VEDDER PRICE

Employee Benefits Briefing

A bulletin designed to keep clients and other friends informed on employee benefits law matters

April 2004

RECENT DEVELOPMENTS IN EMPLOYEE BENEFITS

The Internal Revenue Service and Department of Labor have recently released guidance affecting the administration of retirement plans. Below is a summary of the most significant developments.

DOL Speaks on the Mutual Fund Scandal

The mutual fund trading scandals have left many fiduciaries with difficult decisions on whether to retain certain mutual funds available under their plans' investment options. To assist plan fiduciaries, the DOL recently issued guidance on this thorny issue. The DOL reminded fiduciaries that they have a duty to act prudently and, if the facts and circumstances surrounding a particular mutual fund warrant, conduct a deliberate investigation of the fund. Accordingly, as explained in our November 2003 Employee Benefits Bulletin, plan fiduciaries should tread lightly and take action only after a careful and thorough investigation, taking into consideration the nature of the alleged abuses, the potential economic impact on the plan's investments, the steps already taken by the Fund to limit the potential for abuses in the future and any remedial action taken to make investors whole.

The DOL statement also addressed whether imposing reasonable redemption fees on sales of fund shares or limiting the number of times a participant can move in and out of a fund in an attempt to limit market timing trading would affect a plan's ERISA §404(c) status. Without addressing a specific situation, the DOL stated that these limits would not violate the requirements of §404(c) provided the restrictions are permitted under the terms of the plan and disclosed to participants.

Disclosure of Optional Benefit Forms

The IRS earlier this year finalized its regulations regarding the disclosure of optional forms of benefit. The rules are effective for Qualified Joint and Survivor Annuity (QJSA) explanations with an annuity starting date on or after October 1, 2004, and for Qualified Preretirement Survivor Annuity (QPSA) explanations with an annuity starting date after July 1, 2004. The regulations require that the following items appear in a QJSA explanation with respect to each optional benefit form: (i) a description of the optional form and its eligibility requirements; (ii) an explanation of the financial effect of choosing the optional form; (iii) a description of the relative value of the optional form versus the QJSA; and (iv) a description of other relevant information about the optional form.

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The relative value disclosure is the most complex portion of the new optional benefit forms regulation. The primary goal of the regulation was to disclose the extent to which a lump sum option included the value of any early retirement subsidy because not all do. However,

the regulation goes well beyond this limited concern and will require additional information be given to all participants regardless of whether the plan provides a lump sum option.

The regulation allows an employer to choose between two types of explanations, participant-specific or general. As the name suggests, the first option requires an employer to provide participants with specific information relating to the participant's optional benefit forms. Under this method, the employer must express the QJSA and other optional benefit forms in the same form (*e.g.*, presenting the actuarial present value of the QJSA and all optional benefit forms). Alternatively, a plan could choose to provide the more general explanation along with hypothetical examples. However, if a plan sponsor elects to provide the general explanation it must provide a participant-specific explanation upon request.

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In light of this guidance, defined benefit plan administrators, and administrators of defined contribution plans offering annuity distribution options, should be reviewing their benefit election forms and determining how best to make the additional disclosures.

Retroactive Annuity Starting Dates

The IRS also issued final regulations explaining the circumstances in which plans can allow a participant to elect a retroactive annuity starting date. In order to have a retroactive annuity starting date: (i) the plan document must provide for the use of retroactive annuity starting dates and the circumstances under which they can be utilized; (ii) the participant must affirmatively elect the use of a retroactive annuity starting date; (iii) spousal consent must be received if the survivor benefits under the retroactive annuity are less than the survivor benefits under the QJSA with a starting date after the QJSA notice was provided; (iv) any make-up payments must bear a reasonable interest rate; and (v) benefit calculations at the retroactive date must satisfy applicable Code limitations in effect on both the retroactive date and the actual distribution date.

It appears that a plan would not be considered to be utilizing a retroactive annuity starting date simply because payment is delayed due to reasonable administrative delay or because it is correcting a failure to start payment at the participant's normal retirement date. However, if payment is delayed for other reasons and the plan does not provide for a retroactive annuity starting date, the plan should consider providing for actuarially adjusted payments going forward.

Automatic Rollover Guidance

The DOL recently proposed a safe harbor implementing the automatic rollover provisions of Economic Growth Tax Relief and Reconciliation Act of 2001 (EGTRRA). The effective date of these regulations will be six months after they are finalized later this spring (projected effective date: December 2004 or January 2005).

EGTRRA included a provision that requires plans providing for involuntary small cash-out distributions to be amended to allow the automatic rollover of an involuntary distribution that is over $1,000 but under $5,000. The proposed regulations set forth a safe harbor consisting of six requirements: (i) the present value of the accrued benefits must exceed $1,000 but not $5,000; (ii) the distribution must be rolled over into an individual retirement account; (iii) the rollover must be invested in an investment product designed to preserve principal and yield a reasonable rate of return, and must be offered by a state or federally regulated institution (e.g., a bank or mutual fund company); (iv) the costs relating to the IRA must not exceed costs for comparable IRAs; (v) participants must receive a written explanation of the

automatic rollover provisions in an SPD or summary of material modifications; and (vi) unless exempted, the rollover cannot constitute a prohibited transaction.

Please note that the DOL has also proposed a class exemption allowing the fiduciary of a plan sponsored by a financial institution to deposit the plan's automatic rollovers in the institution's IRAs.

Supreme Court Decides ADEA Benefits Issue

As detailed in the latest Vedder Price Labor Newsletter, the Supreme Court recently rejected Age Discrimination in Employment Act (ADEA) claims by workers in their 40s who claimed they were treated worse than their older counterparts. The claim centered around a collective bargaining agreement between General Dynamics and the United Auto Workers that retained retiree health benefits only for those workers who were age 50 or older as of July 1, 1997. The Court examined the text, history and purpose of ADEA in concluding that ADEA was not meant to prohibit employers from favoring older workers. If the Court had concluded otherwise, many of the basic concepts of pension benefit plans, such as age conditions for benefit commencement, early retirement subsidies and even vesting at normal retirement, would have been vulnerable to challenge.

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The *Employee Benefits Briefing* is published by the law firm of Vedder, Price, Kaufman & Kammholz, P.C. It is intended to keep our clients and interested parties generally informed of legal developments in Employee Benefits. It is not a substitute for professional advice.

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