



IRS Publishes Final Automatic Enrollment Rules

In February, the Internal Revenue Service (IRS) issued final rules regulating automatic contribution arrangements (ACAs). ACAs, which were added to the Internal Revenue Code (IRC) by the Pension Protection Act of 2006 (PPA), are cash or deferred arrangements under which eligible employees, in the absence of an affirmative election, are treated as having made an election to have a specified contribution made on their behalf under the plan. The final regulations (TD 9447) adopt with some modifications the rules published in proposed regulations published in 2007.

Rule Changes Relating to QACAs. ACAs that incorporate design-based safe harbor employer contributions are called qualified automatic contribution arrangements (QACAs). Changes made in the final rules regarding QACAs include:

1. Generally a rehired employee is automatically enrolled in the plan at the minimum contribution percentage that would have applied if the employee did not leave employment. However, if the employee has not been employed and making automatic contributions under the QACA for an entire year, the plan may automatically enroll the rehired employee at the applicable minimum contribution percentage for a brand new employee.
2. Under the final regulations, automatic enrollment applies for periods during which an affirmative deferral election is not in effect. A plan may specifically provide that an affirmative election expires, and may require an employee to make a new affirmative election if he or she wants the prior contribution rate under the expired affirmative election to continue. In the absence of a second affirmative election, the employee may be automatically enrolled at the plan's default percentage.
3. If it is impractical to provide the required QACA notice to new hires on or before the date they become eligible, the notice will nonetheless be treated as provided timely if it is provided as soon as practicable after that date and the employee is permitted to elect to defer from all types of compensation that may be deferred under the plan earned beginning on that eligibility date. Thus, an employer

is required to provide the notice to the employee prior to the pay date for the payroll period that includes the date the employee becomes eligible.

4. The final regulations clarify that the safe harbor nonelective and matching contributions made under a QACA are subject to the withdrawal restrictions found in Treasury Regulation § 1.401(k)-1(d) that apply to QNECs and QMACs. Thus, the maximum distributable amount under Treasury Regulation § 1.401(k)-1(d)(3)(ii) does not include earnings, QNECs, QMACs, or these safe harbor contributions. The final regulations relating to QACAs apply to plan years beginning on or after January 1, 2008.

Rule Changes Relating to EACAs. An Eligible Automatic Contribution Arrangement (EACA) generally allows participants who were automatically enrolled in a plan to opt out of the plan and withdraw automatic contributions made on their behalf. Changes made in the final rules include:

1. The employees who must be subject to the automatic enrollment provisions under an EACA are only those employees who are specified in the plan as being covered employees under the EACA. Thus, automatic enrollment under an EACA need not apply to all employees eligible to make a deferral election under the applicable plan, but only to those employees who are covered by the EACA. The final regulations provide that the plan document must specify the employees who are covered under the EACA and must state whether an employee who makes an affirmative election remains covered under the EACA.
2. The final regulations generally retain the rule in the proposed regulations that the 90-day period to withdraw default elective contributions starts after the date the compensation would otherwise have been included in gross income. Under the final regulations, however, a plan is permitted to set an earlier deadline for the election to withdraw default elective contributions. If a plan offers a permissible withdrawal for covered employees, the election period for the covered employees must be at least 30 days.

The regulations relating to EACAs apply for plan years beginning on or after January 1, 2010. For plan years that begin in 2008, a plan must operate in accordance with a good faith interpretation of IRC § 414(w) (i.e., the EACA rules). For this purpose, a plan that operates in accordance with the proposed regulations under Treasury Regulation § 1.414(w)-1 or these final regulations will be treated as operating in accordance with a good faith interpretation of IRC § 414(w).

Plan Administrator Violated ERISA by Failing to Disclose Claim Administrator's Internal Guidelines

The U.S. Court of Appeals for the Seventh Circuit ruled that a plan administrator violated the Employee Retirement Income Security Act ("ERISA") by failing to provide a participant with the internal guidelines used by its claims administrator. These internal guidelines were expressly cited by the claims administrator in denying the participant's claim for benefits.

In this case, the participant requested coverage for her son's speech therapy under her employer's group health plan. However, the plan's claims administrator denied coverage citing the terms of its own internal guidelines, rather than the terms of the plan document. Upon receiving the denial letter, the participant requested copies of the plan documents, including the internal guidelines, from both the plan administrator and the claims administrator. The claims administrator eventually disclosed the internal guidelines, but not until well after the 30-day period required by ERISA. The court held that the plan administrator violated ERISA by failing to disclose the documents in a timely manner.

ERISA requires that a plan administrator disclose certain plan documents within 30 days of a written request by a plan participant. The court noted that, generally, internal guidelines used by a claims administrator would not be among those documents subject to ERISA's disclosure requirements. However, because the claims administrator cited the internal guidelines as the basis for denying the claim for benefits, the internal guidelines became "the equivalent of plan language" and subject to ERISA's disclosure requirement.

The court held that the disclosure requirement applies to the plan administrator, not the claims administrator, even though the plan administrator delegated responsibility for determining benefit claims. Furthermore, the plan administrator's duty to disclose the documents was not mitigated by the fact that the plan administrator did not possess the claims administrator's internal guidelines. This case serves as a reminder that plan administrators should remain involved with the benefit claim process even when using third-party claims administrators.

(*Mondry v. American Family Mutual Insurance Co.*, 7th Cir. 2009)

IRS Publishes Sample ESOP Provisions

The IRS has published sample plan provisions that may be used in an employee stock ownership plan (ESOP) maintained by an S corporation. The plan provisions address the complex anti-abuse rules that prohibit stock allocations to certain "disqualified persons" where the group of disqualified persons owns 50 percent or more of the stock of the company, including stock that will be allocated under the terms of the ESOP. The purpose of the limitation is to further the ESOP principle of extending stock ownership to a wider group of employees. Essentially, the ESOP design cannot be used to purchase closely-held stock from family owners and then allocate that stock back to family members under the ESOP. This principle exists with non-publicly traded C corporation stock purchased by an ESOP that cannot be allocated back to the seller of the stock or family members when the seller has used the non-recognition rules that allow a deferral of tax on the sale. The rules for S corporations are more complex and require a mock allocation of shares held by the ESOP to determine who will eventually benefit from the plan, and it includes an analysis of any stock options, warrants or other "synthetic equity" held by individual plan participants. The model IRS language is helpful to any S corporation maintaining an ESOP because it allows for a mechanism to be set up within the plan that creates a non-ESOP portion of the plan to avoid violating the nonallocation rules. The language is approved, but not required, by the IRS for inclusion in any S corporation ESOP. A careful monitoring of the nonallocation rules in these circumstances is important because of the steep penalty taxes that apply if the nonallocation rules are violated. *IRS Spring 2009 Newsletter, March, 2009.* (Available at www.irs.gov/retirement in the Newsletter section of the "Retirement Plan Community" section of the website.)

Fiduciary Policy Does Not Cover COBRA Violation

In a recent case, a federal appeals court held that a fiduciary liability insurance carrier was not liable to an insured-employer for litigation expenses incurred by the employer in the defense of a lawsuit based (in part) on the employer's alleged failure to offer COBRA coverage.

The court ruled that the employer's failure to offer COBRA coverage was not a "wrongful act" within the meaning of the fiduciary insurance policy that had been purchased by the employer. The policy defined a "wrongful act" as "any breach of the responsibilities, obligations or duties imposed upon fiduciaries of the Sponsored Plan by [ERISA] . . . or any

negligent act, error or omission in the Administration of any Sponsored Plan.” Surprisingly, the court held that the alleged failure to provide COBRA was not a “wrongful act” because any alleged failure to offer continuing benefits under the plan rested on the employer as plan sponsor, and not as a plan fiduciary. In other words, the alleged COBRA failure was not a breach of the employer’s ERISA fiduciary duties.

The court’s ruling is somewhat surprising. As we all know, ERISA plan documents often expressly incorporate the requirements of COBRA, and SPDs are required to explain the essential features of COBRA coverage. As a result, the obligation to offer COBRA to qualified beneficiaries becomes part of the official plan document and SPD. Of course, failing to comply with the terms of an ERISA plan is a violation of one of ERISA’s principal fiduciary duties.

In this case, the employer was left with no coverage for the costs of the kind of lawsuit it might reasonably have foreseen when it purchased the policy. Employers that maintain fiduciary coverage should conduct a careful review of all policy provisions and exclusions to ensure there are no gaps in coverage. (*Mary Kay Holding Corp. v. Federal Insurance Co.*, 5th Cir. 2009)

Employee Benefits Practice Group

Peter K. Bradley pbradley@hodgsonruss.com

Anita Costello Greer anita_greer@hodgsonruss.com

Michael J. Flanagan mflanagan@hodgsonruss.com

Richard W. Kaiser rkaiser@hodgsonruss.com

Arthur A. Marrapese, III Art_Marrapese@hodgsonruss.com

Daniel R. Sharpe dsharp@hodgsonruss.com

The Guaranty Building, 140 Pearl Street, Suite 100 Buffalo, NY 14202 Tel: 716.856.4000 Fax: 716.849.0349
