet prepared to implement the full range of options available under current law. (*See* 3/19/2014 webinar, "Hot Topics in Employee Benefits – What We're Seeing.")

Employee Stock Ownership Plan (ESOP) Issues (Brian Hector, David Ackerman, John Kober)	
Issue: In *Harris v. Bruister* (S.D. Miss. Dec. 20, 2013), the Secretary of the U.S. Department of Labor (Secretary) brought suit in the U.S. District Court for the Southern District of Mississippi alleging overpayment for stock by the company's ESOP. In a three-year period, defendant trustees sold 100% of the shares of Bruister and Associates stock to the ESOP. The transfer was completed through five separate transactions. The Secretary alleged that defendant trustees breached their fiduciary duties under ERISA when they approved the purchase, and that the five transactions were also prohibited transactions under ERISA. In all five transactions, the defendant trustees relied upon valuations prepared by an independent appraiser to assess the stock's sale price. The Secretary asserts that defendants did not adequately investigate the appraiser's qualifications before hiring him to value the company, supplied the appraiser with incomplete or inaccurate financial information, and were not reasonably justified in relying on the appraiser's valuations. The Secretary claimed that the sales prices for the transactions were inflated. On December 20, 2013, the Court issued an order granting the defendants' motion for summary judgment as to the ERISA prohibited transaction claims brought by the Secretary with respect to two transactions – a transaction that took place in 2002 and one in 2003. The Court ruled that the Secretary's claims with respect to these transactions were time-barred, notwithstanding the signed tolling documents that the Secretary obtained	**Action:** The DOL is increasingly scrutinizing ESOP valuations during its investigations. The fact that the DOL further scrutinizes the independent appraiser's credentials reinforces the importance of ensuring that you have adequately performed your due diligence in selecting a valuation firm and have documented your selection process. Also, this case may affect the DOL's practice in seeking tolling agreements during its investigations. (*See* 3/19/2014 webinar, "Hot Topics in Employee Benefits – What We're Seeing.")

from the defendants. Citing cases decided by the Fifth Circuit, the Court held that the six-year limitation under ERISA may not be waived or tolled regardless of the existence of any tolling agreement between the parties to the contrary. With respect to the Secretary's additional claims, the Court declined to apply the *Moench* presumption of prudence adopted by the Fifth Circuit in *Kirschbaum v. Reliant Energy Inc.*, 526 F.3d 243 (5th Cir. 2008), distinguishing the facts presented in this case from those in *Moench*. The Court noted that in *Bruister*, the question was whether the plan paid too much for the employer securities, which it reasoned does not raise the same policy concerns addressed in *Moench* in connection with the decision whether to invest in such securities at all.	
Issue: Over the last few years, there has been a substantial increase in ESOP-related litigation. This litigation has been driven by a variety of factors, including (1) significant decreases in the value of the company stock resulting from the economic downturn; (2) the DOL's increased and closer scrutiny of ESOPs as part of its national enforcement strategy; and (3) successful outcomes for plaintiffs in a number of DOL-filed lawsuits, as well as class action cases. The recurring theme that is the basis for the recent litigation involves the valuation of the stock, including reasonableness of management projections, impact of employment-related agreements, control premiums, and plan's ownership rights.	**Action:** The DOL will continue its enforcement project against ESOPs for 2014 and thereafter. By keeping in tune with its litigation efforts as well as its general enforcement efforts, one can identify "hot button" issues and hopefully have adequate safeguards in place to avoid future litigation and/or DOL-imposed penalties. The DOL's increased scrutiny of ESOPs underscores the paramount importance of having the right counsel in place at the implementation stage of the ESOP. (*See* 3/19/2014 webinar, "Hot Topics in Employee Benefits – What We're Seeing.")

Health and Welfare Issues (Andy Anderson)	
Issue: Final ACA Shared Responsibility Rules	**Action:** Now that the significant regulatory pieces are in place, employers with 100 or more full-time employees should be undertaking extensive planning so that they are ready for 2015 (employers with 50-99 full-time employees have until 2016). By this fall, employers should be able to identify which employees work, on average, 30 or more hours per week and be prepared to offer them health coverage that is "good enough" and "affordable" at the start of their 2015 plan year. The final rules contain extensive and complicated rules and optional approaches to many facets of the Shared Responsibility rules and will require detailed discussions about how to apply the rules to an employer's unique demographics and business needs. (*See* 2/19/2014 webinar, "Final Affordable Care Act Shared Responsibility Rules — The Last Piece for the 2015 Puzzle," and 2/25/2014 LawFlash, "Final ACA Shared Responsibility Regulations Released.")
Issue: 2014 Plan Amendments	**Action:** The Affordable Care Act (ACA) drove (and continues to drive) many changes to group health plan and cafeteria plan design and operation that go all the way back to 2010. While the regulators adopted generous rules that permitted employers to postpone the related plan document changes, these delays end in 2014. As a result, employers should revise their plan documents by the end of 2014 to capture their past, present, and possibly even future ACA changes. (*See* 3/19/2014 webinar, "Hot Topics in Employee Benefits – What We're Seeing.")

Multiemployer Plan Issues (Althea Day, John Ring, Steve Spencer)	
Issue: The Pension Protection Act (PPA) added new rules for multiemployer pension plans that are significantly underfunded (i.e., in critical or endangered status). Under the PPA rules, such plans are required to adopt a funding improvement plan (for endangered plans) or a rehabilitation plan (for plans in critical status) intended to bring the plans into fully funded status over a 10- or 15-year period. In addition, the PPA rules waive the otherwise applicable excise tax imposed on contributing employers to plans with a funding deficiency. These special PPA rules will expire at the end of 2014 absent Congressional action. In the event the PPA funding rules expire, plans that are operating under a funding improvement plan or rehabilitation plan as of the expiration will continue to operate under those rules. It is not clear, however, how this continuation applies to a plan that first enters endangered or critical status in 2014 (and thus has not yet adopted a funding improvement or rehabilitation plan or where a plan exits and then reenters endangered status). Uncertainty also exists as to whether the excise tax waiver continues to apply after a PPA sunset (regardless of the continuation of an existing funding improvement or rehabilitation plan).	**Action:** Multiemployer plans in endangered or critical status (and those close to endangered status) should work with their actuaries to evaluate the potential funding deficiency and estimate contributing employer excise tax exposure in the event of a PPA sunset. (*See* 3/19/2014 webinar, "Hot Topics in Employee Benefits – What We're Seeing.")
Issue: Multiemployer group health plans often have unique eligibility requirements (e.g., cumulative service hour requirements with contributing employers), and may also have rolling coverage periods (e.g., a requirement that an employee perform a certain amount of service in one quarter for coverage in a subsequent quarter). The ACA prohibits group health plans (including multiemployer group health plans), effective January 1, 2014, from imposing a waiting period in excess of 90 days. For this purpose, a "waiting period" is defined as the "the period that must pass before coverage of an employee or dependent who is otherwise eligible to enroll under the terms of the group health plan can become effective." Final regulations were recently issued that provide examples clarifying certain instances when the unique eligibility requirements of multiemployer plans will be considered to satisfy the ACA 90-day waiting period rules.	**Action:** Multiemployer group health plans utilizing rolling coverage requirements need to be reviewed in light of the final regulations. (*See* 3/19/2014 webinar, "Hot Topics in Employee Benefits – What We're Seeing.")