

# What Benefit Plan Professionals Need to Know for 2024

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IslerDare<sub>PC</sub>

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1. Island of Misfit Benefits
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# 1. Island of Misfit Benefits



# ERISA

- Plan, fund, or program
- Established or maintained by an employer
- For the purpose of providing a listed benefit
- Listed benefits
  - Medical, surgical, hospital → group health plans
  - Sickness, accident, death, disability
  - Prepaid legal
- Consequences: plan document, SPD, Form 5500, claims, and appeals

# Group Health Plan

- ERISA plan that provides medical benefits
- Consequences
  - COBRA
  - HIPAA
  - Affordable Care Act

# Tax Consequences

- General rule – all benefits are taxable unless an exception applies
- Common exceptions:
  - Medical plans
  - Adoption assistance plans
  - Educational assistance plans
  - De minimis giveaways
    - BUT cash and gift cards are never de minimis!



# Questions to Answer

- Is this benefit subject to ERISA?
  - Is this benefit a group health plan?
- What are the tax consequences of the benefit?
- Who will be eligible for the benefit?
- Who will administer the benefit?
- How will the benefit be communicated to employees?

# Eliminate Surprises

The only reason nobody wants a Charlie-In-The-Box is because it's unexpected.

With proper planning (including compliance reviews and vendor vetting), you'll know exactly what benefits you're getting and how they will function.



## 2. SECURE 2.0

# SECURE 2.0 Act of 2022

- “Setting Every Community Up for Retirement Enhancement”
- Bipartisan retirement legislation signed into law on December 29, 2022; builds on SECURE Act 1.0 of 2019
- Broad policy goal is to enhance retirement savings:
  - Close the coverage gaps in retirement savings for small employers and part-time workers
  - Reduce leakage from employer-based retirement plans by increasing portability when change jobs and provide additional discretionary distribution options for emergencies
  - Simplify plan administration and expansion of correction for operational errors
  - Prioritize emergency savings
  - Address adequacy of disclosures to plan participants

# SECURE 2.0 Act of 2022

- 92 new provisions; some mandatory and some optional; different effective dates
  - Implementation of certain provisions is highly dependent on issuance of guidance from government and abilities of recordkeepers to implement
  - Compliance deadline for plan amendments recently extended to December 31, 2026
  - ***Planning and Implementation Checklist***
- Recent guidance from DOL and IRS on implementing certain provisions of SECURE 2.0

# Long-Term Part-Time Employees

## IRS Proposed Regulations: Long-Term Part-Time Employee Eligibility (Mandatory)

- Proposed regulations address requirements under SECURE 1.0 and SECURE 2.0 regarding service credit for long-term part-time employees and their eligibility to make elective deferrals
  - For the 2024 plan year (SECURE 1.0), employees who have completed at least 500 hours in 3 consecutive 12-month periods to be eligible to make deferrals under a 401(k) plan
  - For the 2025 plan year (SECURE 2.0), employees who have completed at least 500 hours in 2 consecutive 12-month periods to be eligible to make deferrals under a 401(k) or 403(b) plan

# Long-Term Part-Time Employees

## Action Steps for Employers:

- Review plan documents for any eligibility exclusions to ensure no conflict with these rules & track hours of any part-time population not eligible as necessary
  - Certain exclusions may be permitted (e.g., based on job classification or work location) but exclusions based on time worked (e.g., part-time, seasonal or intern) should be reviewed
    - Can still exclude from employer contributions; amendment to address entry for elective deferrals and nondiscrimination and coverage testing
  - Exclusion may be outdated (e.g., no interns have been employed), so make sense to remove to avoid potential issues
  - Amend for more generous design to remove exclusions (increased costs v. no administrative burden of tracking hours)

# IRS Notice 2024-2: Guidance on Various Optional SECURE 2.0 Provisions

- Financial incentives to enroll in plan (up to \$250)
  - Employees already contributing to plan are not eligible
- Distributions for terminal illness that would not be subject to the 10% early distribution penalty tax
  - Doctor certification required
- Election to treat employer contributions as Roth after-tax contributions
  - Certain Roth elective deferral rules apply
  - Must be fully vested in match or nonelective to elect Roth treatment (nondiscrimination relief)
  - Tax issues: includable in year of allocation; reportable on Form 1099-R; not wages for FICA or FUTA
  - No guidance on Roth treatment for catch-up contributions by certain high-earning employees (previously delayed implementation until 2026)



# IRS Notice 2024-2: Guidance on Various Optional SECURE 2.0 Provisions

## Action Steps for Employers:

- Determine if would like to implement any of these optional provisions
- Discuss with recordkeeper and third-party administrator to confirm capabilities to implement
- Keep clear record of adoption of any optional changes and ensure amendments are adopted by December 31, 2026

# Pension Linked Emergency Savings Accounts

## IRS Notice 2024-22 and DOL FAQs on Pension Linked Emergency Savings Accounts (PLESAs):

- **PLESA:** Short term savings account maintained within a 401(k) or 403(b) plan; permit up \$2,500 in savings; allow monthly account withdrawals
- Employers may decide to auto enroll participants in PLESA; eligible PLESA participants do not have to participate in retirement plan
- Must match PLESA contributions the same as non-PLESA
- 1x month distributions for any reason

## Action Steps for Employers:

- Determine if interested and discuss with recordkeeper, custodian and third-party administrator; guidance welcome news but still implementation concerns
- Must consider issues with reporting, disclosure, notice, fees, recordkeeping, etc.

# Automatic Portability

## **DOL Proposed Rule on Automatic Portability**

- Policy Goal: reduce retirement plan “leakage” and reduce incidence of missing participants by consolidating retirement accounts from various employers
- Guidance on automatic portability transactions and exemption from statutory prohibited transactions in connection with providers facilitating an automatic portability transaction into Safe Harbor IRA
- Providers must disclose and set reasonable fees

## **Action Steps for Employers:**

- Consider education for new hires and terminating employees
- Be aware of prohibited transaction exemption requirements when selecting automatic portability provider
- If regs are finalized, updates to SPDs may be needed

# **3. Plan Governance**

**(even for welfare benefits!)**

# What Governance?

- Governance – who has authority and supervision over the benefit plan?
  - Default: Company – entity that established the plan
- BUT – sometimes delegate to another entity (“Committee”) or individual(s)
  - Shield of liability from fiduciary breach
  - Draw distinction between fiduciary activities vs. settlor activities
  - More agile and able to act quickly
  - More effective monitoring of day-to-day administration

# What Benefits Need Governance?

- Historically – focus on retirement plans
  - Area for class action litigation (401(k) fees, interest rate assumptions for defined benefit plans)
  - Investment decisions / monitoring
  - Ongoing administration – does not “reset” every year
- Could extend to nonqualified deferred compensation plans
- Rarely seen for welfare plans
  - “Reset” with each new year (new deductible)
  - Historically less fee litigation

# Changing Landscape

- Legislative and agency focus on welfare plans
  - 408(b)(2) fee disclosures expanded to welfare benefits
  - RxDC Reporting
  - Transparency in Coverage requirements (machine readable files)
- Increasing cost trends
  - Specialty drugs
  - GLP-1 (weight loss drugs)
- Class action litigation

# Johnson & Johnson Lawsuit

- Filed February 5, 2024
  - Pension & Benefit Committee – individually named members
- Allegation – breach of fiduciary duty and mismanagement of prescription drug benefits - failure to:
  - Adequately select – analyze participant base, cost-effective model
  - Negotiate and renegotiate favorable terms – rebates, financial concessions, precise provisions, transparency
  - Supervise / monitor – minimize costs and maximize outcomes
  - Retain control over formularies – prevent abuse
  - Avoid conflicts – consultants, PBMs, formulary decisions



# J&J Lawsuit Implications

- Damage to participants – higher cost sharing
  - Premium, deductible, coinsurance, copay
  - Lower wages / wage growth
- Unique factors
  - Self-insured plan
  - Welfare-related Committee
  - VEBA-funded welfare benefits
  - Early stages of litigation

# Where to Start...

- Review current operations
  - Determine roles – fiduciary a **functional** definition: who exercises **discretionary** authority / control over plan or its assets
  - What service providers / “experts” are involved?
  - What is good to keep, and where is there space to improve?
- Determine desired scope
  - What structure – e.g., committee, subcommittee, delegations
  - What’s the Committee’s authority with respect to:
    - Type of task: RFP, plan design, monitoring, contract negotiation, day-to-day troubleshooting
    - Scope of benefits: self-insured vs. fully insured, medical / Rx

# Formalize the Process

- Primary way to show prudence is through process
- Decision making process
  - Consider written documentation to support the formalized structure – charter, written delegations
  - Recordkeeping to show decisions made – e.g., minutes
- Process on selecting and monitoring vendors
  - Process to confirm fee disclosures and what done next
  - Regular RFPs / RFIs
  - Contract negotiation guidelines

# Leverage Experts

- Utilize brokers and consultants
  - Review fee disclosures
  - Ensure market checks, benchmarking
- Be vigilant about conflicts of interest
  - Ask the question
- Hold experts accountable
  - Build in regular reporting from vendors and have brokers or consultants review them
  - Consider audits (or threat of audits)

# Good Housekeeping

- ERISA fiduciary liability insurance, indemnification
- Establish good plan administration habits
  - Organized recordkeeping
  - Documentation of process undertaken
  - Consistent, timely and full correction of errors
  - Disclosure obligations
- Even small steps are worth taking

Not about a particular result –  
but the process taken to reach that result.

# 4. Severance Plans:

To Be *(an ERISA Plan)*  
or  
Not To Be *(an ERISA Plan)*

# ERISA Pros & Cons

- Benefits of severance plan that is subject to ERISA:
  - Preemption of state law
  - No compensatory / punitive damages
  - No right to jury trial
  - Favorable standard of review – arbitrary and capricious
  - Control venue and choice of state law
  - Impose reasonable statute of limitations
  - Exhaustion of administrative remedies (control over discovery)

# ERISA Pros & Cons

- Requirements applicable to ERISA severance plans:
  - Written plan document
  - Participant disclosures (SPDs)
  - Claims procedures
  - Annual Form 5500 filing (unless the plan has fewer than 100 “participants”)
- Additional requirements apply if severance plan is a pension benefit plan
  - Participation, vesting, funding and trust requirements
  - Can be mitigated if structured as top-hat pension plan
- Consequences of failure to comply with ERISA:
  - Potential civil and criminal penalties



# ERISA v. Non-ERISA

- What constitutes an ERISA plan?
  - *Ft. Halifax Packing Co. v. Coyne* - “ongoing administrative scheme”
    - Commitment to systematically pay benefits or any ongoing administrative responsibility to determine eligibility and calculate benefits
  - Simple ministerial payroll practices without discretionary administration are not ERISA plans
    - Severance payments determined using straightforward formula and paid in one lump sum – not an ERISA plan
    - Severance plan eligibility required employer to determine whether an employee’s responsibilities had been substantially reduced and paid in one lump sum payment – ERISA plan

# ERISA v. Non-ERISA

- Factors to consider when determining whether a severance arrangement is an ongoing administrative scheme:
  - Form of severance payments
    - One-time lump sum payment or series of payments
  - Length or term of severance arrangement
    - Ongoing, indefinite plan or upon occurrence of a single event not likely to reoccur
  - Ongoing administrative arrangement of indefinite duration
    - Calculations based on certain factors (e.g., length of service, reemployment prospects, job performance)
  - Employer discretion in determining eligibility and amount of benefits
    - Eligibility for severance if job duties are “substantially reduced”

# Welfare Plan or Pension Plan

- Severance plan is not treated as a pension plan if:
  - Severance payments are not contingent upon employee's retirement
  - Total amount of payments do not exceed two times the employee's annual compensation during the year immediately preceding the termination of employment
  - All payments to the employee are completed within 24 months following the employee's termination
    - Early retirement window program – payments must be made within 24 months after employee reaches normal retirement age, if later

# Internal Revenue Code

- Internal Revenue Code § 409A applies to deferred compensation
  - Limited ability to accelerate or further delay payment of deferred compensation
  - Severe penalties for noncompliance
- General rule is that severance benefits are deferred compensation subject to 409A

# Internal Revenue Code

- Severance payments can be structured to be exempt from 409A
  - Short term deferral exception
    - Paid no later than 2 ½ months after year in which “substantial risk of forfeiture” ends
    - Release of claims – severance agreement must specify deadline
  - Separation pay safe harbor exception
    - Involuntary or voluntary under window program lasting not more than 12 months
    - Lesser of two times preceding year’s compensation or 401(a)(17) limit
    - Paid by end of second year after year in which termination occurred

# Action Items

- Identify all formal and informal arrangements that provide benefits upon termination of employment
- Is arrangement subject to ERISA?
  - Ongoing administrative scheme
  - Employer discretion
- Is arrangement a welfare or pension plan?
  - Payment contingent upon retirement
  - Limit on benefit amount
  - Limit on payment period
- Is arrangement subject to 409A or is it exempt?

# 5. Phantom Stock Plans

# Advantages of Phantom Stock

- Rewards and incentivizes select group of valued employees through award of deferred compensation
- Provides benefit of stock ownership without giving away actual stock, unlike incentive stock options or restricted stock (avoiding repurchase obligations following termination of employment / voting rights)
- Gives employees the contractual right to cash value of phantom stock, which is tied to company's stock price / valuation without concerns about lack of marketability
- Not a qualified plan (avoids key ERISA requirements such as funding requirements; no nondiscrimination requirements for eligibility or terms and conditions; less expensive to administer; more flexibility)



# Disadvantages of Phantom Stock

- Employees may be less familiar with these arrangements than with stock options or other equity award types
- Employees may feel less incentivized to contribute to company growth because they are not true owners
- Requires sufficient cash flow to make cash payments

# Phantom Stock Design Considerations

- **Eligibility** (e.g., requisite service, select group of employees only)
- **Total equity participation vs. appreciation only** (i.e., tied to increase in value of stock from grant date to payment event)
- **Value of reserved pool** (e.g., 10%-15% of company's outstanding equity; potential dilution impact)

# Phantom Stock Design Considerations

- **Vesting** (e.g., time-based, immediate, performance, disability, death, termination without “cause,” change in control, accelerated vesting, etc.)
- **Distribution / payment events** (e.g., change in control, specified payment dates, separation from service, death, etc.)
- **Form of payment** (e.g., lump sum, annual / monthly installments)
- **Forfeiture events** (e.g., termination with and / or without “cause,” resignation, death, disability)

# Taxation and 409A Traps

- Medicare / FICA taxation upon vesting
- Subject to ordinary income tax when actually paid to and received by the employee
- 409A-compliant definitions needed for deferred compensation (e.g., disability, separation from service, change in control does not include IPO)
- 409A non-compliance results in immediate taxation, plus 20% tax and potential penalties on employee

# Other Considerations

- Plan documentation including award agreements
- Coordination with employment counsel (e.g., if restrictive covenants are used)
- Coordination with securities / corporate counsel (e.g., corporate governance, governing documents, registration requirements)

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