LEGISLATIVE AND REGULATORY UPDATE

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Obama budget renews call for PBGC premium hikes, other familiar retirement initiatives: President Obama's FY 2013 budget plan revives several retirement policy initiatives pushed since he took office. Overall, the plan seeks a mix of tax increases – mainly on high-income individuals – and spending cuts designed to trim the deficit by more than $4 trillion over the next decade. While the plan is a nonstarter with Republicans who are drafting their own budget plans, it projects the president's vision for a possible second term and potential post-election battles over "Bush era" tax cuts set to expire at the end of 2012.

Higher PBGC premiums. The 2013 budget reiterates Obama's call to let the PBGC board – not Congress – set premiums and charge more for high-risk plans. The proposal is expected to raise premiums by $16 billion over 10 years – a potentially massive hike for some plans. Unlike an administration plan released last fall, the current proposal doesn't cap premiums at four times a baseline level. Despite business groups' strong opposition, increasing premiums to some degree has bipartisan support as a way to pay for other priorities.

Reduced savings incentives for some. For taxpayers in the reinstated 36% and 39.6% tax brackets (with income exceeding $250,000 if married, $200,000 if single), the "tax value" of employee contributions to defined contribution plans and IRAs would be limited to 28% of the exclusions/deductions that would otherwise reduce taxable income.

Eased minimum distribution and rollover rules. Another proposal would waive minimum required distributions if the total value of an individual's tax-favored retirement plan and IRA accumulations does not exceed $75,000 at the start of the year in which the individual turns 70½ or, if earlier, dies. (The value would be remeasured at the start of any year after the plan or IRA accepts new contributions.) Defined benefit plan annuities in pay status would not count toward the $75,000 threshold. In addition, nonspouse beneficiaries would get the same 60-day rollover opportunity for inherited qualified plan or IRA assets that surviving spouses have.

Workplace plans pushed. A reprised proposal would require every employer – except very small or new ones – to offer "automatic IRAs" if it doesn't sponsor a qualified plan or excludes significant groups of employees from coverage. Tax incentives for small employers to set up qualified plans would double.

E-filing. Under another proposal, the IRS could require electronic filing of certain benefit plan information (akin to the Labor Department's EFAST2 program for Form 5500). **Full text of President Obama's FY 2013 budget plan (OMB, 14 Feb 2012)**

PBGC premium hikes out of payroll tax deal; pension funding changes in highway bill: PBGC premium increases were left out of the final House-Senate agreement to extend the payroll tax cut through 2012 but will remain in play as a way to pay for other legislative priorities. Plan sponsors therefore plan no letup in urging Congress to reject premium increases – particularly the Obama administration's proposal to let the PBGC board, not Congress, set premiums and charge more for high-risk plans. Employers will also continue their drive for enactment of a pension funding stabilization proposal that would make permanent changes to the Pension Protection Act.

Senate stabilization proposal. That drive made some headway this week with the Feb. 15 introduction of a Senate Finance Committee proposal to change pension discount rates and raise revenue to help pay for a major transportation bill. While welcomed by plan sponsors as an important first step, the proposal, as drafted, offers them little funding relief. Although based on the interest rate component of a plan sponsor proposal (which would retain PPA's 24-month averaging period for segment discount rates but limit the monthly rates used in the average to within 10% of a 25-year average value), the Finance proposal would hold the monthly rates to within 15% of a 10-year average. The shorter averaging period and wider corridor combine to severely diminish the proposal's effect on 2012 segment rates and contribution requirements (the first segment rate would increase about 130 basis points, while the second and third segment rates – which drive the bulk of pension liabilities – would be little changed from current PPA rules). Should corporate bond yields rise, the proposal may even have adverse effects.

Outlook. Finance Committee and other congressional staff say they're willing to consider changes, and plan sponsors are working with them to make improvements as the larger transportation bill takes shape over the coming weeks. Whether Congress can pass the broader transportation bill, which could carry the stabilization proposal to enactment, remains to be seen. But with both chambers struggling to find revenue to offset the cost of their respective bills, a funding stabilization proposal (the current Finance proposal is projected to raise $7 billion over 10 years) – as well as some increase in PBGC premiums – could land in a final package.

Additional retirement provisions in play. Other retirement-related, revenue-raising provisions in the mix as part of the transportation bill would accelerate certain death benefit distributions from retirement plans and extend section 420 transfers of surplus pension assets to retiree health accounts through 2021, allowing those assets to be used for retiree life insurance benefits as well as health care benefits.

No-action letter offers private companies relief from registering RSUs: Recently issued SEC guidance spares private companies from a Securities Exchange Act of 1934 requirement to register restricted stock units (RSUs). Without relief, registration generally would be required if a company has more than $10 million in assets and has granted RSUs to 500 or more individuals.

The SEC relief comes through the no-action letter process, which allows parties uncertain whether a particular action – such as not registering – would violate federal securities laws to request written assurance that the SEC staff will not recommend enforcement, based on the facts presented. While no-action letters generally provide relief only to the company making the request, this letter was granted to a law firm and, apparently, can be relied on by any company.

For a company to qualify for the relief, the RSUs must meet conditions similar to those required for stock options under Rule 12h-1 while the company is private or otherwise relying on the relief.

The law firm's letter to the SEC details the required conditions, which include the following:

- The RSUs must be issued under a written plan established by the company, a parent company or a majority-owned subsidiary of the company or parent company.
- The RSUs must be held only by those persons described in Securities Act Rule 701(c) – employees, directors and consultants or, as described below, permitted transferees.
- The RSUs (and, prior to settlement, the underlying shares) may not be transferred directly or indirectly (such as through puts and calls) except by the original holder (except in the case of death) and only (i) to certain family members described in Rule 701(c) through gifts or domestic relations orders or to an executor or guardian in the case of death or disability, (ii) to the company or (iii) in connection with a change in control or similar transaction if, after such transaction, the RSUs no longer will be outstanding and the company no longer will be relying on the no-action relief.
- RSU holders must be provided certain company-specific risk and financial information.

Full text of no-action letter (SEC, 13 Feb 2012); **Full text of law firm letter requesting exemptive relief (SEC, 7 Feb 2012)**

FMLA protects pre-eligible employee's request for post-eligibility leave: A woman who was not covered by the Family and Medical Leave Act (FMLA) when she requested maternity leave but who would have been eligible -- had she not been fired -- when her leave began can sue her former employer for interference and retaliation under the act, the 11th US Circuit Court of Appeals has ruled. Requiring "employees to disclose requests for leave which would, in turn expose them to retaliation, or interference, for which they have no remedy" would be illogical, the court said. Also, the court held, notice of intent to use FMLA leave is an activity protected from retaliation. The case is ***Pereda v. Brookdale Senior Living Communities, Inc.*, No. 0:10-cv-60773-FAM (11th Cir. Jan. 10, 2012))**

Annual dollar limit waiver retained when switching from self-insured to fully insured: Employers generally can breathe easier if they have been granted an annual dollar limit waiver for a self-insured group health plan and wish to switch to a fully insured policy. New guidance from the Department of Health and Human Services explains that sponsors of self-insured plans can purchase a fully insured policy and retain the waiver protection, provided certain conditions are met. The guidance supplements December 2010 clarifications that allow waiver protection to continue when an insured plan switches from one insurance policy to another. Full text of FAQs related to annual limit waivers (HHS, 10 Feb 2012)

Setback for 401(k) fiduciaries in latest appeals court 'stock drop' case: In a new 401(k) "stock drop" case, the 6th US Circuit Court of Appeals has reaffirmed that ESOP fiduciaries are presumed to act prudently regarding company stock investments. However, the decision sets parameters that could make it more challenging and expensive to rely on this "presumption of prudence." In addition, the court said fiduciaries who acted imprudently could be liable for losses, even when the stock fund is part of a larger menu of investment choices. The decision could make it harder to defeat ERISA lawsuits in Kentucky, Michigan, Ohio and Tennessee, even for plans satisfying ERISA Section 404(c).

6th Circuit takes nuanced position in stock-drop lawsuit

401(k) "stock drop" litigation has been tilting fiduciaries' way, as evidenced by notable appellate wins last year for two firms caught up in the Wall Street financial crisis. But the latest ruling from the 6th US Circuit Court of Appeals highlights the continuing risk of fiduciary liability when offering company stock funds in a 401(k) plan or ESOP **(*Pfeil v. State Street Bank & Trust*, No. 10-2302 (6th Cir. Feb. 22, 2012))**. The 6th Circuit confirmed that ESOP fiduciaries are entitled to a "presumption of prudence" with respect to company stock investments. Compared with some other appellate rulings on this issue, however, the 6th Circuit's interpretation is more participant-friendly:

- The presumption of prudence doesn't apply at the pleadings stage of a lawsuit. (This means fiduciaries can't rely on the presumption to avoid the costly discovery phase.)
- To rebut the presumption, participants don't necessarily have to show a company was facing imminent collapse.
- Fiduciaries can't avoid liability by showing that participants were free to select other investments from a larger menu of prudent options (even in the case of an ERISA Section 404(c) plan).

The decision is likely to complicate cases in Kentucky, Michigan, Ohio and Tennessee, where the 6th Circuit has jurisdiction. Time will tell whether it influences the outcome in other circuits.

Lower court absolved fiduciary because participants had control

The dispute arose after General Motors (GM) engaged an independent fiduciary to oversee company stock funds in its 401(k) plans, which were designed as ESOPs. Plan terms directed the fiduciary to invest exclusively in GM stock unless there was serious concern about the company's short-term viability or no near-term possibility of recouping substantial proceeds from the sale of stock in bankruptcy. After huge quarterly corporate losses, the fiduciary suspended purchase of company stock in November 2008 and fully divested by April 2009. But participants claimed the fiduciary breached its duties by not acting earlier, leading to heavy plan losses.

In a September 2010 ruling, the district court said participants raised sufficient red flags about the company's short-term viability to support a plausible claim for breach of fiduciary duty. Even so, the court dismissed the case, finding the alleged breach didn't cause the plan's losses. Since participants could have elected to move their funds out of company stock at any time, the court reasoned, the independent fiduciary wasn't liable for losses caused by participants' own failure to divest. The Department of Labor (DOL) filed an appellate brief criticizing the lower court's decision.

On appeal, the 6th Circuit first considered whether courts must give fiduciaries the benefit of the doubt on company stock investments. Next, the court addressed whether the alleged fiduciary misconduct could have "caused" the plan's losses.

Are fiduciaries presumed to act prudently?

The 6th Circuit was one of the early adopters of what's known in fiduciary circles as the "*Moench* presumption. Jurisdictions adopting *Moench* presume fiduciaries act prudently when offering participants the opportunity to invest in company stock, leaving plaintiffs with the heavy burden of showing that fiduciaries abused their discretion. Consistent with its 1995 decision, the 6th Circuit reaffirmed that ESOP fiduciaries are presumed to act prudently when deciding to remain invested in company stock. However, the court added new gloss that could raise the bar – and litigation costs – for fiduciaries facing stock-drop lawsuits in the 6th Circuit.

Presumption doesn't apply at pleadings stage. The 6th Circuit held that courts should not apply the *Moench* presumption at the early pleadings stage of a lawsuit – instead, *Moench* should be applied only in the context of a fully developed evidentiary record. This means fiduciaries will be less likely to win motions to dismiss and more likely to incur higher litigation costs during the discovery phase. The 6th Circuit acknowledged that other appeals courts (most recently the 2nd Circuit) apply the presumption at the pleadings stage.

Fiduciaries may need to act before impending collapse. Various courts adopting *Moench* have ruled that fiduciaries must override plan terms only when the employer is facing a "dire situation" or is on "the brink of collapse." The 6th Circuit's interpretation isn't quite as narrow. The court declined to say exactly what participants must show to rebut the presumption of prudence, choosing instead to reiterate this broad general rule: Participants must prove a prudent fiduciary acting under similar circumstances would have made a different investment decision. This abuse-of-discretion standard places a "demanding burden" on participants but retains enough flexibility to address unique circumstances, the court said. As a result, participants may be able to overcome the presumption without proving the company's impending collapse or similar dire straits.

On the facts presented in this case, the 6th Circuit concluded that the participants had plausibly alleged that a prudent fiduciary would have made a different investment decision with respect to GM stock. (The court went on to note that the participants would have met their burden even under the narrower standards adopted by other circuits.)

Did fiduciary misconduct cause the loss?

Although the lower court had ruled that the fiduciary couldn't be held liable for actions within participants' control, the 6th Circuit disagreed, finding that fiduciaries must exercise prudence when designating and monitoring the investment options offered to participants. According to the appeals court, fiduciaries cannot avoid liability for offering "imprudent investments" merely by including them in a larger menu of options: "Much as one bad apple spoils the bunch, the fiduciary's designation of a single imprudent investment offered as part of an otherwise prudent menu of investment choices amounts to a breach of fiduciary duty."

Even if the plans qualified as Section 404(c) plans under ERISA, the fiduciary wouldn't be relieved of the responsibility to screen investments, the court concluded. The court cited the recent *Howell v. Motorola* decision, where the 7th Circuit ruled that selecting the menu of investment options is not within the participant's power; instead, this is a core decision relating to plan administration. This viewpoint is consistent with the position that DOL has taken in several appellate court briefs and recently incorporated into final 404(c) regulations.

The 6th Circuit added that a fiduciary cannot assert a 404(c) defense at the pleadings stage of a lawsuit (with limited exceptions). This means a fiduciary can't count on having a case in the 6th Circuit dismissed on either 404(c) grounds or the *Moench* presumption before moving on to the discovery phase.

IRS checking pension plans' compliance with funding-based benefit restrictions: Sponsors of single-employer pension plans that are less than 80% funded may need to provide information to the IRS under an Employee Plan Compliance Unit (EPCU) initiative. An IRS official speaking in a Feb. 23 phone forum noted the IRS is sending "request for information" letters to a random sample of plan sponsors reporting an adjusted funding target attainment percentage (AFTAP) below 80% on their Form 5500 Schedules SB for 2009 or later plan years. The IRS wants to know if plan sponsors are aware of and complying with funding-based benefit restrictions under Code Section 436. The IRS also hopes to determine whether plan sponsors are properly using the funded status certified by the plan's actuary.

Required information. Much of the information requested by EPCU should be readily available and easy to provide, including:

- The plan's AFTAP and certification date for the plan year under review and the prior year
- Other information to determine if restrictions apply: whether the sponsor is in bankruptcy; whether the plan was frozen before Sept. 1, 2005; if any amendments increasing benefits took effect during the year; and, if the AFTAP is less than 60%, if benefit accruals ceased
- Details of any insurance contract purchases and whether any assets and liabilities were transferred to another controlled-group plan to avoid benefit restrictions

But sponsors may have difficulty supplying requested details about all lump sums and other accelerated distributions (such as installments for a fixed period or Social Security level income payments) paid during the year. These details include the recipient's name and Social Security number, payment form, payment date, present value of the total benefit, and lump sum or present value of accelerated payments for forms other than lump sum (sponsors presumably should show present values used in the 50% present-value test).

Completing the request. Plan sponsors may forward the request (with Form 2848, *Power of Attorney and Declaration of Representative*) to the plan's actuary for completion.

Consequences of nonresponse. The IRS has not yet indicated whether failure to respond to the letter will trigger an IRS audit, as was the case with the EPCU's 2010 compliance check letter for 401(k) plans. **IRS website on PPA compliance checks for single-employer DB plans (1 Dec 2011; Full text of the EPCU's compliance check letter (IRS, 17 Nov 2011)**