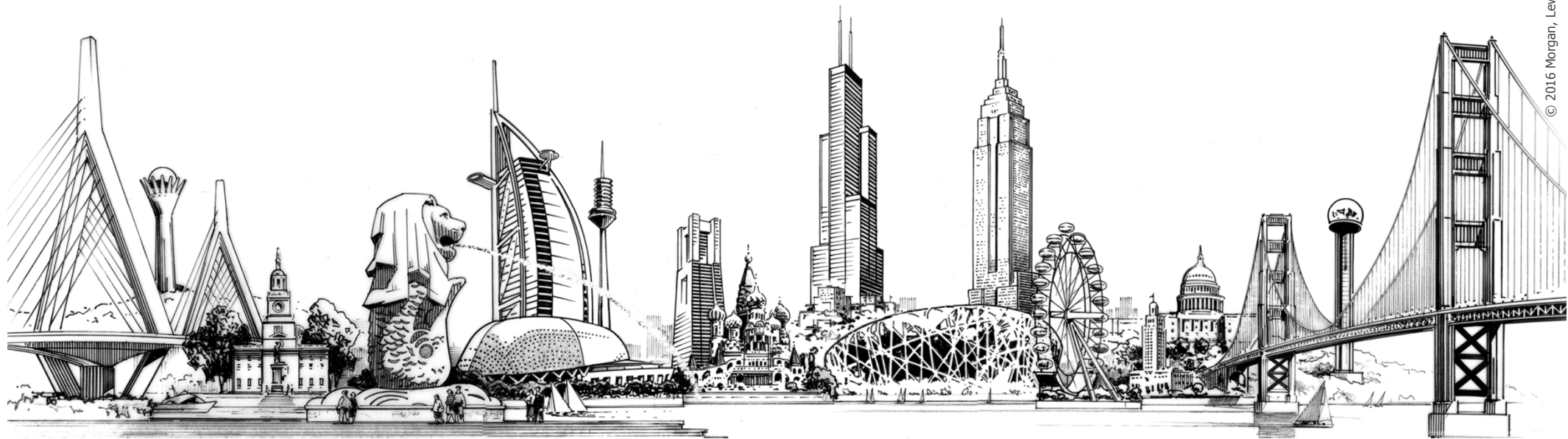


Morgan Lewis

HOT TOPICS IN EMPLOYEE BENEFITS: WHAT WE'RE SEEING

Presenters: Craig Bitman (moderator), Andy Anderson,
Althea Day, Gina Lauriero, Timothy Lynch, and Randy Tracht

December 8, 2016



Agenda

- Post-Election Report
- Health and Welfare
- Plan Sponsor Considerations
- Fiduciary Considerations
- Executive Compensation
- Multiemployer Plans

PRESENTER: TIMOTHY LYNCH

POST-ELECTION REPORT

Presidential Race

- 270 Electoral Votes Needed to Win
- Trump Received 306

By Comparison	
Obama '12	332
Obama '08	365
Bush '04	286
Bush '00	271
Clinton '96	379
Clinton '92	370

Senate Elections

- 114th Congress (2015–2016)
 - Republicans 54
 - Democrats 46

- 115th Congress (2017–2018)
 - Republicans 51
 - Democrats 48
 - (Louisiana Run-off 12/10 – Likely Republican win)

House of Representatives Elections

- 114th Congress (2015–2016)
 - Republicans 247
 - Democrats 188

- 115th Congress (2017–2018)
 - Republicans 239
 - Democrats 193
 - (3 races undecided)

Party Control: Administration/Congress

- Trump has a minimum of 2 years with a favorable House and Senate
- Obama in 8 years had only 2 years with a favorable House and Senate (6 years with a favorable Senate)
- Bush II in 8 years had 6 years with a favorable House and Senate
- Clinton in 8 years had only 2 years with a favorable House and Senate (and 6 years with a very unfavorable House and Senate)
- Bush I in 4 years had a very unfavorable House and Senate
- Reagan in 8 years had 6 years with a favorable Senate (and 2 years with a very unfavorable House and Senate)
- Carter in 4 years had 4 years with a favorable House and Senate

Trump Administration: Key Appointments

- Department of Labor
 - Secretary of Labor
 - Administrator Wage and Hour Division
 - Employee Benefits Security Administration
 - Assistant Secretary – OSHA
 - Assistant Secretary – Policy

- Treasury Department
 - Secretary
 - General Counsel
 - Assistant Secretary – Tax Policy
 - Commissioner – Internal Revenue Service
 - Chief Counsel – Internal Revenue Service

Trump Administration: Key Appointments

- Pension Benefit Guaranty Corporation
 - Director
- Social Security Administration
 - Commissioner
 - Inspector General
- Securities and Exchange Commission
 - Commissioner(s)

Trump and Congress

- House Republican Leadership
 - Speaker Paul Ryan (WI)
 - Majority Leader Kevin McCarthy (CA)
 - Majority Whip Steve Scalise (LA)

- Senate Republican Leadership
 - Majority Leader Mitch McConnell (KY)
 - Majority Whip John Cornyn (TX)

Trump and Congress

- House Democratic Leadership
 - Minority Leader Nancy Pelosi (CA)
 - Minority Whip Steny Hoyer (MD)
- Senate Democratic Leadership
 - Minority Leader Charles Schumer (NY) (new)
 - Minority Whip Dick Durbin (IL)

Trump and Congress

- Senate Health, Education, Labor and Pensions Committee
 - Chairman, Lamar Alexander (TN)
 - Ranking Democrat, Patty Murray (WA)

- Senate Finance Committee
 - Chairman, Orrin Hatch (UT)
 - Ranking Democrat, Ron Wyden (OR)

Trump and Congress

- House Education and Workforce
 - Chairman, Virginia Foxx (NC) (new)
 - Ranking Democrat, Robert Scott (VA)
- House Ways and Means
 - Chairman, Kevin Brady (TX)
 - Ranking Democrat, Richard Neal (MA)

Key Dates

December 9	Funding for the Federal Government Expires
December 10	Louisiana Run-off Election
December 19	Electoral College Convenes
January 3, 2017	First Session of the 115th Congress Convenes
January 20	Inauguration

PRESENTER: ANDY ANDERSON

HEALTH AND WELFARE

AFTER THE AFFORDABLE CARE ACT—WHAT COMES NEXT?

“Repeal and Replace”

- Powerful campaign theme that requires some immediate action
 - Possibly a Day 1 Executive Order defunding enforcement of individual and employer mandate
 - Possibly a Day 1 bill signing of Budget Reconciliation legislation
 - Can be done without any Democratic votes—good idea?
 - Can only reach ACA provisions that have a federal budget impact
 - Model would be HR 3762 from earlier in 2016 (vetoed by Obama)
 - Contained:
 - 2015 repeal of individual and employer mandate
 - 2017 repeal of PCORI, Reinsurance, Risk Corridors, Risk Adjustment, Credit Recapture, over-the-counter drug prohibition, FSA \$ cap, HSA 20% penalty (reduced to 10%), Device Tax, Health Insurance Tax, deduction of Medicare Part D reimbursement
 - 2018 repeal of Cadillac Tax
 - 2018/2019 repeal of Premium Credits, Cost Sharing, Eligibility Data Transfer

“Repeal and Replace”

- Possible Executive Order and “Grand Compromise” approach
 - Pair immediate action with a slower (and possibly bipartisan) solution to both “repeal” and “replace”
 - Likely terms include:
 - No employer or individual mandate
 - Adult children coverage until age 26
 - No preexisting condition exclusions (with restrictions and associated reporting)
 - Preventive care
 - Wellness rules
 - Phase out of Exchanges and subsidies over 2-year period
 - Cap on employer deduction for healthcare (Cadillac Tax part deux)
 - Individual tax credits if no employer coverage
 - Hence, continued reporting of some sort

“Repeal and Replace”

- Risks for employers:
 - Some proposals are not friendly toward employer-provided group health coverage
 - Specifically proposals for “tax credit for all” and an end of the employer deduction
 - Some proposals may encourage state experimentation and weaken ERISA preemption
 - Need to reeducate Congress on the effectiveness of and need for robust employer group health coverage
 - Concerns that a broader Tax Reform proposal may also jeopardize the deductibility of group health coverage

PRESENTER: RANDY TRACHT

PLAN SPONSOR CONSIDERATIONS

Pension Plan “De-Risking” Activities

- Defined benefit plan sponsors continue to pursue and evaluate various “de-risking” activities intended to reduce or manage pension obligations
 - Lump-sum window offerings to terminated participants
 - Transfers of assets and liabilities to insurers through annuity purchases
 - Liability-driven investment (LDI) strategies intended to reduce investment volatility and manage interest rate risk
 - “Borrow to fund” strategies
- Popularity of de-risking strategies stemming from a number of factors
 - Sharply increasing Pension Benefit Guaranty Corporation (PBGC) premium rates (particularly variable rates for underfunded plans)
 - Favorable interest rate assumptions used to calculate lump-sum distributions
 - Ability to borrow capital at favorable rates

Pension Plan “De-Risking” Activities

- Action items for pension plan sponsors
 - Actively evaluate and monitor de-risking strategies
 - Identify short and long-term de-risking goals
 - Undertake administrative steps (e.g., data integrity projects, benefit calculations) necessary to implement de-risking activities
 - Review (and, if necessary, update) internal corporate and fiduciary structures that would be used to implement de-risking activity

Defined Contribution Plan Litigation

- Cases involving defined contribution plans (401(k) plans, 403(b) plans, etc.) continue to be the hottest ERISA litigation trend
- Plan fiduciaries are subject to ERISA's fiduciary duties and responsibilities, including the duties to act in the best interests of plan participants and to act prudently
- Cases involve a number of different theories and claims alleging that plan fiduciaries breached their fiduciary duties, including:
 - Stock-drop cases involving 401(k) plans that offer company stock investments
 - Cases brought against plans alleging that investment and recordkeeping fees and expenses paid by the plans are excessive
 - Cases brought against plans that offer “proprietary” investment alternatives
 - Cases involving plans' stable value fund offerings

Defined Contribution Plan Litigation

- Cases tend to involve larger plans and many have been filed by a particular plaintiffs' firm that specializes in these issues
- Many recent cases have involved plans sponsored by prominent higher-education institutions
- In response to cases, plan sponsors and fiduciaries should proactively evaluate and monitor their plan investments and third-party service provider arrangements
- Evaluating and monitoring activities may vary depending on the plan and applicable circumstances (company stock fund or not, stable value fund or not, etc.), but engaging in procedural prudence is the overall objective

PRESENTER: CRAIG BITMAN

FIDUCIARY CONSIDERATIONS

Department of Labor Fiduciary Regulation

- Recap of the regulation
- What should plan sponsors be doing now?
- Status of the regulation as a result of the presidential election
- DOL regulatory agenda

PRESENTER: GINA LAURIERO

POST-ELECTION CONSIDERATIONS IN EXECUTIVE COMPENSATION

Dodd-Frank Act

- The new administration's campaign included consideration of repealing the Dodd-Frank Act
 - Wholesale repeal is unlikely
 - Would result in revocation of requirements currently in effect (e.g., say-on-pay, frequency of say-on-pay, say-on-golden parachute, and compensation committee independence disclosure)
 - Likely changes to rules not yet in effect
- Potential changes
 - Legislative action
 - Additional rulemaking

CEO Pay Ratio Rule

- Final rules issued
- Requires disclosure of:
 - Median of the total annual compensation of all employees (excluding the CEO)
 - Annual total compensation of the CEO (as determined in accordance with the Summary Compensation Table)
 - Ratio of the employee median to the CEO's annual total compensation
- Based on current rules, will first be applicable for most companies in the 2018 proxy season

Clawbacks and Pay-for-Performance Disclosure

- Clawbacks
 - Proposed rules require public companies to adopt, disclose, and comply with a written policy to recoup incentive-based compensation in the event of an accounting restatement due to material noncompliance with any financial reporting requirement
 - Applies to any compensation granted, earned, or vested based in whole or in part on any financial reporting measure
 - Covers any current or former executive officer who received erroneously awarded incentive-based compensation
- Pay-for-Performance
 - Proposed rules require public companies to disclose information in their proxy statements showing the relationship between executive compensation actually paid and the companies' financial performance (based on total shareholder return of the company and total shareholder return for the company's peer group)

Incentive Compensation for Financial Institutions

- Proposed rules impose significant, detailed new requirements on incentive compensation provided by financial institutions
 - Most stringent requirements for senior executive officers and “significant risk takers”
 - Subject incentive compensation to deferral, forfeiture, downward adjustment, and clawback requirements
 - Time periods vary based on individual’s role and size of the financial institution, but under the proposed rules, senior executive officers of the largest financial institutions will be required to have 60% of their incentive pay at risk for up to 11 years

Internal Revenue Code Reform

- The new administration's campaign proposed tax reform
 - Reducing the maximum corporate rate to 15%
 - Reducing individual tax brackets from 7 to 3
 - Retaining existing maximum capital gains rate (20%)
 - Taxing carried interests as ordinary income
 - Repeal of additional Medicare tax and alternative minimum tax

Internal Revenue Code Reform

- Reduction of the maximum corporate tax rate could decrease the importance to public companies of the performance-based compensation exemption under Section 162(m) of the Internal Revenue Code
 - Smaller portion of compensation performance based
 - More flexibility in structuring performance-based compensation
 - Performance goals
 - Subjectivity
 - Timing
 - Flexibility on employment termination

Internal Revenue Code Reform

- Could lead to increased use of incentive stock options (ISOs)
 - Even more likely if alternative minimum tax is eliminated
 - ISOs provide tax-favored treatment to employees
 - Gains between the grant date and the exercise date can be taxed as capital gains
 - Gains on nonqualified stock options are taxed at ordinary income rates
- Currently, ISOs are less popular
 - Many employees lose the tax benefit when the ISO gain is subject to the alternative minimum tax
 - The employer generally loses the tax deduction otherwise available under a nonqualified stock option
 - Loss of deduction less important if corporate tax rates are reduced

Internal Revenue Code Reform

- Reduced, simplified individual tax brackets
 - Reduction from seven to three
 - Lowering the maximum rate
- Impacts the analysis of whether to defer 2017 compensation
 - Deferral elections generally need to be made by the end of this year

PRESENTER: ALTHEA DAY

MULTIEMPLOYER PLANS

Multiemployer Plans – Uncertainty for Plans in Critical and Declining Status

- Multiemployer Pension Reform Act of 2014 (MPRA) provided new benefit suspension and partition opportunities for pension plans in “critical and declining status” to assist in avoiding insolvency
 - Critical and declining plans
 - Plan projected to become insolvent in current or any of 14 succeeding plan years (~15 years); or
 - Plan projected to become insolvent in current or any of the 19 succeeding plan years (~20 years) and
 1. Ratio of inactives to actives exceeds 2 to 1; or
 2. Plan is less than 80% funded.
- Suspension rules permit trustees to reduce accrued benefits of active and retired participants
 - Conditions
 - Actuary must certify that plan is projected to avoid insolvency with proposed benefit suspensions.
 - Plan determines that even though it has taken “all reasonable measures to forestall insolvency,” plan still projected to become insolvent unless proposed benefits are suspended.
 - Limitations
 - Monthly benefit cannot be reduced below 110% of the PBGC guarantee.
 - Limitations on suspensions for participants/beneficiaries ages 75 to 79.
 - Participants/beneficiaries ages 80 and older and those receiving disability pensions are exempt from suspensions.
 - Benefit suspensions are to be reasonably implemented to avoid plan insolvency.
 - Suspensions must be “equitably distributed” across plan participants, taking into consideration various factors set forth in the statute.
 - Notice/vote requirements

Plans in Critical and Declining Status

- Partition rules permit trustees to apply to the PBGC for financial assistance (to have the PBGC relieve the plan of some of its financial obligations)
- Conditions
 - Plan has taken all reasonable measures to avoid insolvency, including the maximum benefit suspensions;
 - PBGC expects partition will reduce its long-term loss with respect to plan, and partition is necessary for plan to remain solvent; and
 - PBGC certifies to Congress that its ability to meet existing financial assistance obligations to other plans will not be impaired by the partition.
 - Partition must be in the interests of the participants and beneficiaries of at least one of the plans, and
 - Not reasonably expected to be adverse to the overall interests of the participants and beneficiaries of any of the plans.

Plans in Critical and Declining Status

- Temporary and proposed Treasury Regulations and PBGC Interim Final rules were issued in June 2015.
- Final PBGC rules were issued in December 2015 and final Treasury Regulations were issued in April 2016.
- Since June 2015, 11 plans have submitted applications to Treasury for benefit suspensions.
 - Several withdrawn
 - 4 denied
 - 5 still under review
 - None approved

Plans in Critical and Declining Status

- Denied applications include the Central States, Southeast and Southwest Areas Pension Fund, which has more than 400,000 active participants and retirees.
 - Reasons for denial have included the use of actuarial assumptions and benefit reductions that were determined by Treasury to be “not reasonably estimated to allow the plan to avoid insolvency”
- Following denial of Central States’ application, the Secretary of Treasury wrote to Congress citing issues with MPRA
- Suspension prerequisite for partition; no suspension approval/no partition approval
- What’s next?
 - Reapplication?
 - Additional legislation?
 - Issues of substance and timing
 - Trustees of critical and declining plans will need to wait and see

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QUESTIONS?

Register for the next webinar in this series:
March 22, 2017

<https://morganlewisevents.webex.com>

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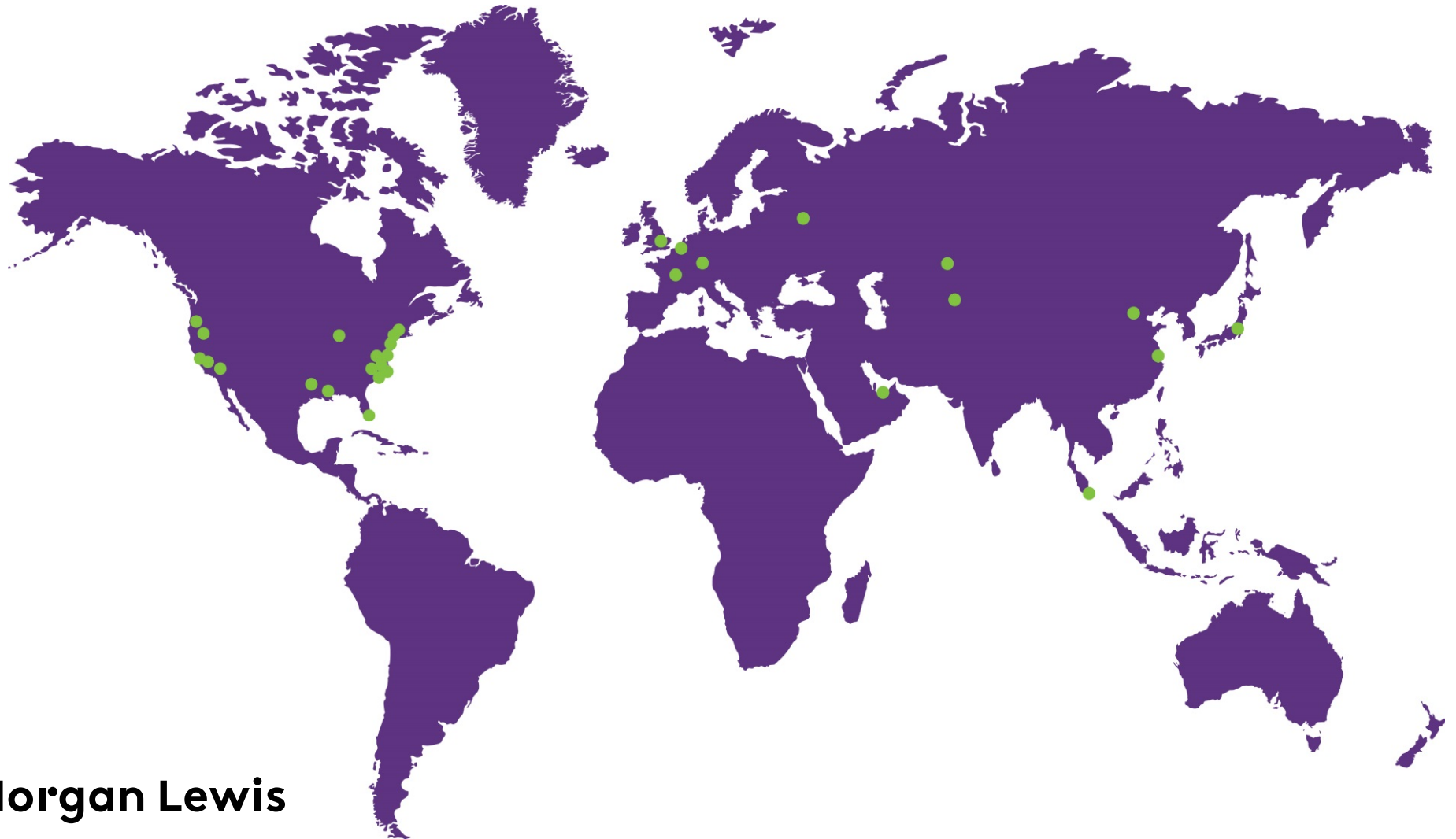
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