

## IRS Issues Final Regulations on ERISA Section 204(h) Notices of Reductions in Future Pension Benefits

The Internal Revenue Service (IRS) has issued final regulations under Sections 204(h) of the Employee Retirement Income Security Act (ERISA) and 4980F of the Internal Revenue Code (IRC) concerning advance notice of a reduction in future pension benefits.\* The final regulations, which are quite similar to the rules proposed last year, affect defined benefit and money purchase pension plans subject to ERISA's minimum funding requirements.

### THE NOTICE TRIGGER

The notice requirement is triggered by a plan amendment that may result in a significant reduction in either the rate of future benefit accruals or an early retirement benefit or retirement-type subsidy (RTS). This includes the obvious, such as cutting the percentage of pay counted toward benefits, as well as other changes in the formula that could reduce the annual rate of growth in the annuity benefit or allocations to participants' accounts. It also covers a change in the basic format for determining benefits (e.g., cash balance conversion), if any participant could end up with a lower pension.

The final regulations add two defining rules:

- A change in a document to which a plan refers in defining benefit amounts, such as a collective bargaining agreement, is considered a plan amendment for which notice must be given before the rate of benefit accrual can decline, and

- The conversion of a money purchase plan to a profit sharing plan is always considered an amendment reducing benefits, even if employer contributions are expected to stay at the same level.

A notice is *not* required if something other than a plan amendment is responsible for reducing future benefits (e.g., if employees automatically become covered under a different benefit formula because they are reassigned). In addition, notices are not required for changes in plan features that are not protected from reduction by IRC §411(d)(6) (e.g., provisions for plan loans and disability benefits).

### REQUIRED CONTENT

The notice must give enough information to enable recipients — every “affected individual” (i.e., participants and alternate payees whose future benefits are reasonably expected to be significantly reduced by the plan amendment) and any labor organization representing them — to understand the effect of the change, including the scope of the possible benefit reduction.

- **Accrual Rate Reduction** The notice must include a narrative description of the benefit formula before and after the amendment, and the effective date of the change. If the likely magnitude of the change is not reasonably apparent from that description, the notice must also include more explanation, typically with illustrative examples.
- **Reduction in Early Retirement Benefit or RTS** The notice must include a narrative description of how the benefit is calculated before and after the change, and the effective date. As with the notice for accrual rate reductions, more information is required if this simple description does not give a reasonable picture of the full impact of the change.

Examples using reasonable assumptions are always required for notices of reductions related to cash balance conversions or wearaways (which occur when a participant accrues no additional benefits for a period

\* The final regulations published in the *Federal Register*, Vol. 68, No.68 (April 9, 2003) are available on the following Web page: <http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/2003/pdf/03-8290.pdf>

because his or her existing accrued benefits exceed the initial accruals under a new formula). If the benefits are based on a factor that is likely to change over time, such as a variable interest rate, the wearaway illustrations are to be based on the facts at the time the notice is given. For amendments that have a varied impact, the notice must include examples that show the general range of the reductions and how different situations would fit within the range. The notice could give examples of the likely worst *and* best cases (*i.e.*, the largest and smallest reductions). However, if plan participants are unlikely to be able to predict how they will fare based on one illustration, more examples may be needed.

## DELIVERY DEADLINES

In general, notice must be given 45 days before the effective date of the amendment making the change. A 15-day-in-advance requirement applies to plan amendments reducing benefit accrual rates in connection with corporate mergers or spin-offs, to all multiemployer plans and to plans with fewer than 100 participants with accrued benefits on the amendment's effective date. When participants may choose between old and new benefit formulas, they must receive additional information for informed decision-making, early enough before the final choice to give time for careful consideration. For corporate transaction-related amendments that only reduce early retirement benefits or RTS, the deadline is 30 days *after* the effective date.

## ACCEPTABLE DELIVERY FORMATS

Section 204(h) notices can be sent with other plan notices. The *only* acceptable delivery formats for the notices are first-class mail, hand delivery or approved electronic means. The electronic notice standards are essentially the same as those that govern for giving other ERISA notices electronically. Electronic notices must alert participants to the significance of the message and let them know that they may request a free paper copy.

## EFFECTIVE DATES

The final rules apply, generally, to plan amendments that take effect on or after September 2, 2003. The rule treating changes in collective bargaining agreements and other documents as plan amendments applies to amendments that take effect on or after January 1, 2004. Until these dates, plan

administrators must make a reasonable, good faith effort to comply with the statutory requirements.

## PENALTIES FOR NONCOMPLIANCE

Employers (for single employer plans) and multiemployer plans will face a \$100 per day excise tax penalty per participant up to a maximum of \$500,000. The penalties can be waived if the IRS determines that the plan sponsor exercised "reasonable diligence" in distributing the notice, did not know of the violation and corrected it within 30 days of discovering it.

If the failure to give a required notice is "egregious," all participants whose benefits would be reduced significantly by the amendment are entitled to their benefit under the terms of the plan before the amendment (if higher than the revised benefit). An "egregious violation" includes an intentional failure to provide the required notice or a failure to provide most of the information to most of the affected participants.



*As with all issues involving law, plan sponsors should rely on their attorneys for authoritative advice on following the final §204(h) rules. The Segal Company can be retained to work with plan sponsors and their attorneys on compliance.*



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