To: Clients and Friends
From: Smith & Downey
Date: June 18, 2010
Re: Recent Developments

A. Health Reform Early Retiree Plan Subsidy Opens Next Week.

As we discussed in more detail at our seminar, employers with early retiree health plans that cover individuals age 55 - 64 are eligible for a federal subsidy, beginning June 23, 2010 and ending when the $5 billion set aside for this purpose is spent.

The regulators recently issued guidance and a draft application necessary for employers to begin to prepare to apply for this subsidy.

Naturally, all employers with eligible plans should prepare to apply for this subsidy immediately, to increase their chances of receiving it before the $5 billion is spent.

B. Extensive Guidance on Losing Grandfathered Status Issued.

On June 17, the regulators published extensive guidance on the types of health plan changes that will cause a plan in effect on March 23, 2010 to lose its grandfathered status under the health reform law. (As we discussed in detail at our seminar, in certain cases the maintenance of grandfathered status can have significant economic value, and grandfathered plans have a significantly relaxed "glide path" for health reform compliance.)

In general, a grandfathered plan will lose its grandfathered status if any of the following occurs:

1. The plan documents fail to include provisions explaining the plan's grandfathered status. (Model language is provided in the rules.)

2. The plan documents fail to include provisions identifying the party to whom grandfathering questions and "complaints" can be directed. (Again, model language is provided in the rules.)

3. The plan fails to keep records of its grandfathered provisions.

4. The plan fails to make its plan documents and records described above available for inspection by participants and the regulators.

5. The employer engages in a business transaction (a merger, a purchase, a sale, etc.) for the purpose of "buying or selling" the plan's grandfathered status.

6. The employer transfers an employee from one grandfathered plan to another grandfathered plan for purposes of evading the grandfathered provisions affecting the employee in the transferor plan.

7. The plan eliminates or substantially eliminates all benefits necessary to diagnose or treat a particular condition.

8. The plan raises its co-insurance percentage.

9. The plan raises its deductible or out-of-pocket maximum more than the rate of medical inflation plus 15% (measured from March 23, 2010).

10. The plan raises its co-pay more than the greater of: (a) the rate of medical inflation plus 15% (measured from March 23, 2010); or (b) $5 times the rate of medical inflation (measured from March 23, 2010) plus $5. [Note that there is significant ambiguity in the language of (b) in the rules.]

11. The employer reduces its contribution toward the total cost of coverage by more than 5%.

12. If the plan had no annual or lifetime limit on March 23, 2010, the plan adds an annual limit.

13. If the plan had a lifetime limit on March 23, 2010, but no annual limit on that date, the plan adds an annual limit less than the lifetime limit on March 23, 2010.

14. If the plan had an annual limit on March 23, 2010, the plan lowers the annual limit.

15. For insured medical coverage, the employer enters into a new insurance contract after March 23, 2010 (rather than renewing an existing contract).

The rules expressly provide that other post-March 23, 2010 changes will not cause a grandfathered plan to lose its grandfathered status (although the regulators request comments on additional types of plan changes that should be added to the list of loss-of-grandfathering changes).

The rules also contain a "grace period" procedure under which certain employers may revoke changes adopted after March 23, 2010 but before June 17, 2010 that caused their plans to lose grandfathered status.

Finally, the rules provide that the regulators may ignore certain "good faith" changes after March 23, 2010 but before June 17, 2010 that "only modestly" exceed the limitations above.

(Unfortunately, there are a number of ambiguities and unanswered questions in the rules that will require clarification and that may alter some of the above interpretations.)

As we discussed at our seminar, it is very important for employers to: (a) identify their grandfathered plans; (b) determine whether those plans' grandfathered status has significant value; and (c) if desired, take the steps necessary to ensure continued grandfathered status. These new rules add some clarity to that process.

C. <u>Deferred Compensation Plan 409A Developments</u>.

As we discussed in a prior E-alert and at our seminar, the IRS recently released Notice 2010-6 containing rules for the correction of nonqualified deferred compensation arrangements (broadly defined) that reflect certain Code Section 409A document failures.

The Notice offers employers an opportunity to correct voluntarily many document failures or ambiguities that otherwise would trigger the very onerous 409A penalties, provided the corrections are made, generally, by the earlier of December 31, 2010 or the employer's receipt of an IRS notice of audit.

Given the IRS's stepped-up audit activity in this area, many employers, particularly those that may not have realized until recently that certain of their compensation and benefits arrangements are covered by 409A, will want to act promptly to avail themselves of the relief provided by the Notice.

For example, virtually all employers and their advisors previously believed that an employee's right to reimbursement of various types of expenses could be exempt from 409A under the so-called "short-term deferral" exemption, and the reimbursement provisions of many employment agreements contain language consistent with this view. Unfortunately, the IRS has stated that the short-term deferral exemption is not available for reimbursement arrangements. However, this IRS has held that this error can be corrected without penalty so long as no reimbursements have been made in a manner that would violate the rather flexible operational requirements of 409A and the affected documents are corrected by the end of this year.

Also, as we announced in a prior E-alert, the IRS published for the first time a new, and restrictive, interpretation of 409A relating to payments that are contingent on the execution by the employee of a release, a non-compete agreement or a non-solicitation agreement. Specifically, the IRS stated that basing payment dates for deferred compensation (again, as broadly defined in 409A) on the date that an employee signs such an agreement is a 409A violation resulting in 409A's very onerous penalties.

Again, under the Notice, in most cases, revisions to reflect this new IRS position may be made by the earlier of December 31, 2010 or receipt of an IRS notice of audit.

Naturally, employers should review all of their deferred compensation agreements (as very broadly defined under 409A to include most traditional deferred compensation plans, employment agreements, severance agreements, reimbursement arrangements, and the like) to determine whether this IRS correction procedure should be used immediately to protect the programs from the very significant 409A penalties.

D. Change in Health Plan Dependent Definition.

Some employers are considering changing their health plan's definition of dependent to increase the limiting dependent child age to 26 and to remove the dependent child student requirement prior to the date they are required to do so by the health reform law (generally, the first day of the first plan year beginning after September 22, 2010).

Although we do not advise this approach, employers taking it should be certain that the changes they make are expressly approved by their plans' insurers or stop loss carriers and ensure that the changes are properly reflected in plan amendments and Summaries of Material Modifications to their plans' SPDs. These employers also should make sure that the applicable Section 125 pre-tax employee contribution rules are followed (for example, by not adding newly eligible dependent children retroactively for coverage that is paid for with pre-tax dollars).

In addition, employers making these in-advance changes should be aware that they likely will need to make further changes to comply with the age 26 portion of the health care reform on the law's actual effective date. For example, the new law requires that employees be given a special 30-day enrollment opportunity during which they can add dependents who are under age 26 and who were previously dropped from the plan or denied coverage, and this new special enrollment period cannot start until after a specified notice is given (e.g., calendar year plans must distribute the notice by December 1, 2010).

Please contact us if we can assist you with any of the above.