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## *ERISA NEWSLETTER*

TO: CLIENTS AND COLLEAGUES  
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This Newsletter discusses –

- The Economy's Impact on Retirement Plans –  
*Lesson #1: Proper Process and Plan Documents Carry the Day;*
- Health Plans Must Comply with Claim Procedures in Denying Benefits;
- Waiver of 2009 Required Minimum Distributions;
- Department of Labor Guidance Regarding Fidelity Bonds; and
- Default Investment/QDIA Implementation Update.

For more information on any of these discussions, please contact Jeffery Mandell at [jeff@erisalawgroup.com](mailto:jeff@erisalawgroup.com) or John Hughes at [john@erisalawgroup.com](mailto:john@erisalawgroup.com).

### **PROPER PROCESS AND PLAN DOCUMENTS CARRY THE DAY**

#### *Lesson One Regarding the Economy's Impact on Retirement Plans*

Several lessons are relevant regarding the impact of the economy on retirement plans. One lesson is discussed in this Newsletter. Other lessons will be discussed in future Newsletters.

The first lesson is that plan sponsors should be taking certain affirmative steps and should be asking specific questions. The steps, questions and answers should then be documented and filed with the plan's records. ERISA requires, among other demands, that plan sponsors act prudently, with expert knowledge, and for the exclusive benefit of plan participants. This means, particularly highlighted now, that plan fiduciaries must proactively determine whether making changes to a plan's investment lineup is required. Fiduciaries must meet with the plan's investment advisors to critically review the plan's investments, and then must carefully document the information reviewed and the decisions that are made. If a plan has an investment policy statement (which on occasion we recommend), it needs to be followed throughout this process.

*A fiduciary who can demonstrate he or she acted prudently by producing contemporaneous documentation of the fiduciary's decision-making process should be well-positioned in this down market to defend against any claim by participants or the Department of Labor of an ERISA fiduciary breach.*

This requirement to carefully monitor a plan's investments is not avoided or minimized if the plan allows participants to make investment decisions for their plan accounts.

Additionally for a plan that allows participants to make investment selections, as do many plans, it is more compelling than ever that the plan be reviewed for Section 404(c) compliance. If and only if a plan complies with Section 404(c) of ERISA will plan fiduciaries avoid direct liability for participant investment choices. Failure to comply with Section 404(c) means that the plan fiduciaries (*even who otherwise meet their investment duties*) are legally responsible, and can be personally liable, for any losses attributable to the participants' own investment choices. This exposure, which is significant, is in addition to the fiduciary's responsibility to select and monitor the offered investments and investment managers. The applicable plan document, summary plan description and employee communications should be reviewed to gain or confirm Section 404(c) protection. Furthermore, the other Section 404(c) requirements should be evaluated.

Many employers are entering into short, but carefully constructed, agreements to indemnify the individual fiduciary employees if such employees are sued or otherwise suffer costs resulting from investment losses or their performance of plan duties.

These and other basic issues of fiduciary concern should be reviewed by employers to both: (a) do the right thing for participants in light of this market, and (b) provide valuable protections for the plan's decisionmakers. Having an institutional trustee for the plan does not relieve the employer of, nor provide protection with respect to, these duties.

ERISA has always required proper process and due diligence by plan decisionmakers to satisfy their fiduciary responsibilities. Historically, many employers (certainly with exceptions) have not been proactive on this front, instead concentrating resources mostly on Internal Revenue Code requirements. The sour investment market and economy now underscore this important aspect of ERISA. Case law makes it clear that the fiduciary who can demonstrate "process" and that he or she asked prudent questions will be best positioned to prevail in a court of law.

### **HEALTH PLANS MUST COMPLY WITH CLAIM PROCEDURES IN DENYING BENEFITS**

Health plans (insured or self-funded) and all other welfare benefit plans subject to ERISA (for example, disability plans) must comply with certain administrative procedures. The plan documents must include precise language, and the required summary plan description must provide specific disclosures regarding the employee's substantive rights and the plan's administrative procedures. If an employee challenges the plan's denial or determination of benefits, the employer whose plan does not satisfy these requirements will find it considerably more difficult to defeat the employee's claim in court. Moreover, following proper claim procedures often averts litigation. Case law is continually populated with situations where the employer failed to comply with one or

more simple, even mechanical, requirements, leading to the employer's loss of the case on technical grounds.

One of the more pronounced repeated failures relates to the plan's benefit appeal procedures. The "appeal" stage is the plan's review prompted by the participant's request following the participant's "claim" denial. After an appeal, an employee has a right to file a complaint in federal court. The Department of Labor has prescribed specific steps and timelines that an employer must follow before denying benefits. Its regulations provide options for the plan regarding the benefit claim denial and appeal process; the chosen options must be spelled out in writing and followed. Certain disclosures must be provided to the affected individual in the plan's summary plan description, as well as throughout the benefit determination process. For example, the disclosures must inform the employee of the specific steps he or she may take to question or challenge the denial, and the employee must be informed that the plan's claim process must be exhausted before the employee may file suit in court. The employer needs to make sure that, in general, the entity or individual reviewing the benefit denial (that is, the appeal) is different than, and not answerable to, the entity or individual that made the initial benefit determination.

Most documents and routine communications with respect to health plans are furnished by insurance companies. Often the employer is not aware of the importance of reviewing and understanding such documents. Whether the plan is insured or self-funded, the employer must ensure that the language and processes comply with ERISA. All health plans should also be reviewed to confirm that certain other language is in the plan so that if there is litigation, the court will provide deference to the plan's decision making (that is, an "arbitrary and capricious" standard of review), rather than diving into the substance of the claim and making the court's own decision as to whether the benefit should be paid or denied (that is, a "*de novo*" standard of review). Many employers lose in court simply because of the absence of this language.

### **WAIVER OF 2009 REQUIRED MINIMUM DISTRIBUTIONS**

The Worker, Retiree, and Employer Recovery Act of 2008 was signed into law on December 23, 2008. In part, WRERA waives required minimum distributions ("RMDs") for 2009.

Internal Revenue Code Section 401(a)(9) and the corresponding regulations generally require that distributions from many retirement plans must commence by April 1 of the calendar year following the calendar year in which the employee attains age 70½ or retires. For individual retirement account ("IRA") owners and 5% owners in plans, distributions generally must commence by April 1 of the calendar year following the calendar year in which the individual attains age 70½. Section 401(a)(9) also governs the timing of payment upon the death of the IRA owner or plan participant.

The waiver for 2009 applies to IRAs and most plans with individual accounts (e.g., profit sharing, 401(k), 403(b), and governmental 457(b) plans). It does not apply to defined benefit plans. The new law, in response to the economic downturn, is designed to allow plan participants and IRA owners to keep more money for their retirement (and to hopefully recoup losses).

The general WRERA provision is straightforward – there is no requirement to take a minimum distribution for 2009. If distributions are made, they may be rolled over to other plans or IRAs if they otherwise qualify for rollover treatment. RMDs were still required for 2008 (even if they were not made until 2009) and are required for 2010 and thereafter. Notwithstanding the seeming simplicity of the waiver, its application has generated confusion and prompted calls for Internal Revenue Service clarification. Some of the outstanding questions relate to whether the waiver is mandatory or permissive, the need for (and timing of) plan amendments, participant and spousal consent requirements, death distributions, and reporting issues.

If you are an individual or beneficiary who wishes to waive the 2009 RMD, or if you are a plan sponsor that has been contacted by plan participants or your recordkeeper/TPA about waiving the 2009 RMD, you will need to take action.

#### **DEPARTMENT OF LABOR GUIDANCE REGARDING FIDELITY BONDS**

In Field Assistance Bulletin No. 2008-04, the Department of Labor sets forth forty-two questions and answers regarding fidelity bonds under the Employee Retirement Income Security Act of 1974, as amended.

ERISA generally requires that every person who handles plan funds or property shall be bonded. The purpose of the bond is to provide a means of recovery to a plan in the event of fraud or dishonesty by those who handle plan funds and property. Fidelity bonds must be in an amount that is at least 10% of the amount of funds handled up to a maximum required amount of \$500,000 per plan (\$1,000,000 for plans that hold employer securities).

The questions and answers provide useful information about the bonding requirements, for example, identifying who must be bonded and for what amounts. Additional points worth emphasis are that: (a) bonds are required, (b) fiduciary liability policies are not fidelity bonds, (c) fidelity bonds cannot have a deductible, (d) fidelity bonds must be placed with a surety or reinsurer that is named on an approved listing issued by the Department of Treasury, (e) there may be circumstances in which a plan service provider must be bonded, (f) fidelity bonds may be purchased with plan assets, (g) the bonding requirements do not apply to all plans, and (h) the bonds may cover more than one plan.

Plan fiduciaries are responsible for ensuring that the appropriate individuals are bonded in the appropriate amounts and under the appropriate vehicle. In fact, plan sponsors report the plan's bonding status every year on the Form 5500. It is important to ensure that bonds are correctly in place so that: (a) the coverage is there if ever needed, (b) the plan fiduciaries are fulfilling their duties, and (c) the plan is accurately reporting its activities to the government. FAB 2008-04 may be accessed at <http://www.dol.gov/ebsa/pdf/fab2008-4.pdf>.

### **DEFAULT INVESTMENT/QDIA IMPLEMENTATION UPDATE**

We previously reported on Department of Labor regulations (“QDIA regulations”) which provide fiduciary investment protection to plan fiduciaries who are forced to select investments for participants in a self-directed plan when those participants fail to exercise their right to direct their investments (i.e., defaulted participants). See our April 2008 ERISA Alert.

We have seen many efforts by plan sponsors, recordkeepers/TPAs, and/or investment consultants to achieve compliance with the QDIA regulations and thus obtain this “safe harbor” protection. However, often those involved with the compliance efforts appear to only recognize one (or sometimes two) of the regulatory requirements. In those instances, compliance will not be achieved and the protections will not be attained.

The best example of this is that in an effort to comply with the QDIA regulations, many plan sponsors changed their plan’s default fund from a money market-type fund to one of the “qualified default investment alternatives,” usually a life-cycle fund or a balanced fund. However, those fiduciaries have not yet complied with or considered the other QDIA conditions. The plan changed default funds and perhaps sent out a notice, but did not address the other requirements or the notice was deficient because it did not contain the information enumerated in the QDIA regulations. In the meantime, recent activity in the investment markets have in general more negatively impacted the qualified default investment alternative type funds, such as balanced funds and life-cycle funds, when compared to money market funds. This leaves fiduciaries susceptible to increased (instead of decreased) liabilities. This is because they changed the default fund, the new default fund lost more money than the old default fund, and they do not have the fiduciary protections available through the regulations.

This is not to assert that money market funds are more appropriate in any circumstance than a balanced fund or a life-cycle fund. The point is that if the change is made in an effort to gain protection from fiduciary breaches for these default investments, the rest of the QDIA regulations must be addressed. If the change was made for some other reason (for example, if the fiduciaries simply believed or were advised that changing the default fund to a balanced fund better served to fulfill their responsibilities), the process leading up to that decision should be properly documented (see page 1).

### **FIRM NEWS**

Jeffery Mandell spoke to the Boise Chapter of the Western Pension & Benefits Conference in February 2009 about the Internal Revenue Service’s Employee Plans Compliance Resolution System.

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*This bulletin is intended to provide general information only and does not provide legal advice. This bulletin does not discuss potential exceptions to the above rules. The application of ERISA laws can be complex. For information regarding the impact of these developments under your particular facts and circumstances, please call us.*