



Benefits & Compensation Law Alert

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Jessica Webb-Ayer, Editor

Obama Administration Encourages Retirement Savings

By Fritz Richter, III and Curtis L. Fisher
Bass, Berry & Sims PLC

Earlier this year, the Obama administration announced several initiatives to encourage retirement savings. In response, the Internal Revenue Service (IRS) issued a series of notices and revenue rulings designed to implement this initiative by: (1) streamlining the process pursuant to which employers may add an automatic contribution arrangement to their 401(k) plans; (2) permitting the contribution of unused paid time off to a qualified plan; and (3) clarifying the available options for employees and employers regarding eligible rollover distributions from qualified plans. A brief summary of the IRS guidance is set forth below.

Notice 2009-65 – Sample Plan Amendments for the Addition of an Automatic Contribution Arrangement

Notice 2009-65 contains two sample plan amendments that may be used to add an automatic contribution arrangement to a 401(k) plan. The first sample plan amendment is for plan sponsors to use when adding a basic automatic contribution arrangement to a 401(k) plan. The second amendment is to be used when adding an eligible automatic contribution arrangement (EACA) to a 401(k) plan.

The notice provides that the sample amendments do not have to be adopted verbatim and the amendments may be modified to conform to a plan's terms and administrative procedures. More importantly, the notice clarifies that the adoption of either sample plan amendment will not result

in the loss of reliance on a favorable opinion, advisory, or determination letter, and the IRS will not treat the adoption of either amendment as affecting the preapproved status of a master and prototype or volume submitter plan.

In order to add an automatic contribution arrangement, the amendment must be adopted by either: (1) the end of the plan year in which the amendment is effective (in accordance with Revenue Procedure 2007-44); or (2) the deadline for adopting amendments made pursuant to the Pension Protection Act of 2006 (generally, December 31, 2009, for calendar year plans), whichever is later. The timely adoption of the amendment must be evidenced by written action taken by the plan sponsor, and notice of the amendment must be provided to affected employees within a reasonable period *before* the amendment is effective.

The IRS also issued Notice 2009-66 and Notice 2009-67, which provide guidance and a sample amendment regarding the addition of an automatic contribution arrangement to a SIMPLE IRA plan.

Plan amendments may be used to add an automatic contribution arrangement to a 401(k) plan.

Revenue Ruling 2009-30 – Guidance on Automatic Deferral Increases Under an Automatic Contribution Arrangement

In February 2009, the IRS issued final regulations regarding automatic contribution arrangements. These arrangements provide for default deferral elections under a 401(k) plan (or other eligible defined contribution plans) for participants who do not affirmatively elect to "opt-out" of participation in the plan or to contribute at a different

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rate than provided in the default election. In Revenue Ruling 2009-30, the IRS addresses how a 401(k) plan that contains an automatic contribution arrangement may permit an automatic increase in the amount of a participant's default contribution percentage (an "automatic contribution increase"). The IRS provides two examples that describe how plan sponsors may structure these arrangements.

In the first example, the IRS considers a basic automatic contribution arrangement. The IRS notes that a plan sponsor has a great deal of flexibility regarding an automatic contribution increase since these arrangements are not subject to the uniformity requirements reserved for an EACA or a qualified automatic contribution arrangement (QACA). As a result, the IRS concludes that an automatic contribution increase will not fail to be an elective contribution merely because the default contribution percentages are increased over time and such increases are, in part, determined by reference to the amount of, and are scheduled to become effective at the time of, future increases in a participant's pay.

In the second example, the IRS addresses how an automatic contribution increase may be structured under an EACA or a QACA. The IRS clarifies that an automatic contribution increase may occur on a date other than the first day of the plan year without violating the qualified percentage requirement (including the uniformity and minimum percentage requirements) relating to a QACA or the uniformity requirements related to an EACA.

Notice 2009-68 – Revised Section 402(f) Safe Harbor Explanations

Notice 2009-68 contains two safe harbor explanations that may be provided to participants who receive an eligible

rollover distribution in order to satisfy the requirements of Section 402(f) of the Internal Revenue Code (Code). The first explanation applies to a distribution that is not from a designated Roth 401(k) account, and the second explanation applies to a distribution from a designated Roth 401(k) account.

The notice clarifies that both safe harbor explanations should be provided to a participant who is eligible to receive an eligible rollover distribution from both a designated Roth 401(k) account and a non-Roth 401(k) account. The IRS states that the new explanations are intended to update the safe harbor explanations previously provided by the IRS in Notice 2002-3 to reflect intervening changes in the law since it was published and to simplify the presentation and descriptions of a participant's options upon receiving an eligible rollover distribution.

Plan sponsors may customize the safe harbor explanations to remove provisions that do not apply to a particular plan or to add information consistent with Section 402(f) of the Code. In addition, plan sponsors are required to update the safe harbor explanations to reflect changes in the law, which become effective after September 28, 2009. The safe harbor explanations previously provided in Notice 2002-3 may continue to be used until December 31, 2009, if they are appropriately modified. However, plan sponsors should take steps to update their explanations to take advantage of the new safe harbor explanations as soon as possible. Although plan sponsors are not required to use the safe harbor explanations, the use of such language will ensure that a plan sponsor is deemed to have complied with the notice requirements of Section 402(f) of the Code.

**Plan sponsors
should take
advantage of the
new safe harbor
explanations.**

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Benefits & Compensation Law Alert

Jessica Webb-Ayer, Managing Editor

bcla@mleesmith.com or jayer@kc.rr.com

Julie Athey, Contributing Editor

bcla@mleesmith.com or bathey@kc.rr.com

David W. Powell, J.D. *Groom Law Group, Chd.
Washington, DC*
Fritz Richter III, J.D. *Bass, Berry & Sims PLC
Nashville, TN*
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Chicago, IL*
Brigen Winters, J.D. *Groom Law Group, Chd.
Washington, DC*

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Revenue Rulings 2009-31 and 2009-32 – Contributions of Unused Paid Time Off

In Revenue Rulings 2009-31 and 2009-32, the IRS addresses plan amendments that permit participants to contribute the cash equivalent of unused paid time off to a profit-sharing plan on either an annual basis or at a participant's termination of employment. The rulings provide that such a contribution may be required by the plan as a non-elective contribution or the plan may permit the participant to elect whether or not to contribute the unused paid time off to the plan pursuant to an elective deferral election.

The rulings provide that an amendment to permit either plan design will not interfere with a plan's qualified status as long as the contributions satisfy the applicable requirements of Sections 401(a)(4) and 415(c), and as applicable, 401(k) and 401(a)(31) of the Code. In addition, the rulings clarify that a participant should not include the amount of the contribution of any unused paid time off to a profit-sharing plan in gross income until a distribution of such amount is made to the participant from the plan. Additionally, a participant should not include the amount of any unused paid time off that is not contributed to the profit-sharing plan in gross income until the taxable year in which the amount is paid to the participant.

Conclusion

It is clear from the IRS guidance issued earlier this fall that the Obama administration is taking steps to encourage participants to increase their retirement savings. The new guidance discussed above provides plan sponsors with several new tools to carry out this initiative.

Advisory Board Member Fritz Richter is a partner and Curtis Fisher is an associate in the Employee Benefits Practice Group of Bass, Berry & Sims PLC, a law firm with offices in Nashville, Knoxville, and Memphis, Tennessee. You can find more information about the firm at www.bassberry.com. ♦

Is the Tide Turning Against Discretionary Clauses in Insurance Contracts?

By Elizabeth A. Nedrow
Holland & Hart LLP

A recent decision by the Ninth U.S. Circuit Court of Appeals may make it harder for insurance companies in some states to defend claims denials. *Standard Insurance Company v. Morrison*, a case decided by the court on October 27, 2009, established its place in claims denial case history by addressing the standard of review in Employee Retirement Income Security Act (ERISA) cases.

Standard of Review History

When a participant brings a lawsuit to challenge a plan administrator's denial of benefits under an ERISA plan, the first issue considered is what standard of review the court will use in reviewing the denial. Plan administrators much prefer the "arbitrary and capricious" standard of review, which allows a court to overturn a claim denial only when the plan administrator's denial of the claim is found to have been unreasonable or unsupported by evidence. The alternative is the much less deferential "de novo" review, in which a court can effectively make its own determination of the claim.

It was unclear which standard would apply in claims denial cases until the U.S. Supreme Court issued its decision in *Firestone v. Bruch* in 1989. This landmark case held that a plan administrator's decision will receive deference under the arbitrary and capricious standard of review when the plan document itself specifies that the plan administrator has full discretion to determine benefit claims. Without such language, the denial would be subject to the more stringent de novo review. As a result, in the 1990s, ERISA benefit plans were overwhelmingly drafted to include "Firestone language" giving the administrator discretion, and therefore, many plan administrators enjoyed the deferential review of the courts.

Some argue that giving plan administrators the advantage of the arbitrary and capricious standard of review is a positive development. They assert that it reduces the amount of administrative and financial costs spent on defending claims, which remain available to the plan. Others, however, argue that the deferential standard of review gives plans an unfair advantage. In particular, critics claim that insurers have an inherent conflict of interest in denying claims (which would be paid from their revenues), and their decisions should be subject to more scrutiny in the courts. These critics no doubt feel that Montana's Commissioner of Insurance, John Morrison, has somewhat leveled the playing field by using a state statute to invalidate discretionary clauses in insurance contracts.

The Morrison Case

The particular Montana statute used by Morrison to invalidate discretionary clauses states that the commissioner of insurance must disapprove any insurance policy form that contains any "inconsistent, ambiguous, or misleading clauses or exceptions and conditions which deceptively affect the risk purported to be assumed in the general coverage of the contract." Morrison determined that discretionary clauses in insurance contracts were invalid under this statute and denied approval to proposed disability insurance forms submitted by Standard Insurance Company.

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