Dinsmore&Shohl LLP
ATTORNEYS

Briefly on Benefits (July 2009)

July 23, 2009

Ben F. Wells , David A. Whaley , C. Mark Bongard

FTC Red Flag Rules -- Does it apply to 401(k) Plan Loans?
by Ben Wells

I have been speaking with Tammy Imhoff, who is our resident FTC insider, about the application of the FTC's new "red flag rules" to 401(k) plans. For those who aren't familiar with them, these rules require financial institutions or creditors that have "covered accounts" to develop prevention programs that identify "red flags" for possible identity theft.

There have been a number of questions about whether these rules apply to 401(k) plans. Tammy tells me that, in a copyrighted report from BNA's Anti-Trust and Trade Regulation Daily, an FTC official (attorney Manas Mohaptra) has stated that the rules generally do not apply to 401(k) plan loans. This is apparently true even if the employer is a financial institution or other entity that would otherwise be subject to the rules.

You can find more information about the red flags rule here.

Rollovers as a Business Start-up
by David Whaley

This week, I was reading a USA Today Article on-line article addressing small businesses and the current economy. It caught my eye because it featured Café Boulevard - one of my favorite restaurants in the City of Dayton which has unfortunately fallen on hard times but is still currently open for business. The article discussed how small businesses - specifically small business start-ups - have been the traditional means of assisting in moving our country out of a recession, but, due to the tightness of the credit market, small business start-ups have not been getting the necessary tools to assist in this process. To address this problem, we have seen an increase of people looking to their IRA or old 401(k) accounts as a means to fund a start-up business.

One particular way to tap into your retirement savings to create a small business is called a "rollover as a business start-up." This is where your IRA or old 401(k) balance is rolled over into the start-up company's 401(k) plan and you direct your plan account to invest in the start-up company's stock. This is a particularly interesting means of starting a business since the startup money remains tax deferred and the earnings on the company's stock are not taxed to the entrepreneur until they take a distribution from the 401(k) plan. The IRS is lukewarm to this process and they have issued a memorandum which details the pitfalls they see in this process. For example, the IRS memorandum raised concerns that investment in the start-up company's stock would be discriminatory because it is not available to all participants in the plan. I recently learned in working through one of these transactions that this concern of the IRS can potentially be

alleviated if the start-up company's 401(k) plan is drafted so that the company's stock as an investment option is only available with respect to a participant's rollover account - thus only rollover dollars are at risk in the company's stock investment. This is an interesting work-around to one of the IRS' concerns with these vehicles.

This is just one means of using IRA or 401(k) accounts to invest in a start-up business. I am sure that if the credit markets do not support funding small business start-ups, we will be investigating many new and interesting ways of using these retirement dollars as a means to fill the credit gaps.

Too Many Claims: What to Do with Competing Claims
by Mark Bongard

Most ERISA plan administrators have experienced the conundrum of receiving too many claims for the same benefit. This can arise under a number of situations. One example is an ambiguous beneficiary designation for a life insurance death benefit. Another example is when a deceased participant retained a former spouse as a designated beneficiary and the plan document is ambiguous regarding its recognition of a former spouse's waiver of benefit rights in a divorce decree.

What is a plan administrator to do? There is one pot of money and multiple hands are reaching for it. The plan administrator could be decisive and look at the facts, apply them to the law and pick the winner. If the facts and the law are crystal clear, perhaps this is the best way to go. The law, however, is often murky and revealed only in shades of gray. Faced with a more opaque situation, the administrator might instead want to utilize a Federal procedure called interpleader.

Interpleader is useful when a plan administrator is faced with multiple claims for the same benefit. To avoid the possibility of having to make multiple payments, the benefit can be paid to the Federal court and the administrator, as the plaintiff, can bring the claiming parties together to compete among themselves for the benefit. The plan administrator can then step back, keep a low profile and let the Court decide.

Ordinarily, the Federal Court will require a diversity of citizenship to entertain an interpleader action. If all of the parties, the plan administrator included, are from the same state, then what is the plan administrator to do? A recent Federal District Court case from the Western District of North Carolina reminds us that ERISA provides its own jurisdictional basis to support a Federal interpleader action even in the absence of a diversity of citizenship (*see* *Union Security Insurance Company vs. Thompson*, filed July 2, 2009).

Interpleader is a useful, practical and efficient procedure to address multiple claimants for a single benefit.

Consider Writing Your Own Statute of Limitations
by Mark Bongard

ERISA is a complicated statute intended to preempt state laws that relate to employee benefit plans. So why didn't they include a statute of limitations that specifies the time within which to file suit in Federal court for a denied benefit claim? Well, they didn't and so throughout the history of ERISA, federal courts have looked to state law to apply a limitations period within which a claim for denied benefits must be brought in Federal Court.

Federal Courts have traditionally applied the applicable state's limitations period for written contracts. Sometimes that can be quite a long period. For example, in Kentucky, the statue of limitations for bringing an action on a written contract is 15 years.

Fortunately for plan sponsors and administrators, a plan may, in its written terms, specify its own statute of limitations. Courts will generally enforce a written self-imposed statute of limitations so long as it is reasonable and is communicated to participants.

A recent decision from the Federal Second Circuit Court of Appeals upheld the application of a three year statute of limitations that began to run before the claimant could have filed an action in Federal Court (*see Burke vs. Pricewaterhousecoopers LLP Long Term Disability Plan*, decided July 9, 2009 and for the record, Judge Sotomayor did not participate in this decision). According to the opinion, the Fifth, Sixth, Seventh and Eighth Circuits have also allowed plan specific limitation periods to start running before the claimant could file an action in Federal Court.

Most plans contain a requirement that a claimant has to first exhaust the plan's administrative claim review process before filing an action for benefits in Court. In this particular case, the plan specific three year period began to run 30 days after presentment of a proof of loss under the plan was due. As a point of interest, the case arose in New York and the applicable state law statue of limitations would have been six years, but for the shorter period within the plan document.

The claimant in this case was held to be time-barred from filing an action in Federal Court because of the way the plan's provisions defined the time the limitations period began to run. If the limitations period had not started until after the appeal was denied, then the claimant's action would have been timely and could have proceeded in Federal Court.

One thing that a plan sponsor can control about plan claims is the period of time within which an action for a denied claim has to be filed in Court. All plan sponsors should consider writing and communicating to participants a plan specific statute of limitations period.

Speaking Engagements

Ben Wells will be doing a presentation at the Ohio/Kentucky ESOP Association Conference in Louisville, KY on August 3rd. The presentation will be an "ESOP Litigation Update."

Ben Wells will be doing the "Employee Benefits Update" at the Ohio Institute of Certified Public Accountants "Accounting Show," at the Sharonville Convention Center on September 30, 2009.