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Retirement Plan News

The Supreme Court rules on SPDs

The U.S. Supreme Court ruling in *Cigna Corp v. Amara* (No. 09-804, May 16, 2011) could have a major impact on employers who sponsor qualified retirement plans subject to ERISA.

Background

The case involved the Cigna defined benefit plan. In November 1997, Cigna provided participants with a newsletter explaining that their existing pension plan was being converted into a cash balance plan. The newsletter also detailed how employees would see an improvement in retirement benefits after the conversion. A class action lawsuit was brought on behalf of approximately 25,000 plan participants alleging that the Cigna cash balance plan provided participants with fewer benefits than previously communicated, thus representing an illegal cutback.

The district court agreed with the plaintiffs' contention and ordered Cigna to pay additional benefits. When issuing its judgment, the district court applied ERISA Section 502(a)(1)(B), which permits participants to sue to recover benefits due under the terms of a plan. Although Cigna admitted that the participant communication was misleading, it disputed the idea that all employees had suffered harm as a result.

Ruling on SPDs and plan terms

The Supreme Court unanimously (8-0 with Judge Sotomayor not participating) rejected an argument that misrepresentations in a summary plan description (SPD) could be considered as actual plan terms. Thus, the SPD would not be enforceable under ERISA Section 502(a)(1)(B).

For years, lower courts have held that discrepancies between SPD language and actual plan document language are controlled by the SPD if the participants showed they would otherwise be harmed (i.e., if the SPD were not followed). In this case, the Supreme Court makes it clear that courts may not rewrite the terms of the plan by having the terms of the SPD override the terms of the plan document. In other words, the language in the SPD may not be used to rewrite the terms of the plan document.

The Court explained that there is a division of authority between the role of the *plan sponsor as settlor* — the person who creates the plan's basic terms and conditions and executes the written instrument containing these terms and conditions, including a provision for plan amendments — and the role of the *plan administrator* — the person who has the fiduciary responsibility of providing participants with

SPDs. The Court states that these roles are distinguished by ERISA, and there is no reason to believe that ERISA intends to mix the responsibilities by giving the administrator the power to set plan terms in the SPD, even if the plan sponsor *is* the plan administrator, as is the case in *this* case.

The Supreme Court stated that it is impossible to interpret the SPD's language as legally binding because the objective of the SPD is to provide clear, simple communication. However, inaccurate or misleading communications by the plan administrator in performing their disclosure duties could be found to violate ERISA's fiduciary requirements.

Ruling on appropriate equitable relief

The majority opinion (delivered by Justice Breyer and agreed to by six Justices) agreed with the district court's ruling that plan participants who were

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Hardship distribution limit

The general rule for hardship distributions is that the maximum amount that can be withdrawn is based on the total of the employee's elective deferrals as of the date of distribution minus any previous distributions of elective deferrals.

Example: A participant has $10,000 in elective deferrals and takes a hardship distribution of $1,000 on March 31, 2011. If the participant needs another hardship distribution on May 4, 2011, and has not made any additional elective deferrals, the maximum amount that can be withdrawn as a hardship is $9,000.

The maximum hardship distribution amount excludes the following: earnings on elective deferrals; qualified nonelective contributions (QNECs) and qualified matching contributions (QMACs), unless such amounts are grandfathered; and safe harbor 401(k) contributions and corresponding earnings.

Grandfathered amounts

If the plan so provides and the records have been maintained, earnings on elective deferrals, as well as QNECs, QMACs, and the earnings thereon, may be included in the maximum hardship amount if they were credited to the employee's account as of a date specified in the plan that is no later than December 31, 1988, or the end of the last plan year ending before July 1, 1989.

Plan design options

It is important to remember that a plan may be written permitting vested sources (such as rollovers, transfers, and nonelective or matching employer contributions) to be available for hardship withdrawal. However, except as noted above, QNECs, QMACs, and safe harbor contributions may not be made available for hardship.

Designated Roth accounts

The designated Roth final regulations state that Roth accounts are subject to the same withdrawal restrictions as pretax elective deferrals. Roth accounts may be made available for hardship distributions. However, the final regulations state that if a hardship distribution of designated Roth amounts is actually taken, it would be taxed as if it consisted of pro rata amounts of after-tax Roth contributions and earnings. Thus, Roth account earnings would be both taxable and subject to a 10% penalty. In addition, if the participant applied for a future hardship, the Roth amount distributed — including the earnings — would be subtracted from the amount of total deferrals available. (Note: If a participant has both pretax and Roth deferrals, he or she can choose which amounts are distributed. There is no requirement that distributions be taken from both types pro rata.)

Example: Joe has a Roth account of $10,000 — $7,000 in designated Roth (after-tax) deferrals and $3,000 in earnings. The maximum hardship distribution he can take is $7,000. If Joe takes $1,000, he is taxed as if $700 (70%) is from designated Roth deferrals and $300 (30%) is from earnings. However, if Joe needs a second hardship distribution, the calculation is treated as if all $1,000 came from his original designated Roth deferrals and the second distribution is limited to $6,000.

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provided with an inaccurate description of a change being made to their pension benefits were entitled to equity relief, but under a different section of ERISA — Section 502(a)(3). This section provides for relief based on a violation of ERISA where plan participants or beneficiaries actually show they were harmed and authorizes "appropriate equitable relief" such as reformation, estoppel, and surcharge for violations of ERISA.

The Court stated that it is not difficult to imagine how the failure to provide proper summary information here, in violation of ERISA, injured employees, even if they themselves did not act in reliance on the summaries. A plan participant or beneficiary must show that the violation caused injury, but need show only actual harm and causation. They are not required to show any detrimental reliance. The Supreme Court remanded the case to the district court to revisit its determination of an appropriate equitable relief remedy for the ERISA violations it found.

An important case

Employers will generally be happy with the Supreme Court's Cigna decision because the Court found that plan participants may not bring lawsuits for misleading or inaccurate ERISA plan communications under ERISA Section 502(a)(1)(B). The requirement that participants must show actual harm to receive an award may reduce the initiation of future class action lawsuits where SPD or plan communication issues arise.

This ruling is also significant because the Supreme Court explicitly rejected the SPD as enforceable over the plan when the SPD contradicts the terms of a plan document. Further, the Court made clear that the language in summary plan communications cannot be treated as the terms of the official written plan document.

Best practices

Although the SPD is not seen as an extension of the plan terms in this decision, misinformation in an SPD can still cause harm. Plan administrators and plan sponsors still need to exercise extreme care in preparing an SPD and in establishing procedures for reviewing the SPD relative to the terms of the plan.

If we can help by answering your questions, please contact us.

Spousal consent requirements

For qualified retirement plans that are subject to minimum funding standards (i.e., defined benefit, cash balance, target benefit, and money purchase pension plans), the normal form of benefit for unmarried participants is a life annuity benefit.

Qualified joint and survivor rules

For married participants, these plans must provide a qualified joint and survivor annuity (QJSA) benefit as its normal form of benefit. Should the participant die before any retirement benefits are paid, these plans are obligated to provide a qualified preretirement survivor annuity (QPSA). QJSAs and QPSAs are mandatory unless the participant and his or her spouse waive the annuity requirements.

If a married participant in a retirement plan with survivor annuity benefits wants to receive a distribution in a different form, the spouse must provide written consent and the consent must be witnessed by a plan representative or notary public.

This requirement also applies if the participant applies for a plan loan. However, if the participant is not married, or there is satisfactory evidence that the spouse cannot be located, spousal consent is not necessary.

Furthermore, spousal consent is not necessary for a distribution or plan loan when the participant's total vested account balance or accrued benefit is $5,000 or less.

Exempt plans

Spousal consent is not required for plans that are exempt from the QJSA provisions. (Specific requirements relating to the unavailability of annuity payments must be satisfied for the exemption to apply.)

Generally, most profit sharing and 401(k) plans are safe harbored from the QJSA rules. Therefore, spousal consent would not be required, unless they permit a plan participant to elect an annuity form of benefit. Note that an employer whose plan is not subject to joint and survivor benefits is permitted to require spousal consent even though the law does not require it.

Suppose a plan subject to minimum funding (e.g., a money purchase plan) is merged with a plan that is safe harbored from the QJSA rules (e.g., a 401(k) or profit sharing plan) and the money purchase assets have been separately sourced. In such a case, the QJSA rules would only need to apply to the assets from the money purchase plan. However, for ease of administration they could apply to all amounts. If a participant seeks a loan that includes assets from the money purchase source, then spousal consent must be obtained.

Spousal consent

There are several requirements that must be met regarding spousal consent for a plan loan:

- The consent must be in writing.
- It must acknowledge the effect of the loan.
- It must be witnessed by a notary public or a plan representative.
- The consent may not be dated earlier than 180 days before the loan is granted.

Similar document and timing requirements apply to distributions at retirement or severance of employment. There is one exception: Spousal consent is *not* required for an in-plan Roth rollover (Roth conversion).

Paperless loans and spousal consent

Thanks to the widespread use of daily valued plans, the Internet, and available technology, paperless loans have become popular. Paperless loans are possible because of the Electronic Signatures in Global and National Commerce Act (ESIGN) and U.S. Treasury regulations that permit electronic communication and consent for certain participant elections, including participant loans.

If the provisions of ESIGN and the Treasury regulations are followed, participant loans and other elections may be completed electronically and will have the same validity and legal effect as paper contracts.

Plans that are subject to QJSA rules, however, require that spousal consent be witnessed in the *physical presence* of a plan representative or notary public. The Treasury regulations state that since spouses often share personal identification numbers (PINs), there would not be adequate security if the participant's spouse's PIN was used to give spousal consent.

Most plans still have the spouse sign a paper consent witnessed by a plan representative or notary public.

RECENT developments

Fee disclosure deadline extensions

The Department of Labor (DOL) has issued final regulations that extend the effective date of the final 408(b)(2) regulations to April 1, 2012. Final 408(b)(2) regulations require retirement plan service providers to disclose comprehensive information about their fees and potential conflicts of interest to plan fiduciaries. The DOL has yet to release the final 408(b)(2) rules and recognizes that service providers will need additional time for compliance.

The final regulations also include an extension of the transition rule for plan sponsors to comply with the new participant-level fee disclosure requirements under ERISA 404(a)(5). The extension would require calendar-year plans to comply no later than 60 days after the later of April 1, 2012, or the date the regulations apply.

403(b) plan termination guidance

In Revenue Ruling 2011-7, the IRS provides guidance on the procedure for terminating a 403(b) plan. The guidance uses four examples to demonstrate how various investments should be handled at the time of the plan termination and explains the specific actions that must be taken for a 403(b) plan to be terminated.

The guidance was welcomed by the retirement plan community, since there was much uncertainty regarding the proper method of terminating a 403(b) plan. Employers who currently sponsor a 403(b) plan and wish to terminate it and replace it with a 401(k) plan will find this guidance helpful.

403(b) compliance project

The IRS Employee Plans Compliance Unit (EPCU) recently launched a compliance project focused on 403(b) issues. Over 300 public higher education institutions were sent a questionnaire asking how they are complying with the universal availability rules requiring that all employees (with limited exclusions) have the ability to contribute elective deferrals to a 403(b) plan.

Additional questions are designed to ascertain whether an organization has been in compliance with the "written plan document requirement" introduced by final 403(b) regulations. The IRS will issue closing letters to organizations that appear compliant and assist those that are not by providing recommended correction methods. Organizations that fail to respond could be subject to a plan examination.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

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