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Compensation & Benefits IN FOCUS
Developments in executive compensation and employee benefits

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In This Issue

DOL Issues New Regulations Requiring Service Provider Fee Disclosures

On July 16, the U.S. Department of Labor (DOL) issued interim final regulations that will require certain Employee Retirement Income Security Act (ERISA) retirement plan service providers to disclose information about services performed and fees received from such plans. While these regulations do not apply to welfare plans, the DOL has indicated that it intends to publish separate regulations requiring welfare plan disclosures at a later date.

Compliance with the regulations’ disclosure requirements will be required for contractual agreements between service providers and retirement plans in order to qualify for an exemption from the prohibited transaction rules under ERISA and the federal tax code. In other words, noncompliance with the regulation would mean the service provider is liable for taxes and penalties related to prohibited transactions if it is a party in interest with respect to the plan. Certain plan fiduciaries may also incur liability if a prohibited transaction occurs, but the regulations contain a special provision to help diligent plan fiduciaries avoid liability.

The regulations generally apply to service providers expected to receive $1,000 or more in compensation for providing any of the following services: (1) service as a fiduciary or a registered investment advisor; (2) certain recordkeeping or brokerage services; or (3) other services for indirect compensation (e.g., accounting, auditing, actuarial, appraisal, banking, consulting, custodial, investment advisory, etc.). Prior to entering into such agreements, or prior to any renewal or extension thereof, the service provider is required to provide plan fiduciaries with a description of (1) the services to be provided; (2) all direct and indirect compensation to be received by the service provider and how it will be distributed among its affiliates; (3) the manner in which compensation will be received; and (4) certain investment disclosures. In addition, during the term of the agreement and upon request by the plan fiduciary, the service provider must disclose all information about its compensation that is necessary for the plan to comply with its own disclosure obligations.

The Pulse

Moving Toward Increased Regulation of Executive Compensation

Executive compensation remains a hot-button issue with both federal agencies and lawmakers. Both have been busy over the past few months passing legislation and adopting rules regarding executive compensation. Some of these developments are highlighted below.

Wall Street Reform Legislation. The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act contains multiple provisions affecting publicly-traded companies. For example, the Act imposes additional independence requirements on compensation committees, requires new executive compensation disclosures (e.g., information showing the relationship between an executive’s compensation and the company’s financial performance), and mandates non-binding shareholder votes regarding executives’ compensation and compensation paid based on or related to a change in control. See Sections 951 through 957 of the Wall Street Reform Act for more information.

Health Care Reform Legislation. The health care reform bills passed earlier this year amended the federal tax code to limit certain health insurance issuers’ deduction for compensation paid to any employees, directors or independent contractors to $500,000 per individual. This deduction limit will apply in 2013 and later years. See Section 9014(a) of the health care reform bill for more information.

Banks. Banking regulators issued final guidance on June 21 designed to discourage banks from having compensation policies that increase risk and decrease a bank’s safety and soundness. The guidance is available here.

Government Contractors. Multiple federal agencies issued an interim rule on July 8 requiring certain federal contractors to disclose the compensation of their top five executives. The rule is available here.

The regulations are expected to become effective July 16, 2011, and are applicable to all agreements for plan services regardless of whether such agreements were in place prior to such date. The DOL has invited comments on the interim final regulations (due by August 30), perhaps indicating that such regulations may change when published in their final form.

The text of the DOL's interim final regulation can be found **here**.

IRS Finalizes Public Employer Stock Fund Diversification Requirements

On May 19, the Internal Revenue Service (IRS) issued final regulations that clarify when public companies must allow plan participants to voluntarily divest employer stock allocated to their retirement plan accounts. The regulations only apply to public companies that maintain defined contribution plans (such as 401(k) plans or profit-sharing plans) where employer stock is an available investment alternative. The regulations require that, subject to certain limited exceptions, participants must always be able to move their own contributions (including rollover contributions) out of employer stock funds. In addition, employer contributions must be eligible for movement from the employer stock fund once the participant has provided three years of service to the company.

The regulations finalize rules first enacted by Congress in 2006. The Pension Protection Act of 2006 required greater diversification rights for public employer stock funds in order to address situations where a company's stock was falling but retirement plan participants were powerless to diversify their accounts and minimize their losses. While the increased flexibility helps participants who will no longer be locked into one, undiversified investment, the new rules can also help plan fiduciaries avoid liability for maintaining the stock fund in times when the value is declining.

In order to comply with the final regulations, retirement plans must have at least three other diverse investment alternatives available under the plan (although, plans typically have many more alternatives). In addition, the plan cannot impose any direct or indirect conditions on investment in, or divestment of, employer stock that do not apply to other plan investment alternatives. For example, with limited exceptions, the final regulations would not permit a restriction that permanently prohibits amounts from being reinvested in employer stock if those amounts previously were divested from employer stock.

While interim diversification guidance is currently in effect, the final regulations become effective for plan years beginning on or after January 1, 2011.

The final regulations can be found **here**.

SEC Soliciting Input on Proxy Disclosure

The SEC is considering updating the proxy rules to "promote greater efficiency and transparency in the system" and "enhance the accuracy and integrity of the shareholder vote." As part of this process, the SEC is soliciting public comments regarding the proxy system, including matters related to executive compensation disclosure. For instance, the SEC is interested in comments on:

- whether proxy advisory firms (e.g., RiskMetrics) should be required to publicly disclose their decision models for approving executive compensation;
- whether it should be concerned with over- or under-voting with respect to shareholder advisory votes related to executive compensation; and
- whether executive compensation information should be reported in an interactive data format.

For more information about the SEC's comment request, click here. Electronic comments may be submitted here or emailed to rule-comments@sec.gov.

IRS Unveils Priorities Regarding Benefit Plans

At a press conference earlier this year, members of the IRS Employee Plans Compliance Unit discussed their current priorities. Below are some highlights.

- Focus on international issues, including multinational corporations, high-income individuals and coverage in U.S. territories (e.g., Puerto Rico). Specifically, the IRS will initiate compliance projects targeted at domestic trusts of foreign plans and IRA distributions to foreign recipients. Also, the IRS hopes to issue formal guidance on international issues related to benefit plans.

Health Care Reform: Guidance Issued Regarding "Grandfathered" Plan Status

Certain provisions of the Patient Protection and Affordable Care Act, as amended (PPACA), do not apply to "grandfathered" group health plans, or have a delayed effective date for such plans. A grandfathered group plan is generally a plan in which an individual was enrolled on March 23, 2010 (the date of PPACA's enactment). However, PPACA did not offer any insight on what would cause a plan to lose its grandfathered status, leading many employers to be hesitant to make any changes to their plans for fear of losing such status.

On June 14, the federal government issued guidance on grandfathered plan status, which, among other things, provides the reasons a plan in existence on March 23, 2010, will nonetheless lose its grandfathered status. Specifically, this status may be lost if:

- the plan eliminates all or substantially all benefits to diagnose or treat a particular condition;
- the plan increases a percentage cost-sharing requirement (e.g., coinsurance requirement);
- the plan increases a fixed-amount cost-sharing requirement (e.g., deductible, out-of-pocket limit) other than a co-pay more than 15 percentage points over the medical inflation rate (e.g., a 36% deductible increase if medical inflation is 20%);
- the plan increases a fixed-amount co-pay more than certain thresholds over the medical inflation rate;
- the employer decreases its contribution rate more than five percentage points below its contribution rate as of March 23, 2010;
- the plan adds or decreases certain annual or lifetime limits; or
- the plan is not a collectively-bargained plan and enters into a new insurance policy, even if the new policy provides the same coverage and cost-sharing as the old insurance policy (policy renewal is not considered entering into a new policy).

Because the changes above are the only changes that may cause a plan to lose its grandfathered status, a plan may generally modify its provisions to comply with federal/state law, voluntarily comply with PPACA, or change its third-party administrator without risking its grandfathered status.

In addition, the guidance imposes disclosure and recordkeeping requirements on a plan in order to maintain its grandfathered status. All plan materials provided to plan participants describing the plan's benefits must include a statement that the plan is grandfathered, and list contact information for questions and complaints (the guidance provides model language). To comply with the recordkeeping requirement, the plan must maintain records documenting the terms of the plan's coverage as of March 23, 2010 (as well as any other supporting documentation), and make those records available for examination upon request.

The grandfathered plan guidance can be found **here**.

- Evaluate areas of concern with respect to 401(k) plan compliance and issue a report during the 2011 fiscal year.
- Finalize guidance on issuing rulings for pre-approved 403(b) plans and develop preliminary guidance on rulings for individually designed 403(b) plans
- Improve the IRS website to provide more information to plan sponsors, including "fix-it guides."
- Investigate abusive tax transactions involving insurance and benefit plan rollovers as business start-ups.

DOL Issues QDRO Guidance

The DOL released a final rule regarding qualified domestic relations orders (QDROs) on June 9, which became effective August 9. QDROs are often used as part of a divorce to divide an employee's qualified plan retirement benefits pursuant to a marital property settlement. The main purpose of this QDRO rule is to clarify that a benefit plan (1) must recognize a QDRO if it is received after a previous QDRO, or if it revises a previous QDRO and (2) cannot reject a QDRO solely on the basis of when it was received (e.g., after the participant dies).

The final rule can be found here.

2011 HSA Limits Announced

The IRS announced the Health Savings Account (HSA) limits for 2011. The annual contribution limit for an individual with self-only coverage under a high deductible health plan (HDHP) will be $3,050 and such limit for an individual with family coverage under an HDHP will be $6,150. In addition, the definition of an HDHP will be modified so that the deductible cannot be less than $1,200 for self-only coverage or $2,400 for family coverage.

More information is available here.

Health Care Reform: Patient's Bill of Rights Regulations Released

On June 22, interim final regulations were issued regarding the "Patient's Bill of Rights" requirements of PPACA. The regulations provide examples, safe harbors and other provisions helpful to the implementation of PPACA.

These rules are generally applicable to all group health plans for plan years starting on or after September 23, 2010, including "grandfathered" plans. This includes the annual dollar limits, the lifetime dollar limits, prohibition on preexisting condition exclusions and prohibition on coverage rescissions. However, the "patient protection" provisions do NOT apply to grandfathered plans.

- **Prohibition Against Lifetime and Annual Limits.** PPACA prohibits plans from imposing annual limits or lifetime limits on the dollar amount of "essential health benefits." The regulations do not provide guidance regarding what is or is not considered an "essential health benefit," but permit good-faith efforts to comply with a reasonable interpretation of that term. The prohibition against annual limits will be phased in until 2014. The dollar value of "essential health benefits" must be no less than $750,000 for plan years beginning on or after September 23, 2010; no less than $1.25 million for plan years beginning on or after September 23, 2011; and no less than $2 million for plan years beginning on or after September 23, 2012 (and before January 1, 2014).

  Additional notice and enrollment rules apply with respect to people whose coverage or benefits ended by reason of having reached a lifetime limit. For example, individuals who have reached the plan's lifetime limit prior to the effective date of the new regulations must be notified that the lifetime limit no longer applies, and those people who are not enrolled in the plan must be given an opportunity to do so.
- **Prohibition Against Preexisting Condition Exclusions.** PPACA prohibits plans from imposing any preexisting condition exclusion on enrollees under age 19. Preexisting condition exclusions currently in effect are permitted to continue with regard to enrollees age 19 and older until the 2014 plan year. The regulations clarify that these prohibitions apply for purposes of denying enrollment in the plan and also specific benefit coverage.
- **Prohibition Against Coverage Rescission.** PPACA prohibits plans from retroactively rescinding coverage unless due to fraud or intentional misrepresentation. The regulations provide guidance as to when rescission is permitted and what constitutes rescission. According to the regulations, it is permitted to retroactively terminate coverage for failure to pay premiums in a timely manner. Also, a termination with only a prospective effect is not considered a rescission and is permitted, such as if ineligible dependents are to be dropped pursuant to an audit of dependent coverage.
- **New Patient Protection Rules (Not Applicable to Grandfathered Plans).** If a plan uses a network of providers, there are three new choice-of-provider requirements imposed by PPACA: (1) the plan must allow participants to designate any participating Primary Care Provider (PCP) who is available; (2) the plan must allow a participating pediatrician to be designated as the PCP for a child; and (3) the plan cannot require any preauthorization or referral to access an obstetrician/gynecologist. The regulations require plans to notify participants of these rights and provide model language for doing so.

Though not all questions raised by PPACA have been answered, there has been enough guidance issued via regulations such that plan sponsors should be in the process of identifying required changes to existing plans for the plan's next open enrollment period. Decisions will need to be made as to what changes will be made and as of what date, and whether grandfathered status will be lost if additional changes are made. Also, plan documents will need to be revised and appropriate notification given to participants.

More information is available **here**.

For a link to the interim final regulations, click **here**.

DOL Expands Category of Employees Who May Qualify for FMLA Leave

The Family Medical Leave Act (FMLA) allows qualified employees to take up to 12 weeks of unpaid, job-protected leave in order, among other things, to care for a child postpartum, to bond with a child after adoption, or to care for a child with a serious illness. In a recent Administrator's Interpretation, the DOL expanded the category of people who may qualify for leave in this context.

The FMLA entitles an employee to leave in certain childcare situations where the employee is standing *in loco parentis* (i.e., in the place of the parent). In such a case, a legal or biological relationship between the child and the caregiver is not required. A previously promulgated FMLA regulation defined being *in loco parentis* as both providing day-to-day care of the child and financially supporting the child.

However, the Interpretation requires only one or the other in order to qualify for leave under the FMLA. Converting what was formally a two-part test to a one-part test will lead to more people qualifying for leave in an *in loco parentis* backdrop.

Such an interpretation by the DOL is not binding on courts, but it is entitled to deference. While it remains to be seen how the courts will deal with this Interpretation, employers should be mindful of it for a few reasons.

For instance, an employer should consider more carefully whether an employee who requests leave, but who is not a part of a traditional parent-child circumstance, is entitled to the leave. Along these lines, the Interpretation permits an employer to "require the employee to provide reasonable documentation or statement of the family relationship." Note that only a "simple statement" is required; employers should be cautious not to be too rigorous in their requirements lest they find themselves accused of putting a chilling effect on requests for leave, or worse, harassment.

Employers should also be mindful that the recent Interpretation may lead to a considerable increase in requests for FMLA leave.

The full text of the Interpretation, which provides a few helpful examples, is available **here**.

Congress Provides Pension Funding Relief

On June 25, President Obama signed legislation that provides short-term funding relief to sponsors of underfunded defined benefit pension plans. The new law, known as the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 (Relief Act), permits temporary modification of existing pension funding rules by allowing plan sponsors of single-employer plans to elect one of two methods for delaying payments to pension plans. By delaying those payments, sponsors should have more cash available in the short term to help fund ongoing operations—a result that is likely to be seen as a benefit to many plan sponsors given recent economic turmoil. However, because the delay methods do not decrease the net amount that must eventually be contributed to a pension plan, use of the Relief Act provisions will likely result in contributions for later years being larger than they otherwise would have been. Sponsors should keep in mind the probable effect of increased contributions in later years when deciding how to satisfy their plan funding obligations.

Under current pension funding rules, which were enacted in 2006 and apply to most single-employer plans, a pension plan's funding shortfall for any year is required to be amortized and paid into the plan over a seven-year period. The Relief Act's methods for delaying payments allow a plan sponsor to choose either to (1) make "interest only" payments (using the plan's effective interest rate) for two years, and then amortize the shortfall for the following seven years, or (2) amortize the shortfall over 15 years. Plan sponsors are also free to use existing funding rules and not take advantage of the assistance provided under the Relief Act. To chose one of the methods under the Relief Act, sponsors must follow rules that are expected to be released by the IRS, and must also notify the Pension Benefit Guaranty Corporation (PBGC) and plan participants pursuant to rules to be released by the PBGC. If either of the Relief Act's methods is selected, in order to help ensure that sponsors do not misuse the increased short-term cash flow created by a reduction in the current pension funding obligation, certain make-up contributions may be required if a sponsor pays annual compensation to any employee in excess of $1 million (including by way of contributing assets to a rabbi trust), or pays an extraordinary dividend.

In a recent notice, the IRS clarified that a plan can elect the funding relief even if it already filed its annual report (Form 5500) for the plan year in which the funding relief is elected. Also, the IRS outlined future guidance it anticipates issuing under the Relief Act.

For more information, the Relief Act can be found **here**, and Notice 2010-55 can be found **here**.

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