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2010 Year-End Compliance Summary

November 16, 2010

With the year-end fast approaching, employers should take time to review their employee benefit plans and assess whether any actions, such as adopting plan amendments and implementing administrative changes, must be taken before December 31, 2010. To assist in that process, this article lists the primary compliance issues and developments affecting health and welfare plans, retirement plans and executive compensation programs that employers should consider.

HEATH AND WELFARE PLANS

HEALTH CARE REFORM REQUIREMENTS

ALL PLANS

- **Grandfathering:** Employers should determine whether each medical plan benefit option will be grandfathered or non-grandfathered. If a medical plan benefit option is grandfathered, model language should be included in applicable documents; the U.S. Department of Labor (DOL) model language is available online. (View additional details.)

- **Pre-existing condition exclusions:** Employers must eliminate medical plan pre-existing condition limitations for children under age 19 effective for plan years beginning on or after September 23, 2010. Although notice is not required, including language in applicable documents is recommended.

- **Lifetime limits:** Employers must eliminate lifetime dollar limits on "essential health benefits" effective for plan years beginning on or after September 23, 2010. Lifetime limits are still permitted for non-essential health benefits. Individuals who previously lost coverage due to reaching a lifetime limit before the new restrictions become effective must be notified of their right to special enrollment (at least 30 days), with coverage effective no later than the first day of the plan year starting on or after September 23, 2010. Employers should provide the model notice that a lifetime limit on essential health benefits no longer applies and that individuals who previously reached the plan's lifetime limit, if still covered under the plan, are once again eligible to enroll in the plan; the DOL model notice regarding lifetime limits is available online.

- **Annual limits:** Employers must ensure annual limits on "essential health benefits" are not less than $750,000 for the plan year beginning on or after September 23, 2010, but before September 23, 2011 (or $1.25 million for the plan year beginning on or after September 23, 2011, but before September 23, 2012; $2 million for the plan year beginning on or after September 23, 2012, but before January 1, 2014; may no longer impose annual limits for plan years beginning on or after January 1, 2014). Annual limits are still permitted for non-essential health benefits.

- **Dependent coverage:** Employers must extend dependent coverage to adult children until age 26, regardless of student status, marital status, financial dependence or place of residence. If the plan is grandfathered, coverage does not need to be extended if the child is eligible for group health coverage through his or her own employer. If the plan is not grandfathered, dependent coverage must be extended regardless of whether the child is eligible for group health coverage through his or her own employer. Dependent children whose coverage, prior to the first day of the plan year starting on or after September 23, 2010, was terminated or did not begin because the availability of dependent coverage for children under the plan or policy ended before the attainment of age 26 must be notified of their right to special enrollment (at least 30 days), with coverage effective no later than the first day of the plan year starting on or after September 23, 2010. Employers should provide the model notice regarding the extended dependent coverage; the DOL model notice regarding the extended dependent coverage is available online.

- **Early Retiree Reinsurance Program (ERRP):** As applicable, employers should apply for certification or claims reimbursement from the ERRP and, once approved, should follow ERRP instructions regarding eligible claims and submission. Employers should provide the model notice to participants describing potential uses for reimbursement payments; the U.S. Department of Health and Human Services model ERRP notice is available online.

- **Over-the-counter drugs:** Employers must amend their health flexible spending accounts, health reimbursement arrangements and health savings accounts to require prescriptions for reimbursement of over-the-counter drugs (except insulin), and notify participants of this new restriction. This change is effective January 1, 2011 (regardless of the grace period for 2010 plan year).

- **Retiree only plans:** Medical plans containing less than two active participants are not subject to the health care reform rules. Employers should consider establishing retiree medical plans separate and apart from active medical plans to take advantage of the exemption.

NONGRANDFATHERED PLANS

- **Preventive care:** Medical plans must provide first dollar coverage with no cost-sharing for certain preventive services and immunizations which are administered under certain circumstances, effective for plan years beginning on or after September 23, 2010. This requirement does not apply to out-of-network benefits. Details regarding preventive services and eligible immunizations can be found online.

- **Claim/appeals:** Medical plans are subject to new internal and external claims procedures, effective for plan years beginning on or after September 23, 2010. Employers should review their plans' claims and appeals procedures to ensure they comply with the expanded internal and external claims and appeals rules.

- **Emergency services:** Emergency services coverage under a medical plan is subject to various new requirements, effective for plan years beginning on or after September 23, 2010. For instance, such coverage (both in-network and out-of-network) must be provided without preauthorization. Also, a medical plan cannot impose higher cost-sharing for out-of-network emergency services or any administrative requirements, or limitations on benefits for out-of-network emergency services that are more restrictive than those imposed on in-network emergency services. Employers should ensure their medical plans comply with the various new requirements on emergency services coverage.

- **Provider selection and referrals:** If a medical plan allows designation of a primary care physician, it must also allow participants to select any available in-network primary care provider, or any allopathic or osteopathic physician specializing in pediatrics in the case of a child. Also, a referral for ob-gyn services provided by an in-network provider may not be required. These new requirements are effective for plan years beginning on or after September 23, 2010. Employers should ensure their medical plans comply with these new requirements.

- **Non-discrimination:** Similar to self-insured medical plans, fully insured medical plans may not discriminate in favor of highly compensated individuals, effective for policy years beginning on or after September 23, 2010. Employers should review their medical plans to determine whether they discriminate in favor of highly compensated individuals.

ADDITIONAL REQUIREMENTS

- **Children's Health Insurance Program (CHIP):** CHIP required that the medical plan document and summary plan description (SPD) be amended effective April 1, 2009, to provide a special enrollment opportunity and notice to employees and dependents who are eligible, but not enrolled for coverage under the plan. The special enrollment opportunity is available when the employee's or dependent's Medicaid or CHIP coverage is terminated as a result of loss of eligibility or the employee or dependent becomes eligible for a premium assistance subsidy under Medicaid or CHIP. This special enrollment opportunity should be requested by the employee or dependent within 60 days of the loss of coverage or determination of eligibility. In addition to the special enrollment communication, employers are required to provide a CHIP Notice annually to their employees. The initial CHIP Notice must be provided by the later of May 1, 2010, or the first day of the first plan year after February 4, 2010 (e.g., January 1, 2011, for calendar-year plans).

- **Genetic Information Nondiscrimination Act (GINA):** GINA prohibits group health plans and insurance issuers from discriminating on the basis of genetic information with respect to eligibility, premiums and contributions, effective for plan years beginning one year after May 21, 2008 (e.g., January 1, 2010, for calendar-year plans). Employers should amend their plan documents, SPDs and other applicable documents, as necessary, to reflect this requirement.

- **Michele's Law:** If a medical plan covers dependents based on full-time student status, coverage must be made available when a child is unable to attend school on a full-time basis due to a medically necessary leave of absence, effective for plan years beginning on or after October 9, 2009. Such coverage must be extended until the earlier of one year from the start of the medically necessary leave of absence or the date on which such coverage would otherwise terminate under the terms of the medical plan. Employers should amend their plan documents, SPDs and other applicable documents, as necessary, to reflect this requirement.

- **Mental Health Parity and Addiction Equity Act of 2008 (MHPAEA):** The MHPAEA was enacted to create parity for mental health and substance abuse benefits, effective for plan years beginning on or after October 2, 2009 (e.g., January 1, 2010, for calendar-year plans). The new requirements only affect group health plans with 51 or more employees in the prior calendar year. Employers should review coverages to ensure equity in accordance with the requirements under the MHPAEA and, if necessary, amend their plan documents, SPDs and other applicable documents, as necessary, to comply with those requirements.

- **HIPAA privacy:** The Health Information Technology for Economic and Clinical Health Act of 2009 (HITECH) included detailed breach notification requirements, effective for breaches discovered after September 23, 2009; however, no penalties will be assessed until after February 2010 (or, if later, after final regulations are released). Employers should ensure their plan documents, SPDs, business associate agreements and other applicable documents are updated, as necessary, to reflect the new HITECH requirements.

- **Educational assistance programs:** The exclusion under Code Section 127 for qualifying educational assistance benefits provided to employees is scheduled to expire at the end of 2010. Future legislation may reinstate the exclusion, possibly retroactive to January 1, 2011. In the interim, employers should consider whether to continue or suspend such programs.

QUALIFIED RETIREMENT PLANS

ALL PLANS

- **HEART Act:** Certain amendments are required under the Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008 and must generally be adopted by the last day of the first plan year beginning on or after January 1, 2010 (e.g., December 31, 2010, for calendar-year plans). However, certain amendments are optional under the HEART Act and must be adopted by the general deadline (or, if later, by the last day of the first plan year in which the amendment becomes effective).

REQUIRED AMENDMENTS:

  - **Differential wage payments:** Differential wage payments are amounts paid to an employee on active duty for a period of more than 30 days and which would have been received from the employer absent being called to active duty. A plan is required to include differential wage payments in the definition of compensation when applying applicable provisions of the Internal Revenue Code, such as the 415 benefit and contribution limits.

  - **Survivor benefits:** A plan is required to provide that survivors of a participant who dies while performing qualified military service must be entitled to receive the same benefits (other than benefit accruals for the period of qualified military service) that would otherwise have been provided under the plan to such survivors had the participant resumed employment and then terminated employment on account of death (in other words, treated as if the participant had died while employed). These additional benefits can include accelerated vesting, ancillary life insurance benefits or other survivor benefits.

  - **Vesting service:** A plan is required to provide service credit for vesting purposes for the period of a deceased participant's qualified military service.

OPTIONAL AMENDMENTS:

- **Differential wage payments:** A plan may include differential wage payments in compensation for determining contributions and benefits.

- **Vesting service:** A plan may provide service credit for vesting purposes for the period of qualified military service for participants who become disabled while performing such service, to the extent permitted under other applicable rules.

- **Benefit accruals:** A plan may provide benefit accruals for the period of qualified military service for all participants who die or become disabled while performing such service on reasonably equivalent terms.

- **Non-spouse beneficiary direct rollovers:** A plan could have allowed non-spouse beneficiaries to request a direct rollover of an eligible rollover distribution to an inherited IRA as early as January 1, 2007. However, the Worker, Retiree and Employer Recovery Act of 2008 (WRERA) made this mandatory for plan years beginning after December 31, 2009. Employers who did not voluntarily implement this direct rollover option prior to the first plan year beginning after December 31, 2009, must amend their plans by the end of the first plan year beginning after December 31, 2009 (i.e., December 31, 2010, for calendar-year plans) to make this option available to non-spouse beneficiaries.

- **Determination letter filing:** Cycle E: Cycle E is the last filing cycle in the Economic Growth Tax Relief Reconciliation Act of 2001 round of determination letter filings. Employers with an Employer Identification Number (EIN) that ends in 5 or 0 should plan to submit an on-cycle application by January 31, 2011.

DEFINED BENEFIT PLANS

- **Cash balance/hybrid plan final regulations:** In October 2010, the U.S. Treasury Department and Internal Revenue Service (IRS) released the final cash balance/hybrid plan regulations. The final regulations include many requirements, such as three-year vesting schedules, the protections against benefit reductions based on age and the standards for setting interest credits at a rate not greater than the market rate of return. The final regulations generally apply to plan years beginning on or after January 1, 2011. Amendments are required by the end of the first plan year beginning on or after January 1, 2010 (e.g., December 31, 2010, for calendar-year plans).

- **Benefit restrictions based on plan funding:** In October 2009, the Treasury Department and IRS released final regulations providing guidance on the funding-based benefit restrictions on defined benefit plans (excluding multi-employer plans) under Code Section 436. Many plans were amended to comply with the regulations in 2009, but certain clarifying amendments are still required for such plans. Amendments for the final regulations are generally required by the end of the first plan year beginning on or after January 1, 2010 (e.g., December 31, 2010, for calendar year plans).

DEFINED CONTRIBUTION PLANS

- **HEART Act:** A plan may treat a participant as having severed employment (for distribution purposes, including distributions from a designated Roth account) while on active duty for a period of more than 30 days. (See amendment deadline above applicable to optional HEART Act amendments.) If a participant elects to receive such distribution, the participant's right to make elective deferrals or after-tax employee contributions must be suspended for the six-month period after the distribution date. Also, unless an exception applies, the distribution will be subject to the 10 percent penalty tax for early distributions if it is not timely rolled over into an eligible retirement plan.

- **Waiver of required minimum distributions:** The WRERA permitted employers to suspend otherwise required minimum distributions under a defined contribution plan for the 2009 plan year. Related amendments generally must be adopted by the last day of the first plan year beginning on or after January 1, 2011 (e.g., December 31, 2011, for calendar year plans). However, employers may wish to consider adopting those amendments in 2010.

- **Diversification of publicly traded employer stock:** Defined contribution plans that invest in publicly traded employer securities must permit participants to invest their accounts in other investments. Amendments are required by the end of the first plan year beginning on or after January 1, 2010 (e.g., December 31, 2010, for calendar year plans).

PUERTO RICO AND DUAL-QUALIFIED PLANS

- Transfers from plans intended to be qualified both in the United States and in Puerto Rico (dual-qualified plans) to Puerto Rico-only qualified plans must be made before January 1, 2011, to avoid qualification and tax problems. (View additional details.) However, based on a recent letter from the IRS to Senator Arlen Specter, there may be concern with regard to the pooling of assets of Puerto Rico and U.S. plans for investment purposes in a U.S. group or master trust arrangement.

EXECUTIVE COMPENSATION

DEFERRED COMPENSATION ARRANGEMENTS

- **Correction of certain plan document failures:** Plan documents for non-qualified deferred compensation arrangements can be corrected to comply with Code Section 409A for certain violations without any penalty, provided correction is completed by year-end under Notice 2010-6. This correction opportunity is particularly helpful for plans that may not have previously been identified as subject to Code Section 409A or that have not been amended for the final regulations under Code Section 409A. Employers must report use of the correction program on annual tax filings. Plan sponsors should review plan documents now and consider correcting any defects using Notice 2010-6 before year-end to take advantage of the correction opportunity. Correction after this year could result in severe adverse tax consequences for affected individuals. View additional details on available corrections.

- **Correction of certain operational failures:** Correcting a failure to comply with Code Section 409A in operation by the end of 2010 under Notice 2008-113 could produce a more favorable tax result for the affected individual (i.e., reduced penalties or no penalties) than if it is corrected in a later year. Common failures typically eligible for correction include inadvertent deferral or acceleration of payments due to administrative error. Employers should confirm that benefits with scheduled payment dates in 2010 are paid before year-end. Employers should also identify any other potential operational failures and determine whether correction should be made this year under Notice 2008-113.

- **Employment agreements and continued health coverage after employment termination:** New nondiscrimination rules under Code Section 105(h) generally apply to insured health plans for policy years beginning after September 23, 2010. If a highly paid individual receives continued coverage on a pre-tax (or employer-subsidized) basis in a discriminatory manner under a policy that is not grandfathered, the insurance proceeds will be taxable to that individual. Employers should consider providing a taxable cash subsidy for highly paid individuals to purchase continued health coverage after employment termination in lieu of providing this coverage on a pre-tax (or employer-subsidized) basis under a group health plan.

INCENTIVE STOCK OPTION (ISO)/EMPLOYEE STOCK PURCHASE PLAN (ESPP) REPORTING

- **New filing with IRS for stock transfers in 2010:** A new IRS reporting requirement under Code Section 6039 will require employers for the first time to file returns directly to the IRS for ISO and ESPP stock transfers that occurred in 2010 (in addition to providing participant statements by January 31, 2011). Filings under this requirement are unlikely to be covered under existing arrangements with plan vendors. In order to be in a timely position to file with the IRS in early 2011, employers should plan now for complying with this new requirement. View the final versions of Form 3921and Form 3922 as well as the instructions.

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