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Compensation & Benefits IN FOCUS

Developments in executive compensation and employee benefits

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DOL Issues Final Service Provider Disclosures Regulation

On February 2, the Employee Benefits Security Administration (EBSA), the organization within the Department of Labor (DOL) charged with administering and enforcing much of the Employee Retirement Income Security Act of 1974 (ERISA), issued its **final rule** under ERISA Section 408(b)(2) relating to service provider disclosures.

The final rule establishes specific disclosure obligations for plan service providers to ensure that plan fiduciaries are provided with the information they need to make decisions when selecting and monitoring the service providers for their plans. The final rule applies to ERISA-covered retirement plans. It does not apply to individual retirement accounts, simplified employee pension plans, SIMPLE retirement accounts, certain frozen annuity contracts and custodial accounts described in Section 403(b) of the federal tax code, or employee welfare benefit plans.

Under the final rule, covered service providers (CSPs) who expect to receive at least $1,000 in compensation for providing services to a covered plan are required to give fiduciaries of the plan information they need to (1) assess the reasonableness of direct and indirect compensation received by the CSP, its affiliates, and/or subcontractors; (2) identify potential conflicts of interest; and (3) satisfy reporting and disclosure requirements under ERISA. Failure to provide such information could cause the plan's continued retention of the CSP to be a prohibited transaction under ERISA. CSPs include the following:

- Service providers who act as ERISA fiduciaries to a covered plan or to a "plan asset" vehicle in which such a plan invests.
- Investment advisers (state or federally registered).
- Recordkeepers or brokers who make designated investment alternatives available to a covered plan.
- Providers of additional services such as consulting, investment advisory, securities brokerage or valuation services to a covered plan who also receive indirect compensation.

The final rule includes a number of changes from the interim final rule issued in July 2010. Among these changes are the following:

- Expansion of information that must be disclosed concerning a CSP's receipt of indirect compensation.

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THE PULSE

Dodd-Frank Executive Compensation Rules Delayed

The Dodd-Frank Wall Street and Consumer Protection Act included multiple provisions relating to executive compensation, including related disclosure, compensation consultants and clawbacks. Many of these new rules are conditioned on the SEC issuing rules to effectuate them.

Recently, the SEC updated its **Dodd-Frank rulemaking implementation website** to indicate a delay in the planned issuance of the executive compensation rules, with some rules intended to be issued in the first half of 2012 and the others to be issued in the latter half.

Whether the SEC will be able to meet its updated timeline remains to be seen. In the interim, employers should do their best to lay the groundwork for complying with these new rules. For instance, employers should consider adding language to equity grants and other incentive compensation awards acknowledging that the grant or award will be subject to any Dodd-Frank-mandated clawback if necessary.

- Conformance of investment-related disclosures for a covered plan's designated investment alternatives to the requirements of the participant fee disclosure regulations.
- A separate provision for the disclosure of changes to investment-related information, which must be updated annually.

The final regulation is effective for both new and existing contracts and arrangements between covered plans and CSPs as of July 1, 2012. This is an extension from the previous April 1, 2012, deadline. As a result, the deadline for plans to provide fee disclosures to plan participants is extended to August 30, 2012, for calendar year plans.

Boards of Directors Emerge Victorious in Recent Executive Pay Lawsuits

Plaintiffs' lawyers recently have seized upon negative shareholder advisory "say on pay" votes under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) as grounds to file lawsuits asserting a breach of fiduciary duty by boards of directors with respect to executive compensation. Commentators are surprised by these lawsuits, since Dodd-Frank explicitly states that shareholder say-on-pay votes may not be constructed to create additional fiduciary duties. However, multiple companies receiving negative votes on their say-on-pay proxy votes have been sued.

A couple of these lawsuits recently have been dismissed. For example, a federal court in Oregon rejected one such lawsuit on procedural grounds, applying Delaware corporate law in affirming the business judgment presumption for the directors. A federal court in California dismissed another such lawsuit for failure to state a claim, based on the text of Dodd-Frank. However, not all companies have been able to dismiss the lawsuits. Last year, a federal court in Ohio denied a company's motion to dismiss the lawsuit against it.

Regardless of whether a company is able to dismiss these lawsuits, they are costly and can generate negative publicity. Consequently, companies should consider (1) focusing on clearly explaining their executive compensation programs and decisions in their upcoming proxy statements, and (2) reaching out to large shareholders to assess whether they have any concerns with the company's executive compensation program, especially if there was a low approval rating on a prior advisory shareholder say-on-pay vote.

IRS Issues Guidance on Reporting Employer-Sponsored Health Care Coverage

At the beginning of the year, the Internal Revenue Service issued **IRS Notice 2012-9** (the Notice) regarding informational reporting to employees, via form W-2, of the cost of their employer-sponsored health coverage. The Notice supersedes prior IRS guidance on this reporting requirement.

The Notice emphasizes that the reporting to employees is for their information only. It is intended to inform them of the cost of health care coverage provided by their employer and does not cause excludable employer-provided health care coverage to be taxable.

Model Amendment for Underfunded Pension Plan Rules Issued

The Pension Protection Act of 2006 added Section 436 to the federal tax code. This new tax rule generally limits an underfunded pension plan's ability to pay certain types of plan benefits until the plan's funding status improves.

Although the rule has applied to plans since 2008, the IRS has delayed the deadline by which plan sponsors must amend their plan documents to include the requirements of Section 436. The deadline for amending a pension plan for Section 436 currently is the latest of (1) the last day of the first plan year that begins on or after January 1, 2012 (i.e., December 31, 2012, for calendar year plans); (2) the last day of the plan year for which Section 436 is first effective with respect to the plan; or (3) the due date (including extensions) of the plan sponsor's tax return for the tax year that contains the first day of the plan year for which Section 436 is first effective for the plan.

As part of issuing the amendment deadline extension late last year, the IRS also issued a **model amendment** on which plan sponsors may rely. The model amendment is designed to incorporate all of the Section 436 provisions the IRS believes are necessary to include in a plan document. Employers that already have amended their plans for Section 436 should consider reviewing the adopted amendment against the IRS model amendment to ensure that the previous amendment made the requisite modifications to the plan.

DOL Issues New Rules Regarding MEWAs

Multiple Employer Welfare Arrangements (MEWAs) consist of unrelated employers banding together to collectively offer health and welfare benefits to their employees, which can help small employers keep costs down. Unfortunately, MEWAs have been

The Notice is generally applicable beginning with 2012 Forms W-2 (i.e., forms required for 2012 that employers are generally required to give employees by the end of January 2013). Employers may rely upon the guidance provided in the Notice until further guidance is issued.

The Notice contains 39 Q&As, several of which make changes to previous IRS guidance or address new topics. Among other points of interest:

- Employers that are required to file fewer than 250 Forms W-2 for 2011 will not be subject to the reporting requirement for 2012 Forms W-2.
- The reporting requirement does not apply to coverage under a health care flexible spending account if contributions occur only through employee salary reduction elections.
- The reporting requirement does not apply to payments or reimbursements of health insurance premiums for a 2% shareholder-employee of an S corporation who is required to include the premium payments in gross income.
- Employers are not required to report the cost of coverage under an employee assistance program (EAP), wellness program or on-site medical clinic if the employer does not charge a premium with respect to that type of coverage when it is provided under COBRA.

DOL Expects to Focus on Health Care and Fiduciary Issues in Coming Months

On January 20, the DOL made its semiannual **regulatory agenda** and regulatory plan statement available on its website. The regulatory agenda is the list of regulations the DOL expects to have under active consideration for promulgation, proposal or review during the following 6 to 12 months.

During 2012, EBSA expects to continue to issue guidance to assist in implementing health care reform to both minimize disruptions to existing plans and practices, and to make implementation of the legislation's market reforms as smooth as possible.

EBSA also expects to re-propose regulations to clarify circumstances under which a person will be considered a "fiduciary" when such person is providing investment advice to employee benefit plans and their participants and beneficiaries. The DOL previously withdrew its proposed regulations on this topic in late 2011 in response to the number of public comments it received with respect to such proposed regulations. The re-proposed regulations are expected to take into account the current practices of investment advisers as well as the expectations of both plan officials and the participants that receive the investment advice.

EBSA is working on a proposed rule that would require that account statements prepared for participants in defined contribution plans (such as 401(k) plans) express the account balance as a lifetime income stream of payments, in addition to presenting the total current value of the account. This proposed rule stems from a 2010 request for information published by EBSA seeking input concerning the steps it may take to encourage the offering of lifetime annuities or benefit distribution options for participants and beneficiaries of defined contribution plans.

Finally, EBSA intends to revise the regulations regarding abandoned plans to include plans of businesses in liquidation proceedings. Such revision is needed to reflect recent changes in the U.S. Bankruptcy Code. The DOL hopes that the changes will allow bankruptcy trustees to use a streamlined termination process and better discharge their obligations under the law.

subject to abuse by certain parties, which has made them a DOL enforcement priority.

As a result of this abuse, the enacted health care reform legislation gave the DOL increased enforcement power, and the DOL issued proposed rules with respect to these new powers. Pursuant to recently proposed rules, the DOL would have the ability to issue cease-and-desist-orders and seize MEWA assets when it detects abuse. In addition, the DOL has proposed modifications to various government forms that MEWAs must file with federal agencies, including the requirement for a MEWA to pre-register its formation with the DOL.

The DOL's proposed rules can be found **here** and **here**.

IRS 2012 Dollar Limits for Retirement Plans

The federal tax code dictates limits on benefits, contributions and other matters regarding retirement plans. Examples of such limits include the maximum dollar amount an employee can contribute to his or her 401(k) account and/or IRA, and the maximum benefit an employee can receive under a retirement plan for a year. Each year, the IRS reviews such limits and determines whether a cost-of-living adjustment is required. The limits for 2012 can be found **here**.

HHS Issues Final Regulations Addressing Electronic Funds Transfers by Health Plans

On January 10, the Department of Health and Human Services (HHS) issued **interim final regulations** regarding the standards applicable to electronic funds transfers (EFTs) made by health plans to health care providers. The regulations were prompted by health care reform legislation that amended the earlier Health Insurance Portability and Accountability Act (HIPAA) by adding EFTs to the list of transactions for which HHS must adopt a standard under HIPAA.

The goal of the new regulation is to make EFTs a more efficient method for the receipt of health claim payments. Comments regarding the regulations are due before March 12, and compliance will be required effective January 1, 2014.

The new interim regulations adopt two standards for health plans that transmit health claim payments to providers using EFTs. Specifically, the standards include (1) a format for when a health plan initiates or authorizes an EFT with its bank, and (2) specific information that must be contained in the EFT. Each EFT must include two specific parts. First, it must contain the EFT payment/processing information. Second, it must contain adjustments to the claim charges in an attached "remittance advice" notice so that any adjustments to the payment are clear and explained. In the event that the remittance notice and the payment arrive at different times (which can cause confusion in reconciling such payments and notices), the EFT regulations require the use of a tracking number so that the notice and payment can be easily and properly reconciled.

Please direct any questions, comments or suggestions regarding this newsletter to your Katten attorney or any of the following members of the firm's **Employee Benefits and Executive Compensation Practice**.

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