



## 209 Benefits 101- A Primer on Employee Benefits Laws

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## Faculty Biographies

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### Tim Rogers

Timothy W. Rogers is a senior attorney in the employment law and benefits section of the law department of Southern California Edison Company (SCE) in Rosemead, California. As lead staff attorney for executive compensation, disability management, and other employee benefits matters, his responsibilities include providing legal counsel to the human resources department, senior management, and the company's compensation and employee benefits committees on a variety of issues relating to plan design and compliance, executive employment and severance agreements, and benefits claims.

Since beginning his career with the company as a law clerk, Mr. Rogers has practiced in a variety of areas including employment law and benefits, securities and corporate governance, election law and litigation.

Mr. Rogers is co-chair of ACC's Employment and Labor Law Committee and its ERISA subcommittee and he is a member of the Western Pension and Benefits Conference. He has served as training committee chair of the SCE law department and is currently on its pro bono committee. For the past two years, he has served on the supervisory committee of the board of the SCE Federal Credit Union.

He received a B.A. from California State L.A. and is a graduate of Loyola Law School.



### Session 209

## Benefits 101 - A Primer on Employee Benefits Law

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## Why Should I Care?

- **ERISA and Employee Benefits matters can come up in various ways:**
  - **Due diligence in mergers and acquisitions and/or financings**
  - **SEC reporting and disclosure**
  - **Litigation / either stand-alone or as part of other causes of action alleging discrimination or other wrongful acts**
  - **Employee Inquiries**
  - **Domestic Relations Orders, Garnishments, Bankruptcy Orders and Stays**
  - **State Wage Deduction Laws**
  - **Financial Exposure for Fiduciary Acts**
  - **Available Class Action Relief**

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## ERISA – History and Development

- Employee Retirement Income Security Act (ERISA) was signed into law September 1974 by President Ford
- Since 1974 a number of legislative acts have been passed amending its various terms
- Some of these acts, often referred to by acronym, are: Pension Protection Act of 2006 (PPA); Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA); Health Insurance Portability and Accountability Act of 1996 (HIPAA); Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA); and Retirement Equity Act of 1984 (REA)
- Other acts have significant, if indirect impact: Age Discrimination in Employment Act (ADEA); Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA); and Bankruptcy Abuse Protection and Consumer Protection Act of 2005

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- Although state law is largely preempted by ERISA, attempts at direct or indirect state regulation persist, often producing litigation challenges:
- e.g., mandated health care coverage; domestic partner benefits



## ERISA – Background

- ERISA is divided into Titles:
  - Title 1 – Reporting and Disclosure Rules for both pension and welfare plans under supervision of Department of Labor (DOL)
  - Title 2 – Administration and Enforcement under IRS coordination with DOL
  - Title 3 – Miscellaneous
  - Title 4 – Plan Termination Insurance – PBGC



## ERISA – Background

- ...and Title 1 of ERISA is further broken into “**Parts**”:
- Part 1 – Reporting and Disclosure
- Part 2 – Participation and Vesting
- Part 3 – Funding
- Part 4 – Fiduciary Responsibility
- Part 5 – Administration and Enforcement
- Part 6 – Group Health Plans
- Part 7 – Group Health Plan Portability, Access, and Renewability Requirements



## ERISA – Background

- ERISA applies to “**Employee Benefits Plans**” divided into two basic groups: “**employee welfare benefit plans**” and “**employee pension benefit plans**”
- “**certain payroll practices**” are specifically recognized as not constituting “**plans**” for ERISA purposes. These include overtime and other premium pay; vacations paid out of employers’ general assets; and unfunded scholarship funds\*
- \* “**Funds**” generally have significant impacts under ERISA



## Pension Benefits

- Defined as any plan, fund, or program providing retirement income to employees or that results in deferral of income by employees for periods extending to or ending beyond termination of employment
  - “**defined benefit**”: providing specific benefit at retirement for employees usually based on wages and years of service; e.g. traditional pension plans providing monthly annuities, or in some cases, lump-sum payout
  - “**defined contribution**”: benefits based solely on contributions to account (by employer or employee) plus investment gains and earnings; e.g. profit sharing, stock bonus, and money purchase plans
  - “**Cash balance**” or “**hybrid**” plans: defined benefit plans whose benefits are determined by reference to hypothetical account balance consisting of accumulated pay credits along with interest credits (employer bears investment risk on plan assets)



## Welfare Benefits

- Defined as any plan, fund or program providing the following benefits through insurance or otherwise (e.g. employer's general assets): health, group life, long term disability, and funded vacation benefits



## Severance Plans

- “**Severance plans**” are generally considered welfare benefits but can constitute pensions:
  - Question: Are severance plans always subject to ERISA?
  - Answer: No. The U.S. Supreme Court has indicated that there must be an administrative scheme to provide benefits in order for there to be an ERISA-covered plan. One-time severance payments triggered only by external events and requiring no administrative scheme are not plans for purposes of ERISA.



## Qualified Pension Plans

- Most pension plans under ERISA are “**qualified plans**” – plans which receive tax-favored treatment under Section 401(a) of the Internal Revenue Code (some of these same requirements are also included under Parts 2 and 3 of Title 1 of ERISA)
- Advantages – Tax-exemption for fund, deductions by employer for contributions made to fund, and tax-deferral for employees on employers’ contributions and earnings
- “**Disqualification**” represents IRS death penalty for plans, plan sponsors, participants, and beneficiaries



## Other Plans and Benefits

- Cafeteria Plans (aka Flexible Benefits Plans): essentially represent a form of benefit delivery versus “**plan**” in broader sense; tax-code creature;
  - Separate written plan allowing employer to offer employees choice between cash and certain (at least one) non-taxable benefits
  - Can't operate to defer the receipt of compensation
  - Can include salary reduction features such as flexible spending accounts
  - Non-taxable benefits eligible for inclusion: health plans (medical, dental, hearing, and vision); group term life insurance up to \$50,000 face amount; accidental death and dismemberment (AD&D); LTD (with proceeds taxable to beneficiary when received); up to \$5,000 in dependent care expenses; vacation buy/sell; and elective 401(k) deferrals



## Other Plans and Benefits

- Section 132 Fringe Benefits
  - No-additional-cost-services (excess capacity services such as hotel accommodations, standby flights for airline employees, etc.)
  - Qualified employee discounts (reduced sales prices of products and services sold by employer)
  - Working condition fringe benefits (use of company car)
  - De minimis fringe benefits (use of photocopier)
  - Qualified transportation fringe benefits (transit passes, commuter highway vehicles, qualified parking)
  - Qualified moving expense reimbursements
  - Qualified retirement planning services
  - Qualified military base realignment and closure fringe
- \* *Non-discrimination rules – working condition fringes, qualified transportation fringes, and qualified moving expenses are **not** subject to non-discrimination rules – only no-additional cost services and qualified employee discounts must be available on substantially same terms to all employees or to an employee classification that doesn't discriminate in favor of prohibited group*





## Other Plans and Benefits

- Executive Compensation Plans under ERISA:
  - “**Top Hat Plan**”: an unfunded plan maintained primarily for purposes of providing deferred compensation for a select group of management or highly compensated employees
    - Top Hat group is more narrow than highly compensated employees for qualified plan purposes.
    - Exempt from Parts 2, 3, and 4 of ERISA relating to participation, vesting, benefit accrual, funding, and fiduciary standards
    - General relief from reporting and disclosure requirements
    - Civil enforcement claims and procedures under ERISA still apply
  - “**Excess benefits plan**”: plan maintained by employer solely for purpose of providing benefits for employees in excess of qualified plan rule limits on contributions and benefits
    - If unfunded, exempt from all requirements of Titles 1 and 4 of ERISA.

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## Qualified Plan Rules

- Participation and coverage: a) completion of no more than one year of service or obtaining age 21; b) meet minimum coverage requirement in terms of “**ratio percentage test**” or “**average benefits test**”
- Vesting: “**graded**” (must be fully vested after 7 years), or “**cliff**” (maximum 5-year vesting requirement)
  - \* *New 3-year cliff vesting required of hybrid plans under Pension Protection Act of 2006*
- Limits on contributions and benefits: Separate limits for defined benefit and defined contribution plans (individuals who are at least 50 years of age by end of tax year are permitted to make “catch-up” contributions to, for example 401(k) plans)
- Anti-assignment provision
  - exception for “**qualified domestic relations orders**”

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## Qualified Plan Rules

- Minimum funding and full funding limitations
- Benefit accruals: generally applied to defined benefit plans; benefit accruals must be spread in reasonably even fashion (with only limited back-loading permitted; on the other hand, “**front loading**”, accruing benefits faster in earlier years, okay without limit)
- Necessary to establish concept of accrued benefits for “**vesting**” to be meaningful (at any given date, vested interests represent percentage of participant’s benefits then accrued)
- Three alternative rules: a) 3% method, b) 133 1/3 % rule, c) fractional benefit rule
  - \* *Participants always 100% vested in accrued benefits attributable to their contributions (mandatory or voluntary)*



## Claims Processing

- ERISA claims procedures (Labor Reg. Section 2560.503-1) apply to all plans subject to Title I
  - Different rules in terms of timing and review methods apply to a) group health, b) disability, and c) all other plans including pensions.
  - If plan fails to follow then a) claimant deemed to have exhausted administrative remedies and b) participants can pursue remedies under Section 502 of ERISA (litigation)
    - \* *Claims procedures don't exclude authorized representatives of claimants from acting on behalf of claimants in pursuing claims or appeals of adverse benefit determinations*



## Claims Processing

- “**Claim**” is request for plan benefits made by participant or beneficiary that complies with plan’s reasonable procedures
- If claim denied in whole or in part, plan administrator must notify claimant within reasonable period of time, but within no more than 90 days after receipt of claim (absent grounds for extension)
- Denial must state: a) reasons, b) specific provisions relied on, c) description of additional materials to complete claim and why necessary, d) description of review procedures, including time limits and statement of claimant’s right to bring action under Section 502(a) following adverse benefit determination on review (appeal)



## Claims Processing

- Appeals: claimants must have reasonable opportunity to appeal to the appropriate named fiduciary and receive full and fair review of claim
- Time to respond is 60 days after notice of initial claim denial (180 for group health and disability plans); must provide claimant opportunity to submit written comments, records and documents relating to benefit claim; claimant shall be given upon request and free of charge all “**relevant**” documents, records, and information
  - \* *Broad standard of “relevance” – information or materials a) relied on in making benefit determination or b) submitted, considered, or produced in the course of making benefit determination regardless of whether or not relied upon*



## Claims Processing

- Decision – generally must be provided within 60 days after request for review received; may be extended 60 days if plan determines special circumstances are present and claimant is furnished with notice before end of initial 60-day period
- Notice must state special circumstances and date by which plan expects to render decision
  - \* *Claimant can always agree to extend time – limits on extensions of time are imposed on plans*
- Notification requirements regarding reasons for benefit denial, access to copies of information, statement regarding claimant's right to bring action under 502(a)
  - \* *ERISA does not require exhaustion of administrative remedies prior to bringing lawsuit, however federal courts have broadly recognized as prerequisite*



## Claims Processing

- Legal action under ERISA Section 502
  - Participants or beneficiaries may bring suit, usually against the plan
    - Injunction or order regarding rights under plan could be brought against fiduciaries having ability to direct the plan to pay benefits
    - No extra-contractual or punitive damage recoveries
  - Scope of review: “**de novo**” unless plan document gives fiduciary discretion to determine eligibility for benefits or to construe plan terms, in which case “**arbitrary and capricious**” standard applies (more deferential)
  - No statutes of limits under ERISA – generally, as matter of federal common law, most analogous state statutes of limitation (such as for contract actions) are deemed to apply; some plans try to establish time limitations in plan document



## Governing Rules

- THOU SHALL ...
- THOU SHALL NOT ...
  
- And a few Thou Shoulds



## Thou Shall . . . Rules

- Establish Proper Documentation
- Reporting and Disclosure Requirements
- Plan Asset Rules
- Bonding Requirements
- Fiduciary Standards



## Thou Shall – Document the Plan

- Plan Document
  - Plan must be in writing & set forth all terms of plan
- Plan Amendments
  - Must be in writing and adopted in accord w/plan's amendment provisions
- Trust Agreement
  - Generally separate from plan document



## Thou Shall – Disclose to Participants

- Summary Plan Description (SPD)
  - ERISA's Statement of Participant Rights
  - Insured plans (e.g., HMOs) – Certificate of Insurance typically inadequate
- Summary of Material Modification (SMM)
- Summary Annual Report (SAR)
- Participant Benefit Statements
  - Also Statement of Deferred Vested Benefits to Separated Employees
- Notice of Change in Vesting Schedule

*Cont'd. . .*



**... *Cont'd* – Disclosure to Participants**

- Notice of Blackout Period (plans w/employer securities)
- Section 204(h) Notice (reduction in benefit accrual rate)
- Tax Notice Regarding Plan Payments (eligibility for rollover treatment)
- Survivor Annuity Notices
  - Qualified Joint & Survivor Option
  - Qualified Pre-Retirement Survivor Annuity

***Cont'd . . .***



**... *Cont'd* – Disclosure to Participants**

- Notices for Domestic Relations Order (QDROs)
- Notices for Medical Child Support Orders (QMCSOs)
- Notice of Failure to Meet the Minimum Funding Requirements
- Notice of Funding Status of Underfunded Plans
- Notice of Intent to Terminate Plan



### **Thou Shall – Provide Special Welfare Plan Notices**

- COBRA Notices
  - At enrollment and upon loss of coverage
- HIPAA Notices
  - Terms of Preexisting Condition Exclusion
  - Special Enrollment Rules
  - Certificate of Creditable Coverage
  - Privacy Notice
- Medicare Part D (Rx Drugs) Creditable Coverage Notice (annual)
- Women’s Health & Cancer Rights Act Notice (annual)
- Mothers’ & Newborns’ Act Notice (inc. in SPD)



### **Thou Shall – Disclose Upon Request/Inquiry**

- To Participants
  - Plan document, trust agreement, bargaining agreement, and other instruments under which the plan is established or operated
  - Statement of participant’s accrued benefits
  - “Serious Consideration Rule” – If employee inquires as to possible plan amendments
    - Specific proposal discussed for purposes of implementation by senior mgmt. w/the authority to implement the change
- To Government Agencies
  - Plan Audit (IRS or DOL)
  - Corporate Audit (IRS)
  - Responding to Participant Complaint





## Thou Shall – Report to the Government

- IRS
  - Form 5500 (Annual Return) – IRS shares info w/ DOL & PBGC
  - Form 5310-A (Notice of Merger, Consolidation, Spinoff of Plan Assets or Liabilities)
- DOL
  - Plan Termination Reports
- PBGC
  - Premiums for Defined Benefit Plan (PBGC Form 1)
  - Reportable Event Notice
- SEC (for plans w/employer securities)
  - Forms S-8 and 11-K
  - Section 16 Reporting/Insider Reports
- CMS – Retiree Drug Subsidy Program Application (annual)
- State Gov't – Reporting for Medical Benefits (possibly preempted)



## Thou Shall – Retain Records

- Records used to compile government reporting must be maintained for at least six years after the filing due date
  - e.g., Supporting documents for Form 5500; Calculations to determine PBGC premiums

*Must “provide in sufficient detail the necessary basic information and data from which the documents thus required may be verified, explained, or clarified, and checked for accuracy and completeness, and shall include vouchers, worksheets, receipts, and applicable resolutions . . .”*



## Thou Shall – Comply w/Plan Asset Rules

- Plans Assets Must be Held in a Trust
  - Exceptions: Participant contributions withheld under a cafeteria plan or in connection with an insured plan (DOL Non-Enforcement Policy – Technical Release 92-01)
- Time Restrictions to Deposit Employee Contributions
  - As soon as contributions can be reasonably segregated from employer's general assets
- Plan Assets Must be for Exclusive Benefit of Participants
  - Pay Benefits
  - Pay Plan Expenses (plan document should provide for this)



## Thou Shall – Secure A Fidelity Bond

- Protects the plan from losses due to fraud or dishonesty from any person handling funds
- Minimum Bond = 10% of funds handled
- Maximum Bond = \$500,000
  - Increasing to \$1,000,000 effective 2007 for plans that hold employer securities

*Not to be confused with **Fiduciary Liability Insurance**, which is discretionary and protects the fiduciary (not the plan)*



## Thou Shall – Comply with Fiduciary Standards

- Fiduciary – any person that:
  - Exercises any discretionary authority or control w/respect to the management of the plan
  - Exercises any authority or control over the management or disposition of the plan's assets
  - Renders investment advice for a fee or other compensation (direct or indirect), or has authority to do so
  - Has any discretionary authority or responsibility (whether exercised or not) in the administration of the plan

*Named Fiduciary – Must be designated in plan document; has authority to control and manage the operation and administration of the plan.*

Cont'd . . .



## ... Cont'd – Comply with Fiduciary Standards

- Primary Fiduciary Duties
  - Duty of Loyalty to Participants & Beneficiaries
    - Exclusive purpose of providing benefits to participants & defraying reasonable expenses of administering the plan
  - Duty of Prudence
    - With the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in like capacity & familiar w/such matters would use in the conduct of enterprise of a like character & w/like aims
  - Duty to Diversify Investments
    - So as to minimize the risk of large losses, unless under circumstances it is clearly not prudent to do so
  - Duty to Act in Accordance with Plan Documents
    - Unless such documents are inconsistent with ERISA

Cont'd . . .



### ... *Cont'd* – Comply with Fiduciary Standards

- Other Fiduciary Duties
  - Monitor performance of appointed fiduciaries
  - Monitor performance of non-fiduciaries performing services for the plan
  - Comply with all legal parameters governing the plan
  - Must be proactive in fiduciary responsibilities
    - Co-fiduciaries may be jointly and severally liable for any breach
- Top 10 Fiduciary Risks – See Appendix A



### The Other Hat – Settlor Functions

- Settlor (i.e., employer) functions include decisions relating to the establishment, design and termination of plans
  - Fiduciary functions relate to the management of the plans
- Which hat are you (or your clients) wearing?
- Attorney/Client Privilege
  - Settlor Capacity – Privilege
  - Fiduciary Capacity – No Privilege
  - Multiple Representation – Privilege is debatable



## Thou Should – Communicate with Care

- Employee Reliance on Information Received From:
  - Summary Plan Description (SPD)
  - Company Newsletters
  - Enrollment Materials
  - HR Communications (Oral or Written)
- Problem: Discrepancy with Plan Document
  - Courts usually construe ambiguities & discrepancies in favor of participants



## Thou Should – Include Disclaimers in SPD & Plan

- Broad disclaimer that inconsistencies between terms of the plan and the SPD must be resolved in favor of those set out in the plan document
- Reservation of rights to amend or terminate the plan at any time
  - Problem area: Promise to provide retiree health benefits forever



### **Thou Should – Request from IRS . . .**

- Favorable Determination Letter on tax qualified status of plan (IRS Form 5300)
  - Must provide Notice to Interested Parties to plan participants prior to filing
- Favorable Determination Letter on termination of plan (IRS Form 5310)



### **Thou Should – Document, Document, Document**

- Maintain contemporaneous written records documenting everything dealing with fiduciary duties
  - What you plan to do
  - What you are doing
  - What you have done



## Thou Shall Not . . . Rules

- What fiduciaries may not do
- Plan assets restrictions



## Thou Shall Not – Restrictions on Fiduciaries

- Fiduciaries Can Not:
  - Mislead participants or make misrepresentations
  - Engage in a transaction involving a party in interest
  - Self-Deal:
    - Deal w/plan assets in your own interest or for your own account
    - Act in any transaction involving the plan on behalf of a party whose interests are adverse to the plan or its participants
    - Receive consideration for your own personal account from any party dealing w/the plan in any transaction involving plan assets (anti-kickback provision)



### Thou Shall Not – Improperly Use Plan Assets

- Cannot hold on to or use employee contributions
- Plan assets may not be used to pay expenses for settlor activities
  - But may be used to pay for implementation of settlor decision
    - e.g., Actuarial study requested by company to determine affect of possible plan design change – cost of study cannot be paid by plan
    - After amendment approved, cost to implement the change may be paid by plan



### Potential Liability for In-House Counsel

- Multiple Representations
  - Conflict of Interest
- Ethical Duties to Clients and Non-clients
- Lawyer's Duty to Report Wrongdoing
- Becoming a Fiduciary to a Plan
  - Corporate counsel may also face non-fiduciary liability if aid & abet corporate officers in breaching their fiduciary duty or if knowingly participate in prohibited transaction





### Make a Mistake? Available Correction Procedures

- EPCRS – Employee Plans Compliance Resolution System (Rev. Proc. 2006-27)
  - Sponsored by IRS – for Qualified Plans
  - 3 Components
    - Self-Correction Program (SCP)
    - Voluntary Correction Program (VCP)
    - Audit Closing Agreement Program (CAP)

*Cont'd . . .*



### . . . *Cont'd* – Correction Procedures

- VFCP – Voluntary Fiduciary Correction Program
  - Sponsored by DOL
  - Plan officials may voluntarily correct fiduciary breaches and potential fiduciary breaches
  - Non-binding on other government agencies
- DFVCP – Delinquent Filer Voluntary Compliance Program
  - Sponsored by DOL
  - To correct Form 5500 problems or submit late or missing 5500s
  - May avoid or minimize civil penalties



## Make a Mistake? – Litigation Risks

- Breach of fiduciary duty
- Ambiguous terms in plan documents
- Prior practice may override plan language
- Effect of formal documents other than Plan
- Representations made by mgmt. or HR
- Claims for interference of protected rights
  - Typically connected with a participant's termination of employment



## ERISA Preemption

- ERISA preempts any and all state laws in order to reserve to Federal government sole power to regulate field of employee benefits and eliminate threat of conflicting and inconsistent state and local regulation
  - State law “**relates to**” employee benefit plan, and is preempted, if has connection with or reference to such a plan, BUT...
  - State law which effects employee benefits plans in too tenuous, remote or peripheral way won't be found to “relate to plan” and will not be deemed preempted.



## ERISA Preemption

- There are numerous cases but general factors regarding “tenuous, remote or peripheral”:
- Laws pertaining to traditional exercises of state authority (e.g. escheat but note conflicting authority in form of DOL Advisory opinions)
- State laws not affecting structure, administration, or type of benefits provided by plan
- State laws not affecting relationship among employers, plan, fiduciaries, participants, or beneficiaries
- Absence of rule or remedy

*\*Just because state law increases ERISA-covered plan’s costs of providing benefits to covered employees DOES NOT result in preemption finding.*



## ERISA Preemption

- “Deemer” and “Savings” clauses
- Savings clause – ERISA doesn’t preempt state laws which regulate insurance, banking, or securities
- Deemer clause – employee benefit plans and trusts won’t be deemed insurance companies or engaged in business of insurance or banking for purposes of state laws purporting to regulate those areas



## Regulating Insurance

- For state law to be deemed to regulate insurance it must:
  - Be specifically directed towards entities engaged in the insurance industry; and
  - must substantially affect risk pooling arrangement between insurer and insured
    - \* *In 1985, the U.S. Supreme Court recognized that a "savings clause" leaves insured plans open to indirect regulation (versus uninsured plans)*
  - Mandated benefits issue



## Executive Compensation

- Types of compensation
  - Equity: stock options, stock appreciation rights, restricted stock, and stock grants
  - Salary: same concepts as for non-executives but with possible deferral ability
  - Annual bonus: often based on performance relative to goals established at the corporate, divisional, and/or individual levels
  - Long term incentives: can take form of cash or equity
    - \* *Variety of instruments and devices*



## Areas of Law

- Securities
- Corporate Governance
- Tax
- ERISA/Benefits
- Labor

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## 162(m) Deduction

- Section 162(m) of Internal Revenue Code denies deduction to publicly held company for compensation paid to "covered employee" in taxable year to extent exceeds \$1million
- Exception for performance-based compensation
  - Paid solely on account of attaining performance goals
  - Goals established by independent compensation committee (two or more outside directors)
  - Material terms (eligibility, business criteria used, maximum amounts payable) approved by shareholders and
  - Prior to payment, compensation committee certifies in writing that performance goals and any other material terms have been satisfied

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## 162(m) Deduction

- “Covered employees” – named executive officers disclosed in proxy summary compensation table
- Stock options and SARs are deemed to be performance based if awarded by compensation committee, compensation is attributable to increase in stock value, plan under which they are awarded states maximum amounts of shares to be awarded, and plan is shareholder-approved
- Stock granted at fair market



## Deferred Compensation

- Elective (salary, bonus deferrals), or non-elective (SERPS, excess benefit plans)
- Unfunded – important for both ERISA and tax purposes
- Generally consist of top-hat plans
- Subject to FICA at time of deferral (above-market earnings taxable under FICA as additional deferrals)



## Deferred Compensation

- Deferred compensation plans avoid qualified plan limitations
  - Benefit limits (Section 415)
  - Compensation limits (401(a)(17))
  - Dollar limitations on elect deferrals
  - Coverage and discrimination



## Difference Between SERPS and Excess Benefit Plans

- Excess benefit plans provide benefit equalization – same terms as qualified plan but avoids limits imposed by 415 and 401(a)(17)
- SERPS include design features beyond qualified plans; for example, use of more generous benefit formula



## Fundamental Tax Principals

- “**Constructive receipt**”: election to defer compensation must be made before beginning of service period and any subsequent elections made after beginning of service period must cause substantial forfeiture (basis for “hair cut” provisions now prohibited under 409(a))
- “**Economic benefit**” – corollary to constructive receipt; if employee receives present economic benefit due to promised payment, then such amounts are includable in income
  - Assignability; fund is dedicated or set-aside
- Section 83 - codification of economic benefit doctrine, addresses taxation of property transferred in connection with performance of services
  - Unfunded and unsecured or substantial risk of forfeiture

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## Perquisites (Personal Benefits)

- Fringe benefits under Sections 132 and 119 – non-taxable if meet requirements including substantiation
- Other taxable perks
- Club dues – Section 274 denies deductibility for amounts paid or accrued for memberships in clubs organized for business, pleasure, recreation, or other purposes but employee can exclude from income (as working condition fringe) amounts deductible under Section 162
- \* *New proxy disclosure rules approved by SEC on July 29 and released on August 11 clarify that the “ordinary” or “necessary” nature of an expense for tax purposes, “is not responsive to the inquiry as to whether the expense provides a perquisite or other personal benefit for disclosure purposes.”*

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## Current Areas of Interest

- Section 409(a)
- New proxy disclosure rules
- Option backdating and springloading



## APPENDIX A TOP 10 RISKS FACING PLAN FIDUCIARIES

- **Committee charter out-of-date** – Does the committee have a written charter describing the scope of its duties? Its composition? Its operating procedures? Its decision-making process?
- **Inadequate fiduciary orientation and education** – Does each newly appointed committee member receive orientation in fiduciary duties and roles and responsibilities of the committee and its members? Are committee members periodically offered fiduciary education briefings or updates?
- **Inadequate governance documentation** – Are committee meetings adequately documented? Does the committee maintain written delegations to staff or third parties, or written resolutions precisely stating the actions taken by the committee? Are detailed, up-to-date policies in place on topics such as compliance, payment of expenses from plan assets, and conflicts of interest? *Cont'd . . .*



## APPENDIX A

### TOP 10 RISKS FACING PLAN FIDUCIARIES . . .Cont'd

- **Deficient committee processes** – How frequently has the committee met in the last 12 months? For each meeting, is a detailed written agenda circulated in advance? Are agenda action items briefed in writing in advance? Is there a yearly plan for committee reviews and annual activities planned throughout the year?
- **Inconsistent plan documents and practices** – Is consistency in the retirement plan governance structure evidenced in board resolutions, plan documents, SPDs, and actual practice?
- **Uncertainty about when an employee is acting as fiduciary** – When discussing or deciding retirement plan issues, do company officers and staff who are also committee members feel uncertain about when they are required to wear their “fiduciary hat” as opposed to their “employer hat”?  
*Cont'd . . .*



## APPENDIX A

### TOP 10 RISKS FACING PLAN FIDUCIARIES . . .Cont'd

- **Lack of understanding of roles or responsibilities** – Is there a document that concisely summarizes what person, entity, or committee is responsible for each of the many roles and functions pertaining to a retirement plan? Do the company officers and committee members understand these roles and responsibilities.
- **Failure to define the board's role** – Does the plan document recite duties for the corporate board of directors that the board does not actually perform (e.g., selection of trustee or benefit administrator; selection of members of plan committee)?
- **Failure to review plan documentation for compliance** – Is there a process for periodically reviewing the compliance of the plan document and SPD with changes in applicable law? *Cont'd . . .*



## APPENDIX A

### TOP 10 RISKS FACING PLAN FIDUCIARIES . . .Cont'd

- **Failure to monitor plan administration and operations** – Has the committee recently engaged in a review of plan operational procedures, including data definitions, systems, benefit calculation procedures, and handling of life events?

*Source: Mercer Human Resource Consulting, Retirement Plan Governance: Top 10 Risks Facing Plan Fiduciaries (2006)*



## APPENDIX B - ONLINE RESOURCES

### ● Government Agencies

CMS: Health and Human Services  
[www.cms.hhs.gov](http://www.cms.hhs.gov)

DOL: Employee Benefits Security Administration  
[www.dol.gov/ebsa](http://www.dol.gov/ebsa)

DOL: Pension Reform  
[www.dol.gov/ebsa/pensionreform.html](http://www.dol.gov/ebsa/pensionreform.html)

EEOC  
[www.eeoc.gov](http://www.eeoc.gov)

IRS  
[www.irs.gov](http://www.irs.gov)

IRS: Forms and Publications  
[www.irs.gov/formpubs/index.html](http://www.irs.gov/formpubs/index.html)

IRS: Tax Information for Plan Sponsor/Employer  
[www.irs.gov/retirement/sponsor](http://www.irs.gov/retirement/sponsor)

IRS: Tax Information for Retirement Plan Community  
[www.irs.gov/retirement](http://www.irs.gov/retirement)

Medicare  
[www.cms.hhs.gov/home/medicare.asp](http://www.cms.hhs.gov/home/medicare.asp)

PBGC  
[www.pbgc.gov](http://www.pbgc.gov)

SEC  
[www.sec.gov](http://www.sec.gov)

Social Security Administration  
[www.ssa.gov](http://www.ssa.gov)

### ● Other Helpful Sites

ABA Joint Committee on Employee Benefits  
[www.abanet.org/iceb](http://www.abanet.org/iceb)

ABA Section of Taxation – Tax Links Index  
[www.abanet.org/tax/sites.html](http://www.abanet.org/tax/sites.html)

Benefits Blog  
[www.benefits.counsel.com/benefits/blog](http://www.benefits.counsel.com/benefits/blog)

Benefits Link  
[www.benefitslink.com](http://www.benefitslink.com)

Directory of 401(k) Resources  
[www.cfo.com/chart.cfm/3036953](http://www.cfo.com/chart.cfm/3036953)

Free ERISA  
[www.freerisa.com](http://www.freerisa.com)

Glossary of Terms – Benefits Compensation  
[www.ifebp.org/resources/glossary](http://www.ifebp.org/resources/glossary)

Glossary of Terms – Managed Care  
[www.members.aol.com/pjpchly/terms.htm](http://www.members.aol.com/pjpchly/terms.htm)