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2010 Year-End Action Items for Employee Plans

Service

Employee Benefits & Executive Compensation

Employers should be aware of some important year-end action items relating to health and welfare plans, qualified retirement plans, and non-qualified deferred and executive compensation. Several notification obligations require immediate attention to satisfy deadlines on or before December 1, 2010. Other items involve plan amendments that must be adopted on or before December 31, 2010.

Click here for action items relating to health and welfare plans.

Click here for action items relating to qualified retirement plans.

Click here for action items relating to non-qualified deferred and executive compensation.

I. Health and Welfare Plans

HEALTHCARE REFORM

The Patient Protection and Affordable Care Act (the ACA) and the Health Care and Education Reconciliation Act of 2010 contain a number of changes that will go into effect beginning January 1, 2011 for calendar year plans. Several of the changes require notification of employees during 2010. These changes include the following:

Grandfathered Status. Plan sponsors that have decided to maintain grandfathered status must provide participants with a statement that the plan intends to preserve the basic health coverage that was in effect on March 23, 2010, and that some of the consumer protections of the ACA may not apply. The Department of Health and Human Services (HHS) has issued a model notice to satisfy this requirement. In addition, to maintain status as a grandfathered plan, the plan sponsor must retain records of the plan terms in

existence on March 23, 2010, including plan documents, insurance policies, summary plan descriptions, and other cost-sharing documentation.

> **Action Item**: Plan sponsors choosing to maintain grandfathered status must retain records and issue the required notice to participants.

Dependents. Group health plans must cover children of employees through age 26 and cannot condition coverage on any factor other than familial relationship with the employee. Grandfathered group health plans may limit this extension of coverage to children who are not eligible for other employer coverage from their own or a spouse's employer. Plans may voluntarily offer to extend coverage earlier than legally required and may provide coverage through the end of the year in which the child reaches age 26, without causing adverse tax consequences.

> **Action Item**: If applicable, plan sponsors must implement the extended coverage to dependent children through age 26, amend plans to reflect their decisions, and communicate changes to participants.

Plan Exclusions and Rescission. Under the ACA, neither grandfathered nor non-grandfathered group health plans are permitted to impose a pre-existing condition limitation on children under age 19. Also, plans other than health flexible spending arrangements may not impose annual or lifetime limits on "essential health benefits" or retroactively terminate coverage, except in the case of fraud or an intentional misrepresentation of a material fact.

> **Action Item**: Plan sponsors must implement these new requirements, amend plans to reflect the changes, and communicate them to participants.

Special Enrollment Rights. Group health plans must provide special enrollment rights for children who have previously aged out, or were otherwise excluded before age 26 due to factors that previously rendered them ineligible, such as financial dependency, marriage or student status, but who are now eligible for coverage. Notice of the special enrollment right is mandatory and must take place at least 30 days before the first day of the first plan year beginning on or after September 23, 2010. Notice may take place during open enrollment if that period satisfies the timing requirement and must be made available in a similar manner for participants or their dependents now eligible for coverage because of the elimination of lifetime limits. HHS has issued model notices to help plan sponsors comply with these requirements.

> **Action Item**: Plan sponsors must act now to notify participants and allow for enrollment due to special enrollment rights.

Retiree-Only Health Plans. The ACA applies to health plans with at least two current employees. Some of the ACA's requirements, such as the prohibition against annual or lifetime limits on

"essential health benefits," could drastically change the plan design and undermine the underwriting assumptions of the portion of an employer's health plan that covers retirees.

> **Action Item**: Plan sponsors providing retiree coverage should consider splitting off the retiree-only portion of the plan into a separate plan by December 31, 2010. In addition, plan sponsors should consider amending wrap plans to exclude retiree-only plans.

Claims Review Procedures. Plan sponsors of group health plans that are not grandfathered are subject to new claims, appeals and external review procedures for plan years beginning on or after September 23, 2010.

> **Action Item**: These new procedures will require plan amendments, which must be communicated to participants. These new procedures may also require the group health plan to contract with independent external review providers.

CAFETERIA PLANS

Over-the-Counter Medications. Beginning January 1, 2011 (regardless of the plan year), expenses for over-the-counter drugs (other than insulin) cannot be reimbursed under a flexible spending account or health reimbursement account unless prescribed by a physician. Plans that currently allow for reimbursement of over-the-counter drugs must be reviewed to determine whether amendments are necessary.

> **Action Item**: Plan sponsors must act now to implement and communicate any changes to participants. Plan amendments must be adopted on or before June 30, 2011.

Dependents. The ACA allows flexible spending accounts and health reimbursement arrangements to offer tax-advantaged coverage and reimbursements for an employee's child who has not attained age 27 as of the end of the taxable year. Pursuant to IRS guidance, an employer may permit employees to make pre-tax salary reductions for such children in 2010, even if the cafeteria plan has not yet been amended to include such coverage, provided that a retroactive amendment is adopted by December 31, 2010. This is an exception to the general requirement that amendments to a cafeteria plan may apply only prospectively.

> **Action Item**: If an employer desires to allow reimbursements for medical expenses incurred in 2010 of children through age 26, the plan must be amended by December 31, 2010.

OTHER LEGISLATION

Mental Health Parity and Addiction Equity Act of 2008. This law, which applies to employers with more than 50 employees, extends the mental health parity laws to substance-use disorders in two ways. First, benefits for mental health and substance-use disorders must be in parity with

medical/surgical benefits with respect to both the application of aggregate lifetime and annual dollar limits. Second, plans may not have different financial requirements (e.g., deductibles, copayments, or coinsurance), treatment limitations (e.g., number of covered visits and days of inpatient coverage), or out-of-network coverage limitations for mental health and substance-use disorder benefits than for medical/surgical benefits.

> **Action Item**: Compliance with final regulations issued in 2010 is required for plan years beginning on or after July 1, 2010. Calendar year plans need to consider appropriate changes effective January 1, 2011.

HIPAA. The Health Information Technology for Economic and Clinical Health Act (HITECH) makes significant changes to the privacy and security requirements of HIPAA. HITECH is generally effective February 17, 2010 and includes the following requirements and restrictions. First, HITECH directly expands privacy and security rules to business associates and their subcontractors, which may require covered entities to revise their business associate agreements to comply with the changes. Second, both business associates and covered entities must comply with new security breach rules that require notification to the individual whose protected health information was compromised. Third, a covered entity generally must agree to an individual's request to restrict disclosures to a health plan, if the protected health information pertains solely to services for which the provider has been paid out of pocket in full. Fourth, HITECH imposes new restrictions on disclosures that prohibit the sale of protected health information and imposes restrictions on the use of protected health information for marketing purposes. Fifth, several changes in enforcement have taken place. Civil penalties have been substantially increased, state attorneys general now have enforcement power, and new regulations require the sharing of civil penalties with individuals.

> **Action Item**: HITECH was generally effective February 17, 2010, but because many changes are dependent upon proposed or pending regulations, document compliance with the HIPAA changes may need to wait until after regulations are issued. However, sponsors should immediately review new securities breach notification rules, and prepare to revise existing privacy policies and notices of privacy practices within 180 days after the effective date of the new rules. Business associate agreements must be revised to reflect the changes within 240 days plus one year after the final rules are published. For group health plans, if not already done, HIPAA privacy policies and business associate agreements should be amended now.

Children's Health Insurance Program Reauthorization Act (CHIPRA). CHIPRA required group health plans to allow new special enrollment opportunities for employees and their dependent children who either lose coverage under Medicaid or a state child health assistance program, or who become eligible for premium payment assistance under such a program. CHIPRA also requires group health plans to provide employees with certain information regarding Medicaid and state health

assistance programs, and to cooperate with government requests for certain plan information. The law required plan amendments to be in place by April 1, 2010 and plan sponsors to provide annual notice to plan participants. The Department of Labor has issued a model notice to help plan sponsors comply.

> **Action Item**: If not already in place, plan sponsors must provide the required notice to employees beginning the next plan year, January 1, 2011, for calendar year plans.

Medicare Secondary Payer: Beginning in April 2009, Centers for Medicare & Medicaid Services (CMS) began requiring group health plans to share certain data with CMS on an ongoing basis. The reporting burden generally falls on insurance companies and third-party administrators, but plan administrators and fiduciaries of self-insured plans that do not use a third-party administrator must self-report. Most of the reporting deadlines have expired, but an important deadline remains: no later than the first filing of 2011, reporting entities must file information on spouses and other family members of active participants whose initial date of coverage was prior to January 1, 2009.

> **Action Item**: Coordinate with your third-party administrator to confirm that they will make this filing.

II. Changes to Qualified Retirement Plans

HEART Act Amendments. Generally, all tax qualified plans, both defined contribution and defined benefit, must be amended to comply with the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act), on or before December 31, 2010, for calendar year plans. The amendment deadline for governmental plans is the last day of the first plan year beginning in 2012 (i.e., December 31, 2012, for calendar year plans). The two mandatory HEART Act amendments apply to survivor death benefits and differential wage payments. A survivor of a participant who died while performing qualified military service during or after 2007 must receive the same plan benefits, including death benefits, that would be due if the participant had resumed employment with the employer and died the following day, including continuous vesting credit during military leave. Differential wage payments must be included as compensation for purposes of calculating limitations on maximum benefits.

> **Action Item**: Adopt corresponding plan amendments to comply with these requirements by December 31, 2010 for calendar year non-governmental plans.

Plan Restatements and Determination Letters for Cycle E Filers. Under IRS procedures, each individually designed qualified plan maintained by an employer with an employer federal tax ID number ending in five or zero must be restated by January 31, 2011. The deadline for requesting a determination letter with respect to a restated plan also is January 31, 2011. In addition, a Cycle D

filer whose first plan year begins on or after January 1, 2009 and ends on or after February 1, 2010 or a single-employer governmental plan that made an election to file in Cycle E also has a deadline of January 31, 2011.

> **Action Item**: Contact us immediately if you would like our assistance with Cycle E restatements or filings.

Roth Conversions. Recent changes permitting in-plan Roth conversions for 401(k) and 403(b) plans that allow Roth contributions became effective on September 27, 2010. However, the absence of IRS guidance has left many open questions regarding how to implement, administer and report such conversions. Plan sponsors that wish to implement in-plan Roth conversions in 2010 prior to IRS guidance must take certain steps, operationally and otherwise, to ensure that conversions are properly implemented. Click here to read our alert on in-plan Roth conversions for more details.

> **Action Item**: Contact us immediately if you would like our assistance implementing in-plan Roth conversions in 2010. Board resolutions enabling the conversions, participant communications, amendments to distribution forms and 1099-R issues must be addressed prior to implementation.

Funding-Based Restrictions on Defined Benefit Plans. The Pension Protection Act of 2006 (PPA) amended the Internal Revenue Code and ERISA to impose funding-based restrictions on benefit payments and limit certain plan amendments if the funding of a non-governmental defined benefit pension plan falls below a certain level. Last December, the IRS extended the deadline to amend defined benefit plans to comply with this change until the last day of the 2010 plan year.

> **Action Item**: Calendar year defined benefit plans that have not yet been amended to incorporate these funding-based restrictions should be amended by December 31, 2010.

Non-Spouse Beneficiary Rollover. The PPA generally allowed non-spouse beneficiaries who receive death benefits to roll over their plan distributions to an individual retirement account or Roth IRA. The Worker, Retiree and Employer Recovery Act of 2008 (WRERA) made the non-spouse beneficiary rollover provision mandatory for plan years beginning after December 31, 2009.

> **Action Item**: Plans that have not yet been amended to provide for non-spousal rollovers should be amended by December 31, 2010.

Cash Balance and Other Hybrid Plans. Cash balance and other hybrid plans must provide, among other things, the following: (1) three-year cliff vesting; (2) an interest crediting rate that does not exceed a market rate of return; and (3) no reduction or cessation of benefit accruals based solely on a participant's age. Final regulations on hybrid plans were released October 18, 2010, and are effective for plan years beginning on or after January 1, 2011.

> **Action Item**: Amendments to incorporate these requirements are required by the last day of the first plan year beginning on or after January 1, 2010 (December 31, 2010 for calendar year plans).

Diversification Requirements for Employer Securities. For plan years beginning after December 31, 2006, two diversification requirements apply to defined contribution plans that are invested in publicly traded employer securities. First, all participants and beneficiaries must be permitted to diversify amounts attributable to employee contributions on at least a quarterly basis. Second, participants with at least three years of service must be permitted to diversify, at least quarterly, amounts attributable to employer contributions.

> **Action Item**: Amendments are required by the last day of the 2010 plan year (December 31, 2010 for calendar year plans).

Discretionary Amendments to Qualified Retirement Plans. Generally, discretionary amendments must be executed by the end of the plan year in which they are implemented (December 31 for calendar year plans). The IRS published on its website a list of recent guidance that may require discretionary amendments. In addition, discretionary design changes for 2011 that would result in a reduction of benefits may need to be adopted in 2010 to avoid a prohibited cutback of accrued benefits.

> **Action Item**: Amendments for discretionary changes implemented in 2010 must be prepared and adopted on or before December 31, 2010. Amendments for discretionary design changes in 2011 that would result in the reduction of benefits may need to be adopted before January 1, 2011.

Puerto Rico Dual-Qualified Plans. Revenue Ruling 2008-40 provides that an employer maintaining a qualified plan that is qualified under both the Internal Revenue Code and Section 1165 of the Puerto Rico Internal Revenue Code (a Dual-Qualified Plan) cannot transfer the assets and liabilities of the Dual-Qualified Plan to a Puerto Rico-only qualified plan on or after January 1, 2011, without triggering a taxable distribution to a participant in the Puerto Rico-only qualified plan. A transition rule excepts-out transfers prior to January 1, 2011, provided the transfer otherwise satisfies the Internal Revenue Code requirements for mergers, spinoffs and asset transfers.

> **Action Item**: Employers maintaining Dual-Qualified Plans may wish to consider transferring any assets of a Dual-Qualified Plan to a Puerto Rico-only plan or splitting their plans into separate United States-only and Puerto Rico-only qualified plans prior to January 1, 2011.

401(k) Safe Harbor Notices. Annual safe harbor notices must be provided to participants by December 1 of each year for calendar year plans.

Action Item: Notices must be provided to participants by December 1, 2010.

401(k) Automatic Enrollment Notices. Required annual notices for automatic enrollment arrangements must be provided to participants by December 1 of each year for calendar year plans.

Action Item: Notices must be provided to participants by December 1, 2010.

Qualified Default Investment Alternatives for Participant Directed Plans. Participant notices for plan sponsors who desire safe harbor relief from fiduciary liability for qualified default investment alternatives must be provided by December 1 of each year for calendar year plans.

Action Item: Notices must be provided to participants by December 1, 2010.

III. Non-Qualified Deferred and Executive Compensation

Correcting Document Failures for Non-Qualified Plan Subject to Section 409A. The IRS has adopted a limited corrections program for certain document failures with regard to non-qualified deferred compensation arrangements subject to 409A. If an eligible document failure is corrected according to certain specified procedures under the corrections program by December 31, 2010, it will be treated as if it was corrected as of December 31, 2008. As a result, correction can be effected without being subject to the penalties for violating 409A.

Action Item: Taking advantage of these corrections can minimize or eliminate the otherwise onerous penalties imposed on employees and other service providers by 409A. We recommend that all employers review any arrangements subject to 409A for document compliance prior to December 31, 2010.

Shareholder Approval Requirements. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) requires the vote of public company shareholders on nonbinding resolutions: (1) to approve executive compensation as disclosed in proxies (say on pay resolution); (2) to determine whether the say on pay resolution should occur every one, two or three years (vote frequency resolution); and (3) to approve compensation to named executive officers that is contingent on a change in control at the same shareholder meeting at which shareholders are asked to approve a change in control transaction. Proposed regulations that were issued by the Securities Exchange Commission on October 18, 2010 require the say on pay resolution and the vote frequency resolution to be put to a vote at the first shareholder meeting occurring after January 20, 2011.

Action Item: Public companies should consider how their 2011 compensation discussion and analysis and tabular disclosures should be presented to minimize issues that could trigger shareholder or proxy advisory firm concerns.

Contact Info

Please contact your Husch Blackwell attorney or a member of the Employee Benefits and Executive Compensation practice group if you have questions or if we can assist in any way.

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