



## Employee Benefits Developments

### Agency Rulings, Opinions, Etc.

#### **DOL Proposes Regulations on Investment Advice.**

The Pension Protection Act of 2006 authorized qualified plans to provide investment advice to participants in participant-directed individual account plans, typically 401(k) plans. If the terms of the rule are followed, the plan sponsor, plan administrator and other fiduciaries are not subject to fiduciary liability as a result of providing the investment advice under the plan, nor will the prohibited transaction rules be applied to the arrangements established to provide or carry out the investment advice. The Department of Labor (DOL) has now issued a set of proposed regulations to implement what is called an "eligible investment advice arrangement" (or EIAA) under the statute. The proposal will likely generate considerable comment from the financial community, and changes in the proposal may be adopted before it becomes final.

The regulations set rules for establishing both computer models and investment advice programs as authorized by the law. Investment advice programs must use flat fees or "fee-leveling" arrangements that prohibit a variation in fees based on the selection of options by participants. The computer model alternative cannot be set up to inappropriately favor investments offered by the fiduciary advisor or an affiliate. Both approaches must be based on generally accepted investment theories that take into account historic returns over time. These programs will take into account other factors specific to a participant such as age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and investment preferences.

The establishment of these regulations will foster the beginning of a new stage in the development of 401(k) plans where plan administrators will increasingly provide the facilities of investment management to participants. In order to satisfy the regulations, the arrangements set up within a plan must be authorized by a plan fiduciary and must satisfy annual audit requirements designed to maintain adherence to the standards established by the DOL. Plans will be required to provide disclosures to participants of the entities involved in the investment advice program, their relationships and the fees provided under the programs to the service providers. The

statutory changes and regulations are designed to extend expert investment advice to the broad audience of 401(k) participants whose retirement security will increasingly depend on their own investment decisions. As the regulations are finalized and gain wider acceptance, plan administrators will become familiar with the structure and operation of EIAs. (*Proposed Rule on Investment Advice for Participants and Beneficiaries*, 29 CFR Part 2550, Federal Register, Aug. 22, 2008)

#### **DOL Issues Proposed Class Prohibited Transaction Exemption on Investment Advice.**

The DOL has proposed a class exemption from the prohibited transaction rules in circumstances that complement the statutory rules and proposed regulations dealing with investment advice to participants in individual account plans and IRAs. The prohibited transaction exemption extends to individualized investment advice provided to a participant following recommendations generated by a computer model as well as individual-level investment transactions. This exemption allows for the provision of investment advice, acquisition and sale of investment securities, and the receipt of compensation by a plan-related advisor if required conditions are met. Without this exemption, the covered transactions would be impermissible and subject to the excise tax on prohibited transactions. The required conditions are:

- The underlying investment advice must be authorized by a plan fiduciary, such as the plan administrator or trustee.
- The advice must be based on generally accepted investment theories.
- The advice must take into account individual information furnished by the participant.
- The advice must be provided under either the computer model approach or the fee-leveling approach authorized by the statute and the newly proposed DOL regulations on these investment advice models.

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The exception also requires notification to the individual of all the affiliated roles played by the parties involved in the investment advice transactions, including fees paid to each party and how participant information is used in the process. The adviser must disclose its fiduciary status and provide the information in a reasonable and comprehensive manner. Fiduciary advisors will be subject to an annual audit requirement in order to retain the exemption.

This exemption, together with the related proposed regulations on investment advice, will open a new era of participant-directed plan procedures. Before the statutory changes and this new prohibited transaction exemption, plan administrators and other fiduciaries have cautiously avoided providing investment advice to participants because of the threat of potential liability for fiduciary responsibility or prohibited transaction penalties. This proposed exemption will be final after a period of comments on the proposal and probably the finalization of the investment advice regulations. (*Proposed Class Exemption for the Provision of Investment Advice*, Federal Register, Aug. 22, 2008)

#### **IRS Issues Updated Correction Procedures.**

The Internal Revenue Service (IRS) recently updated the Employee Plans Compliance Resolution System (EPCRS), its comprehensive system of corrections for sponsors of qualified retirement plans. A retirement plan that corrects operational or document errors under EPCRS can continue the plan's tax qualified status. The revised EPCRS builds on earlier versions of the correction program. Some highlights include:

- Streamlined voluntary correction program (VCP) submissions for certain common failures, such as failure to administer plan loans in accordance with Internal Revenue Code (IRC) § 72(p)(2) and failure to timely adopt certain discretionary amendments for qualified plans.
- Allowing the use of the Department of Labor's Voluntary Fiduciary Correction Program on-line calculator to make earnings adjustments to correct distributions or contributions, if the plan sponsor demonstrates that it is not feasible to make a reasonable estimate of actual investment results.
- Additional guidance on whether a determination letter request should or should not be submitted in connection with a VCP submission or correction under audit cap.
- Permitting the clarification of self-correction by plan amendment for certain failures.
- Expansion of the time period in which to complete certain self-correction actions.

- Rules on correcting IRC § 415 annual addition errors for defined contribution plans, as these rules are no longer contained in the IRC § 415 regulations. (Rev. Proc. 2008-50)

#### **IRS Restricts Certain Pension Transfers.**

Investment banks and other financial service companies have expressed increased interest in taking over frozen pension plans from plan sponsors that want to offload the financial and administrative burdens of maintaining those frozen plans. Some commentators have expressed skepticism about these pension buyout arrangements, and whether it is in the best interest of participants to allow transfers of pension plans to disinterested financial services companies. The Internal Revenue Service (IRS) took a look at this issue and published a ruling that is expected to restrict the ability of financial service companies to market these arrangements, at least in the short-term.

In Revenue Ruling 2008-45, the IRS held that a transfer of the sponsorship of a qualified retirement plan from an employer to an unrelated taxpayer violates the exclusive benefit rule (see Internal Revenue Code (IRC) § 401(a)(2)), unless the transfer is made in connection with a transfer of business assets, operations, or employees. The fact pattern in the ruling involves Corporation A, which maintains an underfunded, frozen defined benefit plan. Corporation A transfers sponsorship of the plan to its wholly-owned Subsidiary B, along with cash and marketable securities. The amount of the transferred cash and marketable securities is equal to the amount of the plan's underfunding, as determined with reference to specified actuarial assumptions, plus an additional margin. Subsidiary B does not maintain any trade or business, has no employees, and has nominal assets. Shortly after the transfers, ownership of at least 80% of Subsidiary B's stock is transferred to Corporation C, an unrelated corporation. Accordingly, Subsidiary B is no longer a member of Corporation A's controlled group, but instead is a member of Corporation C's controlled group. The transfer of B stock to Corporation C is not made as part of a transfer of business assets (other than cash or marketable securities transferred to Subsidiary B), operations, or employees from Corporation A's controlled group to Corporation C's controlled group. The only business risk or opportunity in the transaction for Corporation C is potential profit from the acquisition and operation of the plan. The IRS ruled that the described transfer of plan sponsorship violates the exclusive benefit rule because the plan would no longer be maintained by an employer to provide retirement benefits for its employees and their beneficiaries.

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Along with the ruling, the Treasury Department also issued a news release announcing a framework of principles developed by the Treasury Department, the Labor Department, the Commerce Department, and the Pension Benefit Guaranty Corporation that is intended to guide the development of legislation that could permit pension plan transfers in circumstances where the transaction is in the best interests of plan participants, their beneficiaries, employers, and the pension insurance system. This legislative framework would, in certain circumstances, permit a pension plan (or a portion of a plan) under which benefits are no longer accruing to be transferred to an entity unrelated to the participants' employer (or former employer). Under the proposed framework, a transfer would need to meet the following conditions:

- Plan participants, their representatives, and ERISA regulators would be required to receive advance notice of a plan transfer, with sufficient information to permit regulators to review and, if appropriate, approve the proposed transaction;
- Only financially strong entities in well-regulated sectors would be permitted to acquire a pension plan in such a transfer;
- The parties to the transaction would be required to demonstrate that participants' benefits and the pension insurance system would be exposed to less risk as a result of the transfer, and that the transfer would be in the best interests of the participants and beneficiaries;
- Limitations on transfers would be imposed to limit undue concentration of risk;
- Transferees and members of their controlled groups would assume full responsibility for the liabilities of transferred plans and would comply with post-transaction reporting and fiduciary requirements; and
- Subsequent transfer transactions would be subject to the rules applicable to original transfer transactions. (Rev. Rul. 2008-45)

### **IRS Changes Treatment of Dependents of Divorced Parents.**

In August the Internal Revenue Service (IRS) issued guidance describing the circumstances under which it will treat children of divorced or separated parents as the dependents of both parents for purposes of certain health and fringe benefits, regardless of whether the custodial parent has released the claim to an exemption for the children. Beginning in 2005, children in these situations were generally treated as the noncustodial parent's dependents only if the custodial parent

released his or her claim to the exemption. If the custodial parent did not release the claim, only the parent entitled to the claim under Internal Revenue Code (IRC) § 152 could treat the children as dependents for purposes of calculating various deductions and exclusions from income, including for certain health and medical benefits and expenses, no-additional-cost services or qualified employee discounts, and distributions from Archer Medical Savings Accounts and Health Savings Accounts. The revenue procedure is effective August 18, 2008, but taxpayers may apply the guidance in any taxable year after 2004 for which the limitation period for credits or refunds had not expired as of August 18, 2008. (Rev. Proc. 2008-48)

## **Cases**

### **Misrepresentation about Section 415 Limitation Results in Additional Plan Benefits.**

The District Court of Alaska has held that a multiemployer pension plan is estopped from changing its plan administrator's representation of a participant's benefit amount. In this case, an individual was employed by a teamsters' local from June 1970 through June 2004, and was eligible to accrue benefits under two plans: the Teamsters Affiliate Pension Plan (TAPP) and the Alaska Teamster-Employer Pension Trust Fund (Alaska Plan). Prior to retirement, the individual inquired whether the benefits under one plan would result in the reduction of benefits under the other. The TAPP representative informed the individual that the TAPP benefit would not be reduced through aggregation with the Alaska Plan. Absent aggregation, the individual was entitled to receive \$2,145 per month from the TAPP plan. After aggregation and compliance with Internal Revenue Code (IRC) § 415 rules limiting benefits, the TAPP benefit was reduced to \$62 per month. TAPP argued that providing the higher benefit was illegal because it would exceed the maximum benefit limitations imposed by IRC § 415. TAPP indicated that it intended to incorporate the limitations of IRC § 415 by reference even though there was a "scriveners error" that was contained in the plan's provision regarding IRC § 415 at the time of the individual's retirement. The district court found that the so-called scriveners error created an ambiguity in the TAPP document and thus held that TAPP was estopped from reducing the benefit from amount originally represented. The Court also found that even though the benefit amounts were expressed as an estimate, the individual had specifically requested information on whether the plans would be aggregated in a manner that would result in a reduced benefit. The Court found that the answer to this question would be a clear "yes" or "no," and therefore, the answer did not fall within the benefit statements rules of an estimate. (*Bloom v. Teamster Affiliates Pension Plan*, D. Alaska, 2008)

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## Collective Bargaining Agreement Trumps ERISA Plan Document.

In a recent case, the district court for the District of Arizona, ruled that a reservation of rights clause in an Employee Retirement Income Security Act (ERISA) plan document giving an employer authority to modify retiree health benefits could not be given effect if the underlying collective bargaining agreements (pursuant to which retiree benefits were conferred) did not themselves provide for such authority. The Court's rationale was that collective bargaining agreements are negotiated by unions and employers, and establish a contractual relationship that cannot be unilaterally modified by an ERISA plan document to which the union was not a party. The specific lesson to employers based on this decision is to expressly include a reservation of rights clause in a collective bargaining agreement if the parties do not intend retiree health benefits to be "vested." In a broader sense, this case could be cited for the proposition that an ERISA plan document cannot unilaterally amend the terms of any mutually negotiated contract which forms part of the ERISA plan (e.g., an insurance contract which is intended to fund plan benefits). (*Alday v. Raytheon Co.*, (D. Ariz., 2008))

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