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Compensation and Benefits Insights

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IRS Issues New 162(m) Guidance

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On August 21, 2018, the Internal Revenue Service (the "IRS") issued Notice 2018-68 (the "Notice") which provides initial guidance and clarification on amendments made to Section 162(m) of the Internal Revenue Code ("Section 162(m)"). The Notice is narrowly tailored to address issues relating to the identification of covered employees and the operation of the grandfather rule, including when a contract will be considered materially modified so that it is no longer grandfathered. In addition, the guidance provided under the Notice is less favorable than many practitioners expected.

Generally, Section 162(m) imposes a $1,000,000 deductibility limit on compensation paid to a "covered employee" (as defined below) of a "publicly held corporation," for any taxable year, subject to certain exceptions. As we reported here, the Tax Cuts and Jobs Act (the "TCJA") made significant amendments to Section 162(m) which consisted of: (1) the elimination of the qualified performance-based compensation and commissions exclusions from the definition of "applicable employee remuneration;" (2) the expansion of the definition of "covered employee;" and (3) expanding the definition of "publicly held corporation" to include any company which is an issuer (a) the securities of which are required to be registered under Section 12 of the Securities Exchange Act if 1934, as amended (the "Exchange Act"), or (b) that is required to file reports under Section 15(d) of the Exchange Act, such as issuers of debt securities or foreign private issuers. The TCJA also provided a transition rule applicable to certain outstanding arrangements (commonly referred to as the grandfather rule). The changes to Section 162(m) under the TCJA apply to tax years beginning after December 31, 2017. Under the grandfather rules the amendments to Section 162(m) do not apply to remuneration which is provided under a written binding

Our Practice

We advise public, private, taxable and tax-exempt clients on a wide variety of issues related to the design, preparation, communication, administration, operation, merger, split-up, amendment and termination of all forms of employee benefit plans and executive compensation programs and related funding vehicles. The firm has defended clients in significant high-profile ERISA litigation matters, including 401(k) plan "stock drop" cases and other breach-of-fiduciary-duty class actions.

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contract that was in effect on, and not modified in any material respect on or after, November 2, 2017.

Covered Employees

Under the TCJA, a "covered employee" is defined as any employee of the taxpayer if (1) such employee is the principal executive officer (PEO) or principal financial officer (PFO) of the taxpayer at any time during the taxable year, or was an individual acting in such capacity, (2) the total compensation of such employee for the taxable year is required to be reported to shareholders under the Exchange Act by reason of such employee being among the three highest compensated officers for the taxable year (other than the PEO or PFO), or (3) such employee was a covered employee of the taxpayer (or any predecessor) for any preceding taxable year beginning after December 31, 2016, and includes any employee who would be a covered employee if a proxy statement was required to be filed.

The amendments under the TCJA provided that the term covered employee includes any employee who is the PEO or PFO of a publicly held corporation at any time during the taxable year, or was an individual acting in such a capacity. It was unclear whether an employee must have served as an executive officer at the end of the taxable year in order to be considered a covered employee. The Notice clarified that there is no end-of-year requirement.

In addition, the Notice clarified that executive officers of publicly held corporations can be covered employees under Section 162(m) even when disclosure of their compensation is not required under the rules of the Securities and Exchange Commission (the "SEC").

Written Binding Contract

The amendments to Section 162(m) made by the TCJA do not apply to remuneration payable under a written binding contract which was in effect on November 2, 2017 and which was not modified in any material respect after such date. It is important to note that the amendments apply to:

- any amount of remuneration that exceeds the amount of remuneration that applicable law obligates the corporation to pay under a written binding contract; or
- any renewal of a written binding contract.

A written binding contract is treated as renewed as of the date that any termination or cancellation, if made would be effective, if the contract is terminable or cancelable by the corporation without the employee's consent after November 2, 2017. Thus, if a contract provides that it will automatically be renewed or extended as of a certain date unless either the corporation or the employee provides notice of termination of the contract at least 30 days before that date, the contract is treated as renewed as of the date that termination would be effective if notice was given.

If a compensation plan or arrangement is binding, the amount that is required to be paid as of November 2, 2017, to any employee pursuant to the plan or arrangement will not be subject to TCJA's amendments to Section 162(m) even though the employee was not eligible to participate in the plan or arrangement on November 2, 2017. As a result, if an arrangement is in place on November 2, 2017 and the employee was employed on November 2, 2017 or the employee had the right to participate in the plan or arrangement under a written binding contract, any amounts received by such employee will not be subject to the TCJA's amendment.

Material Modification

A "material modification" made after November 2, 2017 to any written binding contract will cause the contract to be treated as a new contract that is subject to the TCJA's amendments as of the date of the material modification. Under the TCJA a material modification occurs when the contract is amended to increase the amount of compensation payable to the employee. If a written binding contract is materially modified, it is treated as a new contract entered into as of the date of the material modification. Thus, any amounts received before the material modification is not affected, but amounts received after a material modification are treated as paid under a new contract. In addition, a modification of a contract that accelerates the payment of compensation is a material modification unless the amount of compensation paid is discounted to reasonably reflect time value of money. If the contract is modified to defer the payment of compensation, any compensation paid or to be paid that is in excess of the amount that was originally payable to the employee under the contract will not be treated as resulting in a material modification if the additional amount is based on either a reasonable rate of interest or a predetermined actual investment (whether or not assets associated with the amount originally owed are actually invested therein) such that the amount payable by the employer at the later date will be based on the actual rate of return in the predetermined actual investment (including any decrease, as well as any increase, in the value of the investment).

The adoption of a supplemental contract that provides for increased compensation, or the payment of additional compensation, is also a material modification if the facts and circumstances demonstrate that the additional compensation is paid on the basis of substantially the same elements or conditions as the compensation that is otherwise paid. However, a material modification of a written binding contract does not include a supplemental payment that is equal to or less than a reasonable cost of living increase over the payment made in the preceding years. Finally, the failure, in whole or in part, to exercise negative discretion under a contract does not result in the material modification of that contract.

Effective Date and Request for Comment

The TCJA's amendments apply to tax years beginning on or after January 1, 2018. The Treasury Department and the IRS anticipate that the guidance in the Notice will be incorporated in future regulations that will apply to any taxable year ending on or after September 10, 2018. Comments are requested on additional issues under Section 162(m) and written comments may be submitted through November 9, 2018.

Next Steps

We will continue to monitor the developments in this area as they occur. In the meantime, King & Spalding would be happy to assist you with any questions you have about the Notice. Stay Tuned!

In Closely Watched Mutual Funds Case, 8th Circuit Sets High Bar For Labeling Retirement Plan Investments 'Imprudent'

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Mutual Fund Challenges Must Allege Poor Performance Against Meaningful Benchmarks to Avoid Dismissal

In *Meiners v. Wells Fargo & Company*,[i] the U.S. Court of Appeals for the Eighth Circuit clarified the burden plaintiffs must meet to state a claim for breach of fiduciary duty under the Employee Retirement Income Security Act ("ERISA") based on the inclusion of allegedly underperforming and expensive investment funds. Because plaintiffs often lack detailed information about the process plan fiduciaries followed to make investment choices, pleading a plausible claim that those fiduciaries have acted imprudently can pose a significant challenge. But the Eighth Circuit refused to water the pleading standard down to account for this reality in *Meiners*. Rather, the Eighth Circuit held that "[t]o show that 'a prudent fiduciary in like circumstances' would have selected a different fund based on the cost or performance of the selected fund, a plaintiff must provide a sound basis for comparison—a meaningful benchmark."[ii] As one of the first appellate decisions to tackle this thorny issue head on, litigants should expect *Meiners* to be cited as persuasive authority beyond the Eighth Circuit.

BACKGROUND

ERISA class action litigation challenging mutual fund fees and performance has been on the rise since the Supreme Court's 2015 decision in *Tibble v. Edison International*,[iii] which confirmed that plan fiduciaries have a continuing duty to monitor investment options and remove imprudent ones. But *Tibble* also left open the question of what exactly is the scope of the fiduciary duty to monitor, and thus, what is required to plead a viable claim that duty has been violated.[iv] *Meiners* at least partially answers that question.

In *Meiners*, a participant in Wells Fargo's 401(k) plan accused plan fiduciaries of favoring Wells Fargo's own target date funds as investment options, rather than offering cheaper and better performing alternatives, such as Vanguard target date funds.[v] In particular, the plaintiff alleged that the Wells Fargo plan fiduciaries sought to maximize their own profits by generating fees and "seed" money for their underperforming funds.[vi]

The district court dismissed the complaint because the plaintiff's comparison to Vanguard funds was insufficient to show that the performance and fees of the Wells Fargo funds rendered them imprudent investment choices.[vii] After reviewing fund prospectuses, the district court held that investors would expect the Wells Fargo and Vanguard funds to perform differently because they have different investment strategies (the Wells Fargo funds have a higher bond allocation).[viii] The district court also held that the plaintiff failed to establish cheaper Vanguard and Fidelity funds as reliable comparators, *i.e.*, ones that offer similar services or are of similar size.[ix] Finally, the district court found that the plaintiff did not show that the Wells Fargo funds are more expensive "compared to the market as a whole."[x]

THE EIGHTH CIRCUIT'S OPINION

The Eighth Circuit affirmed the district court's dismissal. The court acknowledged that plan participants have "different levels of knowledge regarding *what* investment choices a plan fiduciary made as compared to *how* a plan fiduciary made those choices."[xi] But, because "ERISA plaintiffs typically have extensive information regarding the selected funds," they are expected to marshal that information and "provide a sound basis for comparison—a meaningful benchmark" by which to evaluate the cost or performance of the challenged funds.[xii] And failure to do so equals failure to state a claim under the plausibility standard articulated by the Supreme Court in *Twombly* and *Iqbal*.[xiii]

As a result, the Eighth Circuit agreed with the district court that comparing an allegedly underperforming fund to one with a different investment strategy does not say anything about whether it was an imprudent choice.[xiv] Nor is it enough to allege that "cheaper alternative investments with *some* similarities exist in the marketplace."[xv] Indeed, the Eighth Circuit made clear that its prior decision in *Braden v. Wal-Mart Stores Inc.*[xvi] (which involved a comparison to cheaper share classes of the same funds) should not be read to support such a watered-down pleading standard.[xvii] Finally, in considering whether the plaintiff's examples met the "meaningful benchmark" standard, the Eighth Circuit affirmed the district court's close analysis of fund prospectuses that were not attached to the complaint, finding that they were "necessarily embraced by the pleadings."[xviii]

The Eighth Circuit recognized in *Meiners* that the analytical rigor of its decision contradicted some earlier (unidentified) district court decisions supporting the plaintiff's position.[xix] Calling into question "the rationale of these cases," the Eighth Circuit explained that "the existence of a cheaper fund does not mean that a particular fund is too expensive *in the market generally* or that it is otherwise an imprudent choice. Any other conclusion would exempt ERISA plaintiffs both from pleading benchmarks for the funds and from pleading internal processes about selecting funds."[xx] And because the plaintiff in *Meiners* had failed to plead a plausible claim of imprudence based on comparison of the Wells Fargo funds to meaningful benchmarks, the Eighth Circuit determined that it could not reasonably draw any inference that the plan fiduciaries had retained the challenged funds out of improper motives.[xxi] Thus, even in so-called "proprietary fund" cases like *Meiners*, the Eighth Circuit held that ERISA plaintiffs are required "to pair allegations of self-interest with allegations of an imprudently chosen fund in order to survive a motion to dismiss."[xxii] Without first establishing that a fund is an imprudent choice based on comparison to an analytically rigorous benchmark, a plaintiff is not entitled to discovery to test their conclusory allegations of unlawful motives and conduct.[xxiii]

KEY TAKEAWAYS

Following *Meiners*, ERISA plaintiffs alleging breaches of fiduciary duty based on fund fees and/or performance now have a clear burden to meet if they wish to avoid dismissal. Plaintiffs should not assume that their lack of access to information about the process that plan fiduciaries use to select and retain investment funds will entitle them to a relaxed pleading standard.

To the contrary, *Meiners* teaches that the identification of "meaningful benchmarks" by which to measure performance and fees will be required to state a plausible claim of fiduciary breach. Absent such benchmarks, "no inference can be reasonably drawn that the [plan fiduciaries] retained those funds . . . out of improper motives"[xxiv]—not even in so called "proprietary fund" cases.

While *Meiners* involved the employer's own funds, nothing in the Eighth Circuit's rationale limits it to that situation. In fact, the same week *Meiners* was decided, a federal district court in New York employed similar reasoning to rule in favor of New York University in a case involving allegedly excessive fees and underperformance.[xxv] In the NYU case, the court identified several additional factors to consider in determining appropriate benchmarks, including the fund's cash holdings, domestic-foreign allocation, and passive versus active management.[xxvi] Following *Meiners*, courts should demand specific allegations about these (and potentially more) factors before allowing ERISA breach of fiduciary duty claims to proceed to expensive and time-consuming discovery. A complaint lacking such analytical rigor should be dismissed for failure to state a claim.

September and October 2018 Filing and Notice Deadlines for Qualified Retirement and Health and Welfare Plans

Employers and plan sponsors must comply with numerous filing and notice deadlines for their retirement and health and welfare plans. Failure to comply with these deadlines can result in costly penalties. To avoid such penalties, employers should remain informed with respect to the filing and notice deadlines associated with their plans.

The filing and notice deadline table below provides key filing and notice deadlines common to calendar year plans for the next two months. If the due date falls on a Saturday, Sunday, or legal holiday, the due date is usually delayed until the next business day. Please note that the deadlines will generally be different if your plan year is not the calendar year. Please also note that the table is not a complete list of all applicable filing and notice deadlines (including any available exceptions and/or extensions), just the most common ones. King & Spalding is happy to assist you with any questions you may have regarding compliance with the filing and notice requirements for your employee benefit plans.

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Deadline	Item	Action	Affected Plans
September 15 (8 ½ months after the end of the plan year)	Minimum Contribution Deadline	Deadline for plan administrator to contribute balance of minimum contributions necessary to avoid a funding deficiency.	Defined Benefit Plans

Deadline	Item	Action	Affected Plans
September 30 (within 9 months of the end of the plan year)	Summary Annual Report (SAR)	Deadline for plan administrator to distribute Summary Annual Report for prior year to participants and beneficiaries. This deadline may be extended until 2 months following the close of the extension period for filing a Form 5500, if applicable.	Defined Contribution Plans Health and Welfare Plans (unfunded welfare plans are exempt)
September 30 (last day of the 9th month following the end of the prior plan year)	Certification of Adjusted Funding Target Attainment Percentage (AFTAP)	Deadline for actuary to certify AFTAP to avoid presumption that AFTAP is less than 60%.	Defined Benefit Plans
October 15	Medicare Part D Creditable Coverage Notice to Individuals	Deadline for employers that provide prescription drug coverage to Medicare Part D eligible individuals to provide a written disclosure notice to Medicare eligible individuals and their dependents covered under the plan indicating whether their prescription drug coverage is creditable coverage.	Health and Welfare Plans that provide prescription drug coverage to Medicare Part D eligible individuals
October 15 (2 ½ months after extension granted)	Form 5500	Deadline for plan administrator to file Form 5500 for prior year if deadline was extended by filing a Form 5558.	Retirement Plans Health and Welfare Plans
	IRS Form 8955-SSA	Deadline for plan administrator to file Form 8955-SSA if deadline was extended by filing a Form 5558.	Retirement Plans

Deadline	Item	Action	Affected Plans
October 15 (9 ½ months after the previous plan year)	PBGC Premium Filing	Deadline for plan administrator to pay flat-rate or variable PBGC premium for current plan year.	Defined Benefit Plans

[i] Slip Op. No. 17-2397 (8th Cir. Aug. 3, 2018).
[ii] *Meiners*, Slip Op. at 5.
[iii] 135 S. Ct. 1823 (2015).
[iv] *Tibble*, 135 S. Ct. at 1829.
[v] *Meiners*, Slip Op. at 2.
[vi] *Id*. at 3.
[vii] *Meiners v. Wells Fargo & Co.*, 2017 WL 2303968, at *2-3 (D. Minn. May 25, 2017).
[viii] *Id.* at *3.
[ix] *Id*.
[x] *Id.*
[xi] *Meiners*, Slip Op. at 4 (emphasis original).
[xii] *Id.* at 5.
[xiii] *Id.* at 3 (citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 557 (2007); *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009)).
[xiv] *Id*. at 5.
[xv] *Id*. at 6 (emphasis original).
[xvi] 588 F.3d 585 (8th Cir. 2009).
[xvii] *Meiners*, Slip Op. at 6-7
[xviii] *Id*.
[xix] *Id.* at 7. The plaintiff on appeal had relied on *Gipson v. Wells Fargo & Co.*, 2009 WL 702004 (D. Minn. Mar. 13, 2009); *Wildman v. Am. Century Servs., LLC*, 237 F. Supp. 3d 902 (W.D. Mo. 2017); *Leber v. Citigroup, Inc.*, 2010 WL 935442 (S.D.N.Y. Mar. 16, 2010); *Urakhchin v. Allianz Asset Mgmt. of Am., L.P.*, 2016 WL 4507117 (C.D. Cal. Aug. 5, 2016); *Krueger v. Ameriprise Fin., Inc.*, 2012 WL 5873825 (D. Minn. Nov. 20, 2012); *Moreno v. Deutsche Bank Am. Holding Corp.*, 2016 WL 5957307 (S.D.N.Y. Oct. 13, 2016); *Lorenz v. Safeway, Inc.*, 2017 WL 952883 (N.D. Cal. Mar. 13, 2017); *Terraza v. Safeway, Inc.*, 2017 WL 952896 (N.D. Cal. Mar. 13, 2017); *McDonald v. Edward D. Jones & Co.*, 2017 WL 372101 (E.D. Mo. Jan. 26, 2017); and *Pledger v. Reliance Trust Co.*, 2017 WL 2624302 (N.D. Ga. Mar. 7, 2017).
[xx] *Meiners*, Slip Op. at 7 (emphasis original).
[xxi] *Id.*
[xxii] *Id.* at 8.
[xxiii] *Id.*
[xxiv] *Id.* at 7.
[xxv] *Sacerdote v. New York Univ.*, 2018 WL 3629598 (S.D.N.Y. July 31, 2018).
[xxvi] *Id.* at *28-30.