



*Let us help you manage your benefits cost and risk.*

Monthly Newsletter – Volume 3, No. 3 – March 5, 2007

## Monthly Newsletter – Volume 3, No. 3 – March 5, 2007

### *Highlights of the Month*

- 1. Internal Revenue Service Issues Checklist for Sponsors of 401(k) Plans**
- 2. Department of Labor Releases Regulatory Guidance Document Regarding Fiduciary Adviser Selection and Monitoring**
- 3. Department of Labor's Employee Benefit Security Administration Issues Regulations to Extend Mental Health Parity Act Provisions Through 2007**
- 4. Sixth Circuit Court of Appeals Issues Ruling Regarding Severance Plans and Release Requirements**
- 5. Eighth Circuit Court of Appeals Rules That Participants Must Prove Detrimental Reliance on Faulty Summary Plan Description**
- 6. Class Certification of Action Arising from Employer Securities Offered in 401(k) Plan is Vacated**
- 7. Winter Newsletter From the Internal Revenue Service Refers to Federal Agency Guidance on Mandatory Distributions of Amounts More Than \$1,000 to IRAs**

### Internal Revenue Service Issues Checklist for Sponsors of 401(k) Plans

The Internal Revenue Service (IRS) has recently published a checklist for plan sponsors of 401(k) plans. The checklist is in a question and answer format, with "No" answers indicating a potential compliance problem. The checklist is followed by more specific and detailed guidance on each topic covered by the questions. Checklist questions relate to topics such as changes in the plan document, definition of compensation, communication with service providers, depositing of employee deferrals, required plan filings, and nondiscrimination testing. The checklist is intended to be a quick review tool to identify potential problem areas in plan compliance. The checklist can be obtained at <http://www.irs.gov/pub/irs-tege/pub4531.pdf>. A similar checklist has also been issued for 403(b) plans and can be found at <http://www.irs.gov/pub/irs-pdf/p4546.pdf>.

### Department of Labor Releases Regulatory Guidance Document Regarding Fiduciary Adviser Selection and Monitoring

In February, the Department of Labor (DOL) Employee Benefits Security Administration (EBSA) issued Field Assistance Bulletin (FAB) 2007-01 which addresses the statutory exemption regarding investment advice. FAB 2007-01 was released to respond to



*Let us help you manage your benefits cost and risk.*

questions from the retirement services industry regarding the effects of the Pension Protection Act of 2006 (PPA) on the DOL's approach to plan advice issues. The PPA amended both the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (IRC) to add a statutory exemption relating to the provision of investment advice. [PPA § 601 added a statutory exemption under § 408(b)(14) of ERISA and § 4975(d)(17) of the IRC.] Under § 408(b)(14) of ERISA, investment advice provided under an "eligible investment advice arrangement", as defined in § 408(g), to participants and beneficiaries of a defined contribution plan that permits participant direction of investments is exempted from the prohibited transaction rules. In addition to the exemption for the investment advice, the investment transaction entered into pursuant to the advice, and the direct or indirect receipt of fees or other compensation by the fiduciary adviser (or an affiliate) in connection with the provision of advice is also exempted. [An "eligible investment advice arrangement" is an arrangement that either provides that fees received by the fiduciary adviser for investment advice, or with respect to the investment of plan assets, do not vary in connection with the investment option selected, or is an arrangement that uses a computer model under an investment advice program meeting the requirements of § 408(g)(3).]

The DOL provided guidance in FAB 2007-1 in the form of questions and answers which are summarized below.

- Q1.** *Did enactment of the investment advice provisions of the PPA invalidate or otherwise affect prior guidance issued by the DOL concerning investment advice?*
- A1.** Except for providing that persons who develop or market computer models described in § 408(g)(3) or who market investment advice programs using such models, are fiduciaries; and requiring advisers to expressly acknowledge their fiduciary status, § 408(b)(14) and § 408(g) do not alter ERISA's framework for determining fiduciary status or recast otherwise permissible forms of investment advice as prohibited. It is the view of the DOL that the new provisions do not invalidate or otherwise affect the prior guidance provided by the DOL relating to investment advice.
- Q2.** *To what extent are the standards for selecting and monitoring a fiduciary adviser described in § 408(g)(10) different from the standards applicable to plan fiduciaries who offer an investment advice program with respect to which relief under the statutory exemption for investment advice [§ 408(b)(14)] is not required?*
- A2.** It is the view of the DOL that the same fiduciary duties and responsibilities apply to the selection and monitoring of an



*Let us help you manage your benefits cost and risk.*

Monthly Newsletter – Volume 3, No. 3 – March 5, 2007

investment adviser for participants and beneficiaries in a participant-directed individual account plan, regardless of whether the program of investment advice services is one to which the statutory exemption applies, with the exception of certain requirements under § 408(g)(10)(A)(i). Subparagraph (B) of § 408(g)(10) makes clear that plan fiduciaries have a duty to prudently select and periodically monitor the advisory program, but no duty to monitor the specific advice given by the fiduciary adviser to any particular recipient of the advice. It is the view of the DOL that a plan sponsor or other fiduciary that prudently selects and monitors an investment advice provider will not be liable for the advice furnished by the provider to the plan's participants and beneficiaries, whether or not that advice is provided pursuant to the statutory exemption under § 408(b)(14). With regard to the selection of service providers generally, the DOL has indicated that a fiduciary should engage in an objective process that is designed to elicit information necessary to assess the provider's qualifications, quality of services offered and reasonableness of fees charged. Such a process should take into account the experience and qualifications of the investment adviser, including the adviser's registration in accordance with applicable federal/state securities laws; the willingness of the adviser to assume fiduciary status; and the extent to which advice furnished to participants will be based on generally accepted investment theories (GAIT). In monitoring investment advisers, the DOL anticipates that fiduciaries will periodically review the extent to which there have been changes in the initial selection criteria specific to the adviser, including whether the adviser continues to meet applicable federal/state securities law requirements and whether advice to participants continues to be based on GAIT. Consideration should also be given as to whether contractual provisions of the engagement are being adhered to, the utilization of the investment advice service by participants in relation to its cost to the plan, and any participant comments/complaints regarding the quality of the advice rendered.

**Q3.** *For purposes of an "eligible investment advice arrangement" within the meaning of § 408(g)(2)(A)(i), is an affiliate of a fiduciary adviser subject to the level fee requirement?*

**A3.** Under § 408(g)(2)(A)(i), only the fees or other compensation of the fiduciary adviser may not vary based on the investment option selected. This section references only the fiduciary adviser, not the fiduciary adviser or an affiliate. An affiliate of a registered investment adviser, a bank or similar financial institution, an



*Let us help you manage your benefits cost and risk.*

Monthly Newsletter – Volume 3, No. 3 – March 5, 2007

insurance company or a registered broker dealer will be subject to the varying fee limitation only if that affiliate is providing investment advice to plan participants.

## **Department of Labor's Employee Benefit Security Administration Issues Regulations to Extend Mental Health Parity Act Provisions Through 2007**

The EBSA has issued a technical amendment [*Federal Register, February 27, 2007 (Volume 72, Number 38, Pages 8628-8630)*] extending the interim final rules under the Mental Health Parity Act (MHPA) to December 31, 2007. The MHPA provides health insurance parity between mental health benefits and other medical/surgical coverage by requiring that annual or lifetime dollar limits for mental health benefits be no lower than the dollar limits for medical/surgical benefits offered by a group health plan. The act applies to group health plans or health insurance coverage offered by issuers in connection with a group health plan that offers both mental health and medical/surgical benefits. However, it does not require plans to offer mental health benefits.

When originally signed into law in 1996, the MHPA contained a sunset provision stating that the act would not apply to benefits for services furnished on or after September 30, 2001. Since then, MHPA has been amended five times to extend the sunset date. President Bush most recently extended the sunset date of the MHPA when he signed the Tax Relief and Health Care Act of 2006 (*P. L. 109-432, 120 Stat. 2922*) on December 20, 2006.

## **Sixth Circuit Court of Appeals Issues Ruling Regarding Severance Plans and Release Requirements**

In an opinion issued on February 20, 2007 [*Godleski v. FirstEnergy Corp., et. al., No. 06-3448, 2007 WL 507046 (6<sup>th</sup> Cir., Feb. 20, 2007)*], the Sixth Circuit Court of Appeals reversed a decision of the district court and awarded severance benefits to the plaintiff in spite of the fact that he had not signed the release that the employer contended was a precondition to obtaining those benefits.

Lawrence Godleski was employed by FirstEnergy Solutions, a subsidiary of FirstEnergy Corp. ("FirstEnergy"), from 1997 through early 2004. He was a participant in the company's severance benefits plan which provides severance pay and other benefits for employees who are laid off. Godleski was notified in January 2004 that his position was being eliminated and that he would be eligible for a lump-sum severance payment under the severance benefits plan, provided that he did not obtain another position with a



*Let us help you manage your benefits cost and risk.*

FirstEnergy company by February 27. Godleski was given an exit interview on February 24, at which time he was given a release form that was to be returned by April 12. On February 24, he received an offer from a wholly-owned subsidiary of FirstEnergy. On February 27, Godleski accepted the offer from the subsidiary and began work there on March 1. On April 8, Godleski attempted to submit the signed release to the manager of the severance benefits plan. The manager refused to accept the release and informed Godleski that he was ineligible for severance benefits under the plan because of his employment with the subsidiary. The manager told Godleski that he could seek a review of the denial of benefits by filing a claim with the severance plan's Appeals Committee. Godleski filed such a claim, which was denied, as well as an appeal, which was also denied. The denial of the appeal stated that benefits were denied because a release had to be completed to be eligible for benefits, and that one of the conditions of the release was that the employee would not seek employment with the company or any of its subsidiaries or affiliates. Since Godleski accepted employment with a subsidiary of FirstEnergy, the Appeals Committee determined that he did not qualify for benefits under the terms of the severance plan. Godleski then filed a suit alleging violation of ERISA and seeking payment of benefits under the severance plan.

In the district court opinion, the court sided with the defendant holding that Godleski's employment at the subsidiary did not nullify his eligibility for severance benefits but that his failure to sign the release within the deadlines set by the plan did nullify his eligibility for benefits under the terms of the severance plan. The Sixth Circuit Court reversed this decision on appeal. The Court first stated that since FirstEnergy's only ground raised on appeal for affirming the district court's decision was the failure of Godleski to sign the release, his employment with the subsidiary is not considered as an alternative ground for affirmance. The Court further went on to state that the problem with the Appeals Committee's ruling was that it failed to account for the fact that the severance plan provides two methods for obtaining severance benefits: either by obtaining them automatically or by filing a claim for them. The plan's terms state that "benefits will be offered automatically for those who qualify under provisions" and that it is "not necessary ... to submit a claim unless you believe you qualify and have not been notified that you will be offered severance benefits." The Court stated that it "is clear that Godleski had to sign a release by a certain date in order to receive benefits automatically offered, there is no similar timing requirement with respect to benefits sought by filing claim." The Court determined that the language of the plan was such that a release agreement was not necessary as part of a claim for benefits and that the manager's refusal to accept the release on April 8 constituted a rescinding by FirstEnergy of its previous severance offer. This put Godleski in the role of a participant denied benefits under the plan, and the Court determined that neither the Appeals Committee nor the district court provided any explanation of requirements for filing a claim that Godleski failed to meet. Since the "Claims Process" provisions of the plan did not include any language regarding



*Let us help you manage your benefits cost and risk.*

a release agreement, this could not be a condition precedent to receiving plan benefits by filing a claim and Godleski met all other requirements of the Claims Process as described by the severance plan. The Court thereby reversed the district court's decision and remanded it with instructions to enter a judgment in favor of the plaintiff.

### **Eighth Circuit Court of Appeals Rules That Participants Must Prove Detrimental Reliance on Faulty Summary Plan Description**

In a ruling issued on February 22, 2007 [*Greeley v. Fairview Health Services*, No. 06-2854, (8<sup>th</sup> Cir., 2007)], the Eighth Circuit Court of Appeals reversed the district court's ruling in a case regarding a faulty summary plan description ("SPD") stating that a participant must show "detrimental reliance" on such a faulty document in order to recover damages.

On February 20, 1998, Fairview Health Services ("Fairview") mailed a letter to its pathologists stating that they would be eligible for long-term disability benefits until they reached age sixty-seven. The letter was accompanied by a summary of benefits that did not contradict this representation. The plan actually provided for such benefits only until age sixty-five; however, this plan document was never mailed to the pathologists. In December 1998, Daniel Greeley and his attorney received a copy of the long-term disability plan in preparation for filing an application for benefits under the plan. The plan stated that benefits would be provided until age sixty-five or seventy, or for one to five years, depending on the age at disability. In 1999, Greeley quit practicing as a pathologist because of a disabling medical condition. In January 2001, he inquired about the maximum benefit period and a Fairview human resources employee sent him a memo stating that benefits expired at age sixty-five. In October 2003, Greeley's attorney sent Fairview a letter requesting assurances that benefits would continue until age sixty-seven as described in the February 1998 letter. Fairview did not respond to the attorney's request. In October 2004, Fairview informed Greeley that his benefits had expired because he had reached age sixty-five. Greeley filed suit in district court in December 2004 alleging improper denial of benefits and fraud. On cross motions for summary judgment, the district court granted such judgment in favor of Greeley on the ERISA claim and in favor of Fairview on the fraud claim. Fairview appealed the decision arguing that the district court was in error in ruling that Greeley's action was not barred by the two-year statute of limitations, that the 1998 memo and benefits summary should be considered to be a "faulty" SPD, and that Greeley was prejudiced by the SPD.

In its ruling in favor of Fairview, the Court found fault with the district court's adoption of a "likely harm" prejudice standard. (The district court correctly determined that in order to recover damages under a faulty SPD, Greeley had to show he was prejudiced by



*Let us help you manage your benefits cost and risk.*

it. However, they explained the prejudice based on a Second Circuit Court ruling that required a plan participant to show that he or she was "likely to have been harmed as a result of a deficient SPD".) The Court relied on its own precedent [*Maxa v. John Alden Life Ins. Co.*, 972 F.2d 980 (8<sup>th</sup> Cir., 1988)] and determined that in order for an employee to recover from his employer for a faulty SPD, an employee must show that he relied on its terms to his detriment. In the Court's opinion, detrimental reliance means that the plaintiff took action, resulting in some detriment, that he would not have taken had he known that the terms of the plan were otherwise or that he failed, to his detriment, to take action that he would have taken had he known that the terms of the plan were otherwise. The Court then went on to state that assuming the February 1998 memo did constitute a faulty SPD, Greeley must demonstrate that he took action, or failed to take action, that he would not have otherwise, resulting in some detriment to him. The Court found that since Greeley testified that he had no choice but to go on disability because of his medical condition, he offered no evidence that he changed his course of action or otherwise relied on the faulty SPD.

### **Class Certification of Action Arising from Employer Securities Offered in 401(k) Plan is Vacated**

The Fifth Circuit Court of Appeals, in reversing a district court ruling, vacated a class certification in a fiduciary breach case which was based on a drop in price in an employer stock fund which was part of the employer's 401(k) plan. The Court held that the ERISA 404(c) defense was applicable to the plan as a whole and remanded the case for reconsideration. [*Langbecker v. Electronic Data Systems Corp.*, 2007 WL 117465 (5<sup>th</sup> Cir., 2007)]

Electronic Data Systems Corp. ("EDS") offered a 401(k) plan to its employees which included a menu of investment options. Participants directed the investment of their contributions to the plan and made decisions as to when and how to change the allocation of their investments. The plan's trustees selected the menu of investment options and were responsible for monitoring the options. During the period under consideration in this case, the plan offered between 13 and 18 investment options, one of which was a fund invested in EDS stock. Plan documents discussed the various investment options, explaining the manner in which participants could invest their contributions, and rated the options based on a relative risk scale. Such documents rated the EDS stock fund as the highest risk and warned participants that investing in a single stock violated principles of diversification in portfolio management. The documents also explained that EDS would provide a matching contribution invested in the EDS stock fund and that after two years, such contributions could be moved out of the EDS stock fund. In September 2002, EDS published an earnings warning which led to a significant drop in its stock price. Some



*Let us help you manage your benefits cost and risk.*

participants in the plan filed a claim that the trustees breached their fiduciary duty of prudence by continuing to offer the EDS stock fund as an investment option, by directing and approving investment in the stock fund rather than safer alternatives, by investing matching contributions in the stock fund, by failing to take adequate steps to prevent the plan from suffering losses from its investment in EDS stock, and by failing to implement a strategy to compensate for the high risk of EDS stock as a plan investment. They sought class action status and reimbursement from EDS for losses suffered by the plan and injunctive relief to either remove the stock fund as an investment alternative or to replace the trustees with one or more independent fiduciaries. The district court certified a class for the claims consisting of all plan participants (and their beneficiaries) for whose accounts the plan made or maintained investments in EDS stock between September 1999 and October 2002. EDS appealed the class certification.

In its ruling, the Fifth Circuit Court of Appeals addressed three major points: Did ERISA § 502(a)(2) entitle plan participants to seek derivative relief for the plan as a whole to recover losses that were alleged to have arisen from the trustees actions? Did ERISA § 404(c) bar class certification? Did releases from approximately 9,000 former employees obtained in exchange for severance benefits bar class certification?

Under ERISA § 502(a)(2), fiduciaries are personally required to make good any losses to the plan caused by their breach of duty or the fiduciaries may be replaced. EDS argued that because the plan was a participant-directed individual account plan and that any recovery of monetary damages would have to be allocated among up to 85,000 class members based on their individual investment strategies, no plan-wide relief could be made. The Court found no merit in EDS' arguments on this point.

The district court ruled that ERISA § 404(c), which relieves fiduciaries of liability where loss results from a participant's exercise of direction and control of his own account, is inapplicable to a suit on "behalf of the plan as a whole." [Under § 404(c) a participant exercises control over his assets only if the plan offers a diversified array of investments; provides adequate information concerning the investments; and authorizes flexible and autonomous control by the participants.] The Court disagreed with the district court's conclusion. Neither § 502(a)(2) nor §404(c) include an exception to the availability of § 404(c) when a plaintiff sues on behalf of a plan. DOL regulations state that § 404(c) may be a defense to liability when the loss is a direct and necessary result of a participant's exercise of control [Reg. 25550.404c-1(d)(2)(i)] The Court found this regulatory language to be an acceptable interpretation of the statutory language. However, a footnote to this DOL regulation narrows the statutory language and the Court found this interpretation to be unreasonable because it contradicts the statutory language in cases where an individual account plan complies with the DOL regulations' disclosure,



*Let us help you manage your benefits cost and risk.*

diversification and participant-control provisions. The Court thus vacated the class certification.

With respect to the group of approximately 9,000 former employees who had signed releases in order to receive severance benefits, the Court found that this group should have been separately considered in the class certification, perhaps as a separate subclass, if class action was otherwise deemed appropriate.

Finally, the Court found substantial conflicts to exist among members of the class certified by the district court that might preclude class certification. As an example, the Court cited the existence of over 40,000 participants who, at the time the class action was brought, still maintained an investment in the EDS stock fund within the plan. The suit called for shutting down the stock fund, thus creating a conflict with those in the plan who may not have wanted the stock fund closed.

### **Winter Newsletter from the Internal Revenue Service Refers to Federal Agency Guidance on Mandatory Distributions of Amounts More Than \$1,000 to IRAs**

Section 6575 of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") amended the IRC to require that mandatory distributions of more than \$1,000 from a qualified plan be paid in a direct rollover to an Individual Retirement Account (IRA). The IRS has been informed by plan sponsors/administrators that some banks will not establish IRAs without the participant's signature indicating that they are following the rules of the Customer Identification Program ("CIP") of the USA Patriot Act (P.L. 107-56). In the Winter 2007 edition of *Retirement News for Employers*, the IRS has referred to guidance from the federal agencies that drafted these regulations.

The guidance from those agencies was issued in the form of a list of frequently asked questions and the pertinent excerpts follow:

"The staff of the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Financial Crimes Enforcement Network, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision, and the United States Department of the Treasury ("Agencies") are issuing these frequently asked questions ("FAQs") regarding the application of 31 C.F.R. § 103.121. This joint regulation implements section 3261 of the USA Patriot Act and requires banks, savings associations, credit unions and certain non-federally regulated banks ("bank") to have a Customer Identification Program ("CIP"). While the purpose of the FAQs document is to provide



*Let us help you manage your benefits cost and risk.*

Monthly Newsletter – Volume 3, No. 3 – March 5, 2007

interpretive guidance with respect to the CIP rule, the Agencies recognize that this document does not answer every question that may arise in connection with the rule...

4. *The CIP rule requires a bank to verify the identity of each "customer." Under the CIP rule, a "customer" generally is defined as "a person that opens a new account." If a pension plan administrator chooses to remove a former employee from the plan pursuant to section 657(c) of EGTRRA, it is required by law to transfer these funds to a financial institution. In addition, an administrator of a terminated plan may remove former employees that it is unable to locate, by transferring their benefits to a financial institution. Would a plan administrator or the former employee be a "bank customer" where funds are transferred to a bank and an account established in the name of the former employee, in either of these situations?*

In either situation, the administrator has no ownership interest in or other right to the funds, and therefore, is not the bank's "customer." Nor would we view the administrator as acting as the customer's agent when the administrator transfers the funds of former employees in these situations. A customer relationship arises and the requirements of the rule are implicated when the former employee "opens" an account. While the former employee has a legally enforceable right to the funds that are transferred to the bank, the employee has not exercised that right until he or she contacts the bank to assert an ownership interest. Thus, in light of the requirements imposed on the plan administrator under EGTRRA, as well as the requirements in connection with plan terminations, the former employee will not be deemed to have "opened a new account" for purposes of the CIP rule until he or she contacts the bank to assert an ownership interest over the funds, at which time a bank will be required to implement its CIP with respect to the former employee. This interpretation applies only to (1) transfers of funds as required under section 657(c) of EGTRRA, and (2) transfers to banks by administrators of terminated plans in the name of participants that they have been unable to locate, or who have been notified of termination but have not responded, and should not be construed to apply to any other transfer of funds that may constitute opening an account."