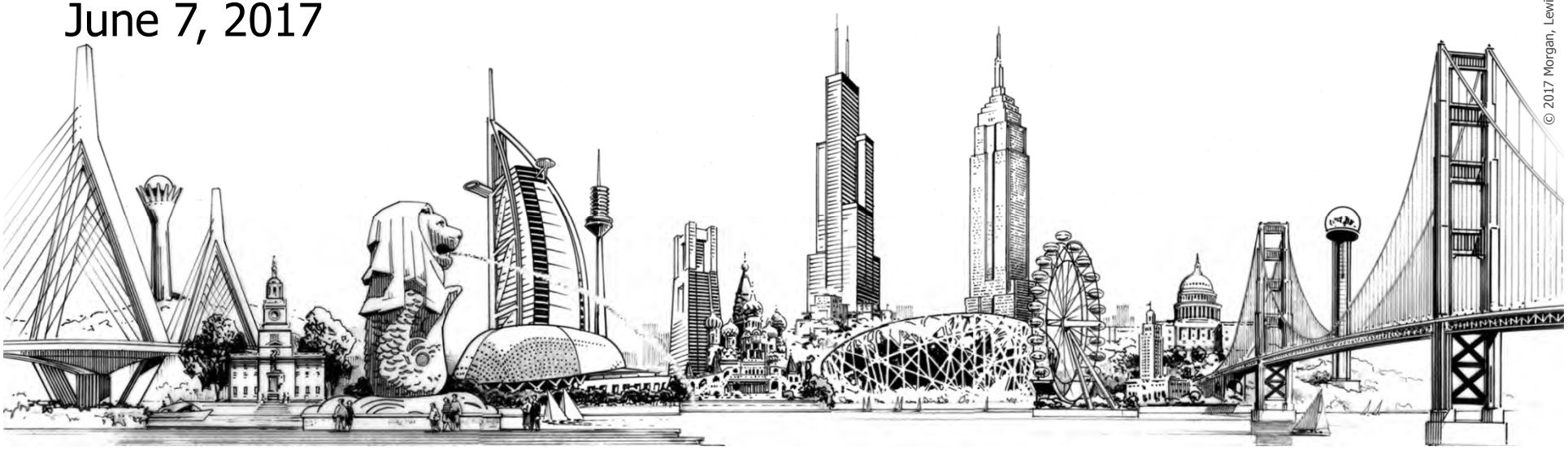
Morgan Lewis

# HOT TOPICS IN EMPLOYEE BENEFITS: WHAT WE'RE SEEING

Presenters: Julie Stapel (moderator and presenter), Brian Dougherty, Andy Anderson, and Brian Hector

June 7, 2017



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# Agenda

- Health and Welfare
- Plan Sponsor Considerations
- Employee Stock Ownership Plans (ESOPs)
- Fiduciary Considerations

PRESENTER: ANDY ANDERSON

# HEALTH AND WELFARE

# REPEAL AND REPLACE: ACA FOR AHCA

# Repeal and Replace

- American Health Care Act of 2017 (AHCA)
  - Passed by full House on May 4 (with one vote to spare)
    - Expect consolidated bill language and Committee Report
      - Difficult to track changes on top of changes on top of changes
  - In the Senate
    - Inevitable revisions, if not total replacement
      - Politics harder, margins narrower in Senate
      - CBO score available now; does not significantly move needle
      - Could die in Senate
    - Senate back from recess this week
      - Draft language to circulate soon
      - Some Senators believe the bill will be ready by July
      - Other Senators are pessimistic and predict that there will not be a bill until 2018

# Repeal and Replace

- Watch for:
  - Possible modifications to tax-free employer health coverage
  - Modifications to proposed tax credits
  - Glide path for ACA Medicare expansion
  - Fate of Cadillac Tax

# Repeal and Replace—House Bill

- What Affordable Care Act (ACA) provisions stay?
- Could only address ACA provisions that have a federal budget impact
  - Federal and state based Exchanges (ACA reporting)
  - Preventive care services with no cost sharing
  - Dependent coverage to age 26
  - Appeals and external review standards
  - Provider nondiscrimination rules
  - Prohibition of lifetime and annual dollar limits
  - Essential health benefits standards (subject to state waivers)
  - Prohibition on pre-existing condition exclusions

# Repeal and Replace—House Bill

- What ACA provisions stay?
  - Requirement for all plans to apply in-network level of cost sharing for out-of network emergency services is not changed
  - SBCs
  - Wellness incentives permitted under ACA

# 2017 Planning—Increasingly Unlikley

- House AHCA language would permit employers to:
  - Consider increasing HFSA contributions, due to 2017 repeal of cap
    - May require guidance from IRS due to cafeteria plan rules
    - Maybe mini-enrollment for expenses incurred for the balance of 2017?
  - Expand permissible HRA/HFSA reimbursements to include over-the-counter drugs?
    - Likely retroactively effective back to start of 2017

# 2018 Open Enrollment Planning

- Prepare for repeal of employer and individual mandates:
  - Change eligibility rules back to "traditional" full-time definition?
  - Drop "least expensive" plan and/or abandon affordability-based premiums?
  - Abandon PEO contracting efforts focused on employer mandate?
- Communicate broader HRA/HFSA rules (if not done in 2017):
  - Eliminate HFSA contribution limits
  - Recognize use of HRA/HFSA for over-the-counter
- Communicate higher HSA contribution limits
- Abandon EGWP and go back to traditional Retiree Part D subsidy (since it will again be deductible)?
- Begin to think about, in 2020, whether some workers are "better off" under House tax credit and do not offer them employer group health coverage?
- Will Medicaid changes impact your population?

PRESENTER: BRIAN DOUGHERTY

# PLAN SPONSOR CONSIDERATIONS

# Qualified Plan Opinion Program (QPOP)

- IRS discontinued its five-year cycle tax-qualification determination letter program
  - Determination letters only available to new and terminating individually designed plans
- Determination letter assurances, for tax-qualification purposes, are needed
  - Credit transactions
  - Corporate acquisitions and divestitures
  - Participant bankruptcies
  - Certain investment vehicles
  - Annual audits

# Qualified Plan Opinion Program (QPOP)

- About QPOP
  - Morgan Lewis will offer opinions as to whether individually designed plans satisfy tax qualification requirements
  - Review plan documents, amendments, and other related documents provided to determine IRS qualification requirements as to the form of the plan
  - Provide a report identifying any plan amendments that are needed to comply with tax qualification requirements
  - Opinion letter will not cover operational compliance, demographic issues, or independent review of the sponsor's controlled group structure
- QPOP reviews can be provided on an ad hoc basis, annually, or at such other intervals that meet the client's needs

PRESENTER: BRIAN HECTOR

# EMPLOYEE STOCK OWNERSHIP PLANS (ESOPS)

# *Brundle v. Wilmington Trust*

## Background

- *Brundle v. Wilmington Trust*, N.A, No. 15-cv-1494 (E.D. Va Mar. 13, 2017)
- Plaintiff, a former employee of Constellis Group, Inc. and former participant in its ESOP, brought a lawsuit against defendant trustee alleging a prohibited transaction rather than mere breach of fiduciary duty, forcing defendant trustee to argue on basis that adequate consideration standard was met
- ESOP purchased 100% of company stock in December 2013 for $201M. Company sold to competitor six months later
- Plaintiff alleged that Wilmington, the transactional ESOP trustee, overpaid for the shares of employer stock and improperly received fees in violation of Section 406(b)(2) of the Employee Retirement Income Security Act (ERISA)
- Court denied cross motions for summary judgment in November 2016

# *Brundle v. Wilmington Trust*

## District Court Decision

- Trustee did not violate Section 406(b)(2) or (3) (did not act on behalf of adverse party, fees were reasonable), but violated Section 406(a) by approving ESOP purchase for more than fair market value
- Court believed Trustee failed to:
  - adequately consider pre transaction valuation report prepared back in 2013;
  - probe its appraiser's reliance on company projections;
  - investigate the appropriateness of the valuation report's control premium;
  - probe its appraiser's decision to round up certain estimates in its report; and
  - take an appropriate amount of time in its determination of value

# *Brundle v. Wilmington Trust*

## Damages

- Despite "no evidence . . . . [t]hat the participants in this ESOP have actually suffered a loss," the court estimated damages as the amount the ESOP allegedly overpaid
- Court found $29.7M in total damages (plaintiff's expert estimated over $100M), calculated as follows:
  - Acceptance of company projections: $4.3M
  - Beta: The court found that the damages caused by the valuation firm's use of a lower industry risk (beta) in its analysis resulted in $2.9M in damages since the company was riskier than most companies in the industry

# *Brundle v. Wilmington Trust*

## Damages

- 10% control premium, lack of control discount: $17.9M
  - Court believed ESOP did not obtain sufficient control post-transaction
- SARs: $1.6M
  - Court believed stock appreciation rights plans should have been accounted for in valuation
- Rounding: $3M
  - Court accepted plaintiff's expert's analysis that appraiser's practice of rounding up certain estimated values resulted in overpayment

# *Brundle v. Wilmington Trust*

## Caution

- This case underscores the increasingly highlighted importance of ESOP trustees taking time to properly vet their retained financial advisor's valuation, with particular emphasis on scrutinizing company-provided projections and assumptions
- This case further underscores the importance of "process" – ESOP trustees need to document each step and decision of their valuation determinations, and should hold meaningful and well-attended trustee committee meetings during the course of the ESOP transaction

PRESENTER: JULIE STAPEL

# FIDUCIARY CONSIDERATIONS

# Update on Status of the Fiduciary Rule

- After years and years of ups and downs, we find ourselves on the eve of the applicability of the fiduciary rule (or just shy of 60 hours away).
- Brief Background
  - The Department of Labor (DOL) has revised a 33-year-old regulation defining when a person is considered a fiduciary when providing investment advice.
  - The overall effect of the rule will be to broaden the investment advice that is considered fiduciary and the parties who will be considered fiduciaries.
  - There have been many twists and turns in the path to the rule's applicability, including as a result of the new administration.
  - The rule became final on June 6, 2016 and was slated to become "applicable" on April 10, 2017. That date was delayed 60 days until June 9, 2017.
  - Two new prohibited transaction exemptions were adopted along with the rule—one called the Best Interest Contract Exemption and one called the Principal Transaction Exemption. Several provisions of these exemptions do not become applicable until January 1, 2018.

# Update on Status of the Fiduciary Rule

- Most Recent Developments
  - On April 7, 2017, the DOL issued a notice delaying the applicability date by 60 days (until June 9, 2017).
    - Notice was issued the last business day before the originally proposed applicability date (nothing like a little suspense . . .)
    - Loosened some of the exemption conditions
    - But "impartial conduct standards" become applicable on June 9
  - On April 27, 2017, Alexander Acosta was appointed as the Secretary of Labor.
  - On May 22, 2017, Secretary Acosta wrote an op-ed in *The Wall Street Journal* confirming that the June 9 applicability date would not be changed.
    - "Respect for the rule of law leads us to the conclusion that the date cannot be postponed."
    - The DOL will continue to examine the rule and how to revise it—with the SEC as a full participant in the process.

# Update on Status of the Fiduciary Rule

- Most Recent Developments
  - On the same day (May 22, 2017), the DOL issued Frequently Asked Questions (FAQs) regarding the transition period between June 9, 2017 and January 1, 2018.
    - The DOL intends to issue a Request for Information for "additional public input on specific ideas for possible new exemptions or regulatory changes based on recent public comments and market developments."
      - Specifically mentioned further consideration of "clean shares"
      - Possibility of streamlined requirements for certain types of products
    - The DOL recognizes that implementing the rule is not so easy and that the various market participants may need more time to comply with the rule.
    - The DOL reiterated that there will be no regulatory enforcement until at least January 1, 2018 for those working diligently and in good faith to comply.
    - The DOL clarified that the rule becomes applicable at 11:59 p.m. on Friday, June 9, 2017 to facilitate new compliance systems over the weekend.

# Update on Status of the Fiduciary Rule

- What's next?
  - Financial service provider clients are preparing for compliance (or at least diligent and good faith efforts to comply) by June 9.
  - Plan sponsor clients should confirm how participant-facing service providers intend to comply with the rule.
    - Advice v. education
    - Rollovers
  - Plan sponsors are also receiving various types of communications about the so-called "independent fiduciary exclusion."
    - Special rule for communications to sophisticated fiduciaries independent of the party providing the communication
    - Requires party providing the communication to confirm that certain conditions are met
    - Plan sponsors may be asked to make affirmative representations or deemed representations via "negative consent"
    - Take care that the representations don't go too far
  - As always, stay tuned. This isn't over.

# Latest Developments in *Tatum v. RJR* "Stock Rise" Litigation

- On April 28, 2017, the United States Court of Appeals for the Fourth Circuit ruled for the plan fiduciaries in the ongoing *Tatum v. RJR* litigation.
- Sometimes referred to as "stock rise" litigation (in contrast to the more common "stock drop" litigation) because the plaintiffs allege that the fiduciaries breached their duties by eliminating a stock fund before prices went up (in contrast to not eliminating a stock a fund before prices went down).
- The RJR fiduciaries liquidated and terminated a Nabisco stock fund (the RJR plan had a Nabisco stock fund as a result of the earlier RJR/Nabisco spin-off transaction) at a time when Nabisco stock was at historic lows. Shortly after the fund was wound up, Nabisco stock rebounded to historic highs.
- At the trial court level, the district court held that the RJR fiduciaries had successfully shown that a "hypothetical prudent fiduciary *could* have made the same decision" (even though the district court found the process of deciding to divest and the timing for divestiture to have been imprudent).

# Latest Developments in *Tatum v. RJR* "Stock Rise" Litigation

- The case went up to the Fourth Circuit for the first time and the court sent it back because it found that the district court applied the wrong standard—it should have asked if a hypothetical prudent fiduciary *would* have made the same decision.
- The District Court came to the same conclusion, even applying the "would" standard.
- And back the case went to the Fourth Circuit, where it affirmed the district court that a hypothetical prudent fiduciary would have made the same decision.
- Analysis focused on the "efficient market theory," i.e., that market price reflects all public information about a stock.
  - Plaintiffs argued that fiduciaries should have known the Nabisco stock was going to rise.
  - Courts rejected that, holding that fiduciaries have to use available evidence.
  - Citing *Fifth Third*, "a fiduciary cannot be required to predict the future."
- There was a strenuous dissent, so there is a possibility for rehearing *en banc* or petition to the US Supreme Court.

# Latest Developments in *Tatum v. RJR* "Stock Rise" Litigation

- Key Takeaways
  - Should be a very helpful opinion for plan fiduciaries because it seems to relieve fiduciaries of any obligation to make the right prediction about the direction of a stock price.
  - May cause some plan sponsors to reconsider company stock funds.
    - This had felt like a case of "damned if you do, damned if you don't" because participants could sue if the fiduciaries kept the stock fund and they also could sue if the fiduciaries terminated the stock fund.
    - Absent a rehearing or Supreme Court petition, however, this is a pretty strong "win" for plan fiduciaries, so perhaps fiduciaries will feel more comfortable, especially given the reliance on the efficient market hypothesis.

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Leader of Morgan Lewis's health and welfare task force, Andy R. Anderson is often recognized for his work in counseling clients on employer, individual, and insurer issues created by the Affordable Care Act, and regulatory compliance issues in relation to the Internal Revenue Code, ERISA, COBRA, HIPAA, and Mental Health Parity. Tax-exempt organizations and Fortune 500 companies turn to Andy for handling their benefit plans,  and legal review surrounding welfare benefit plans, government self-correction programs, cafeteria plans, and VEBAs.

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Brian J. Dougherty counsels and represents clients in a range of employee benefits and ERISA-related matters. Co-leader of the firm's Plan Sponsor Task Force, he addresses complex legal issues related to benefit plan design, administration, compliance, and litigation, as well as executive compensation matters, including equity compensation, nonqualified arrangements, and employment agreements. Brian represents large and medium-sized enterprises operating in for-profit and tax-exempt industries.

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Brian D. Hector counsels clients on Employee Retirement Income Security Act (ERISA) and employee benefits issues, including employee stock ownership plans (ESOPs), qualified benefits plans, executive compensation, fiduciary liability, and related securities matters. As head of Morgan Lewis's ESOP Task Force, he advises public and private ESOP clients on corporate governance, succession planning strategies, ownership transition issues, and liquidity transactions. He also represents enterprises before the US Internal Revenue Service (IRS) and Department of Labor (DOL) in a range of ESOP and employee benefits matters.

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Julie K. Stapel helps employee benefit plan sponsors and financial service providers with the investment, and management of employee benefit plan assets. She advises clients on ERISA fiduciary and prohibited transaction rules, and their impact on investment products and services, and helps those clients use investment documentation and other tools to manage potential fiduciary risks while providing top-quality benefits and services. She also works with plan sponsors and financial service providers to address ERISA–related compliance issues.

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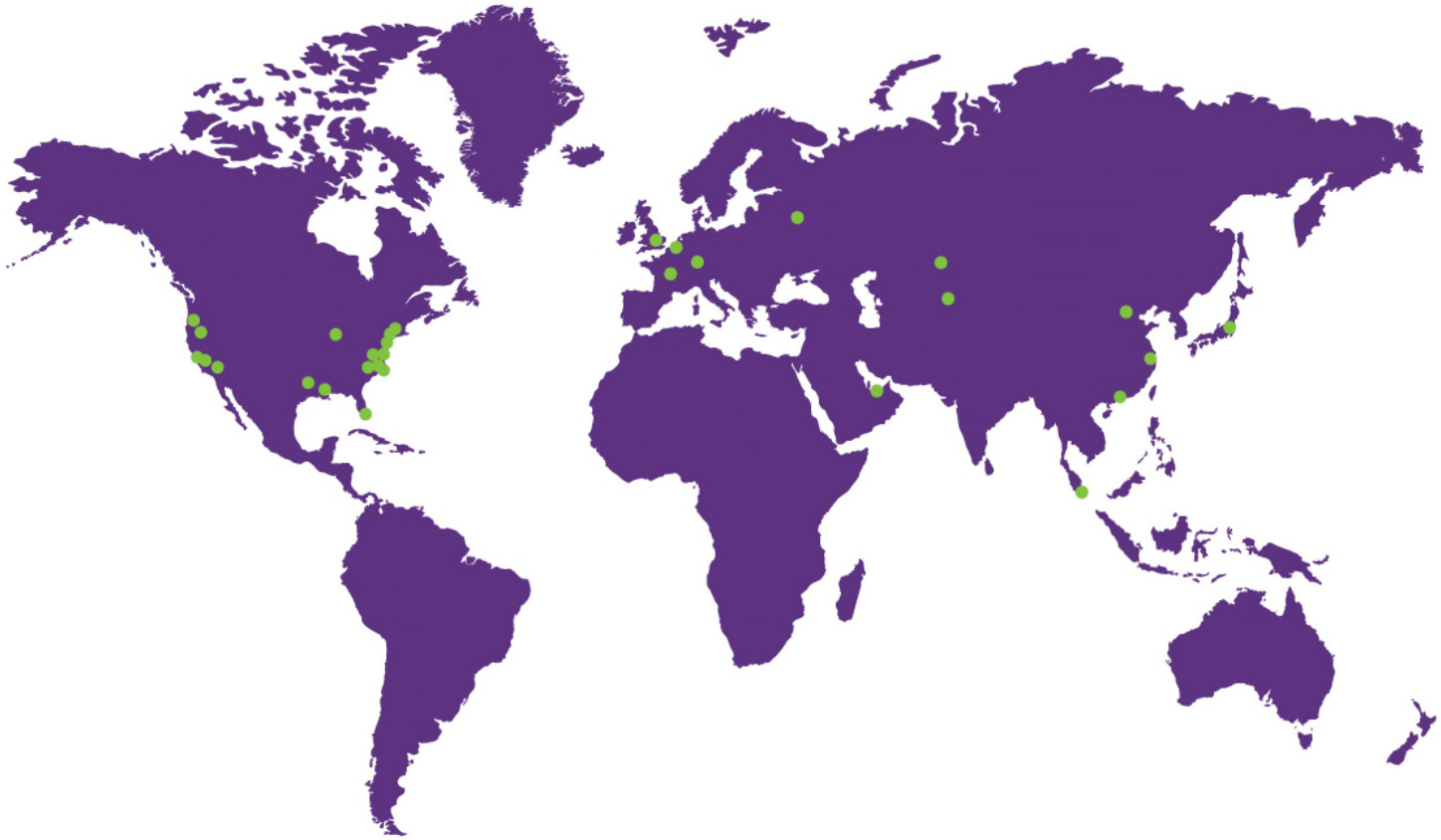

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