

Morgan Lewis

Hot Topics in Employee Benefits
– What We're Seeing

**ERISA at 40: Successful
Middle Age or Midlife Crisis?**

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Agenda

- A Brief Look at ERISA's Achievements and Midlife Challenges
- Challenges to Retirement Plans
- Plan Investments
- The Future of Employer Stock in Qualified Plans Post-*Dudenhoeffer*
- Multiemployer Plans
- Effect of ERISA on Health and Welfare Plans
- “Qualified” Nonqualified Plans—A Look at Nonqualified Plans in the ERISA Era
- Questions

A Brief Look at ERISA's Achievements and Midlife Challenges

Presenter: Robert Abramowitz

Brief Overview

Major Accomplishments of ERISA

- Benefit Security
 - Funding
 - Vesting
 - Fiduciary protections
 - Clearer rules
- Tax-Advantaged Vehicles for Retirement Savings
 - 401(k) and 403(b) plans; Individual Retirement Accounts (IRAs)

Current Challenges

- Decline of defined benefit (DB) plans
- PBGC funding
- Slow and costly resolution of “grey” areas – e.g., fiduciary rules for employer stock, definition of church plan

Challenges on the Horizon

- Adequacy of retirement income
- Security of retirement income

Challenges to Retirement Plans

Presenter: Lisa Barton

Challenges to Retirement Plans

- Demise of defined benefit plans
 - Higher compensation and benefits costs
 - Transient nature of workforce
 - *Loss of “long-term incentive”*
 - Perception that “portability” is preferred
 - Stock market decline and funding requirements
 - *Soaring stock market in 1980s helped to ease transition to defined contribution (DC) plans*

Challenges to Retirement Plans

- Issues for 401(k) plans
 - Shift to worker-funded retirement
 - Participant investment management and responsibility
 - Leakage from retirement savings
 - *Loans and withdrawals*
 - Impact of fees on retirement benefits

Challenges for Retirement Plans

- Internal Revenue Service and Department of Labor Correction Programs
 - IRS “Employee Plans Compliance Resolution System”
 - DOL Voluntary Fiduciary Correction Program
- Expectation to identify and correct failures
 - Evolution of compliance programs
- Increased focus on compliance by agencies
 - Impact of corrective actions (or lack thereof) during audits

Plan Investments

Presenter: Julie Stapel

Plan Investments—What Would Surprise ERISA Drafters?

- Sophistication, institutionalization of plan investments, including alternative investments
 - Can take a while for regulations, exemptions to catch up to investment practices
- Globalization of plan investments
 - Section 404(b) can be vexing
- Change in role of DC plans and changes in DC plan investments
 - Growing dominance of DC plans has required a change in thinking about investments
- Technological changes in trading, investing, and plan administration
 - Daily valuation (and so much more) for DC plans
 - New financial instruments, exchanges etc.

Plan Investments—What Will We Talk About 40 Years from Now?

- Even more changes to defined contribution investments as nearly all private sector American workers will be relying exclusively on DC plans
 - Move toward greater institutionalization, such as use of collective funds and separately managed accounts
 - Innovation in investment vehicles and structures (such as target date funds)
 - Assumes there still is a defined contribution system
- Retirement income strategies, especially as life spans continue to increase
 - “Back to the future” as many DC plans eliminated retirement income options previously
- Huge growth in the IRA assets

The Future of Employer Stock in Qualified Plans *Post-Dudenhoeffer*

Presenters: John Ferreira, Azeez Hayne, Brian Hector

ERISA Stock Cases – Claims of Imprudence

- Often accompany securities fraud claims
- Artificial inflation
 - Claim that stock price was artificially inflated because adverse information was concealed from participants and market, and stock price tanked when the truth was revealed.
- Significant downturn/decline in stock value
 - E.g., industry downturn, failed business model, collapse or near collapse of company (and stock price)
- ERISA misrepresentation claims often brought at the same time

Statutory Backdrop

- ERISA treats employer stock in “eligible individual account plans” (EIAPs) differently from other investments.
- Section 404(a)(2): EIAPs are exempt from duty to diversify and duty of prudence to the extent it requires diversification.

Statutory Backdrop

- Section 407(b)(1): EIAPs are exempt from “10% limit” that otherwise applies to investments in employer stock.
- Pre-*Dudenhoeffer*: the *Moench* prudence presumption.

Fifth Third Bancorp v. Dudenhoeffer

- Former participants challenged prudence of the company stock fund (CSF) because stock price declined during relevant period due to alleged participation in subprime lending.
- District court applied prudence presumption in dismissing the complaint.
- Sixth Circuit reversed, ruling presumption should not apply at the pleadings stage.

Fifth Third Bancorp v. Dudenhoeffer

- Court also found that plaintiffs had alleged a misrepresentation claim because the summary plan description (SPD) adopted SEC filings that were alleged to be misleading.
- Court found that the decision to incorporate by reference SEC filings into the SPD was a fiduciary decision.

Supreme Court's *Dudenhoeffer* Decision

- No presumption of prudence for stock funds:
 - “In our view, the law does not create a special presumption favoring ESOP fiduciaries. Rather, the same standard of prudence applies to all ERISA fiduciaries, including ESOP fiduciaries, except that an ESOP fiduciary is under no duty to diversify the ESOP’s holdings.”
- No hardwiring:
 - “[T]he duty of prudence trumps the instructions of a plan document, such as an instruction to invest exclusively in employer stock even if financial goals demand the contrary.”

Supreme Court's *Dudenhoeffer* Decision

- No duty to second-guess the market price when the stock is traded in an efficient market.
 - Absent “special circumstances” a plaintiff cannot state a prudence claim based on public information alone.
- No duty to violate securities laws, e.g., by selling stock based on alleged inside information.

Supreme Court's *Dudenhoeffer* Decision

- There may be a duty to disclose or cease making new purchases based on alleged inside information.
 - In ruling on a motion to dismiss, courts must determine whether fiduciary reasonably could have believed disclosures or ceasing purchases would have done more harm than good.

Actions Sponsors Have Considered

- Remove/freeze CSF
 - Can be replaced with other vehicles for employee stock ownership that carry less risk (e.g., an ESPP)
- Hire an independent fiduciary to make CSF-related decisions
- Reevaluate plan and investment policy statement (IPS) language related to investment in company stock

ESOPs

- Tax Reform Act of 1984 allowed tax-free rollover treatment for C corporations
- The emergence of the S corp ESOP in 1998
- Increase in Department of Labor investigations and ESOP litigation
- Recent settlements result in DOL requiring more in-depth procedural prudence for fiduciaries

Multiemployer Plans

Presenter: Althea Day

Multiemployer Plans

- Regulatory structure predates ERISA
 - Taft-Hartley Act (Labor Management Relations Act of 1947)
 - *To address abuse of pension funds*
 - Corruption
 - Big unions – too big
 - Welfare and Pension Disclosure Act
 - *Reporting and disclosure requirements*
 - Foreshadow ERISA requirements

Multiemployer Plans

- ERISA – 1974
 - Further refined pension protections
 - *New reporting and disclosure rules*
 - *Minimum funding requirements*
 - *Minimum participation and vesting requirements*
 - *Fiduciary rules to prevent abuse of pension assets*
 - *Civil enforcement through DOL, participants, and beneficiaries*
 - Multiemployer Pension Plan Amendments Act of 1980 (MPPAA)
 - *Created multiemployer guaranty fund of the PBGC*

Multiemployer Plans

- What went wrong?
 - Pensions terrifically underfunded
 - *PPA addressed issues, but not fast enough*
 - 2008
 - Low interest rates
 - Unionized employers facing stiff nonunion competition without legacy costs
 - *Using defined contribution plans not pensions*
 - Health funds
 - *Challenged by Affordable Care Act requirements*

Effect of ERISA on Health and Welfare Plans

Presenter: Andy Anderson

Effect of ERISA on Health and Welfare Plans

- Almost, at enactment, an afterthought:
 - Reporting
 - Disclosure
 - Bonding
 - No participation, vesting, funding, etc.
- As with the rest, voluntary
- Then began the drumbeat of additions to the still-voluntary H&W benefits:

Effect of ERISA on Health and Welfare Plans

- COBRA
- MEWAs
- HIPAA
 - *Preexisting condition exclusions*
 - *Special enrollment*
 - *Nondiscrimination*
 - *Privacy*
- Newborns' and Mothers' Health Protection Act
- Mental Health Parity Act

Effect of ERISA on Health and Welfare Plans

- Women's Health and Cancer Rights Act
- Michelle's Law
- FMLA
- USERRA
- Adopted children
- Pediatric vaccines
- QMCSOs
- GINA

Effect of ERISA on Health and Welfare Plans

- Then, everything changed:
 - **The Affordable Care Act**
 - *Key provision: Shared Responsibility Excise Tax*
 - Technically part of the Internal Revenue Code
 - Practically, an “Offer You Cannot Refuse”
 - *Ancillary provisions:*
 - Adult children rules through preexisting condition exclusion to repeal of annual or lifetime limits for essential health benefits
- Would ERISA drafters have anticipated that, alone among other benefits, health benefits are now mandatory?

“Qualified” Nonqualified Plans—A Look at Nonqualified Plans in the ERISA Era

Presenter: Daniel Hogans

Evolution of Nonqualified Deferred Compensation Under ERISA

- Impact of the “top-hat” plan exception
- Exemption from funding, fiduciary, and vesting requirements
- Challenges in identifying a “select group of management or highly compensated” employees
- Continuing uncertainty and litigation pressure points for top-hat plans
- Effects of benefit limits on qualified retirement plans under the Internal Revenue Code

Evolution of Nonqualified Deferred Compensation Under ERISA

- Impact of Section 132 of the Revenue Act of 1978 and the creeping expansion of nonqualified deferred compensation plans
- Effects of benefit limits on qualified retirement plans under the Internal Revenue Code
- Increases in compensation complexity and performance-based arrangements
- “Qualification” of deferred compensation plans under Internal Revenue Code Section 409A

Questions?

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