Employee Benefits Law Information Memo

June 2009

Electronic Dispatch

Go to BS&K Employee Benefits Law Home Page

REDUCING BENEFIT COSTS REQUIRES CAREFUL PLANNING

In these economic times, it would not be unusual to look at the cost of providing certain benefits and wonder if there is any room to cut costs. Whether an employer can successfully accomplish this without exposing itself to excessive risk requires understanding the nature of protected benefits under the Internal Revenue Code (Code) and the Employee Retirement Income Security Act (ERISA). In this Information Memorandum, we will summarize some of the legal consequences of common benefit reductions.

Accrued Retirement Benefits Cannot be Reduced

Accrued benefits in a tax-qualified retirement plan, such as a defined benefit, profit-sharing, 401(k), 403(b) or money purchase plan, cannot be reduced by amendment. What is an "accrued benefit"? In defined contribution plans, the accrued benefit is the account balance; in defined benefit plans, it is the annual benefit payable at retirement that has already been earned by virtue of, for example, the prior performance of services.

If an employer wants to change the amount of contributions to be made or the rate at which benefits accrue in a retirement plan, it may do so, but only on a prospective basis. A review of the plan document will reveal whether employees have already earned the right to benefits in the current year. For example, a plan may require 1,000 hours of service in a plan year in order for a participant to be entitled to a contribution or an additional benefit accrual for that plan year. A plan amendment eliminating that year's contribution or accrual will only be effective if it is adopted (and, in certain cases explained below, communicated) to participants *before* participants have earned the requisite 1,000 hours of service. On the other hand, a plan that requires a participant to be employed on the last day of the plan year can be amended at any time prior to that last day of the plan year to eliminate the contribution or accrual requirement for the entire year, subject to the notice and safe harbor conditions discussed below.

If the plan terms do not condition the receipt of the year's contribution or accrual on service or employment on the last day of the plan year, then contributions generally must be made and benefits generally must be accrued with respect to compensation earned prior to the effective date of the plan amendment.

In some very limited circumstances, plans that are subject to minimum funding requirements (e.g., defined benefit plans, cash balance-type plans and money purchase plans) may be amended to reduce accrued benefits with the approval of the Secretary of the Treasury.

Reductions in Future Accruals May Require Notice

For defined benefit plans (including cash balance-type plans) and money purchase plans, an amendment to reduce the rate of future accruals, freeze or terminate the plan, or an amendment to "convert" the plan to a profit-sharing plan, generally will not be effective unless participants receive an ERISA "204(h) notice." The 204(h) notice must be provided to participants not less than 45 days prior to the effective date of the amendment (15 days for multiemployer and small plans) and must describe the amendment and its impact on participants. Failure to provide the notice may result in the employer being assessed with an excise tax equal to $100 per participant for each day the notice is delayed.

Changes to 401(k) Safe Harbor Plans are Permitted Under Certain Circumstances

A 401(k) safe harbor plan that uses nonelective contributions to satisfy the ADP test may be amended during the plan year to reduce or suspend the employer's safe harbor nonelective contributions, if certain conditions are met. The employer must have a substantial business hardship and provide a supplemental notice to all eligible employees at least 30 days in advance of the effective date of the amendment (or, if later, the date the amendment is adopted). Employees must be given a reasonable opportunity after the notice is given, and before the reduction or suspension of employer contributions, to change their elective deferrals. The plan must be amended to specify that it will satisfy the ADP test using the current year testing method.

A safe harbor plan that uses the matching contribution method to satisfy the ADP test can be amended prospectively to reduce or eliminate matching contributions under similar conditions.

This document may be considered "Attorney Advertising" under the rules of some states.
The hiring of a lawyer is an important decision that should not be based solely upon advertisements.

Benefit Changes That Can Trigger Vesting

An employer-initiated permanent reduction in force, or cessation or decrease in future benefit accruals that increases the likelihood of a reversion of plan assets to the employer, can cause a partial plan termination that results in all affected participants being fully vested, regardless of their years of service. The termination of a plan, and a complete discontinuance of contributions (as opposed to a temporary suspension of contributions) to a defined contribution plan, also result in affected participants being fully vested. Who is an "affected participant" can depend on the terms of the plan, including when forfeitures occur.

Health and Welfare Plan Changes

In general, health and welfare benefits do not vest, and employers generally have the right to amend or terminate these benefits if the employer has consistently reserved the right to do so. However, these benefits may become vested, and may not be reduced or eliminated, if the employer has promised (e.g., through plan terms or communication), to continue the benefits. Prior to reducing or discontinuing these benefits, employers should evaluate whether they have made such a promise by reviewing plan documents, summary plan descriptions and plan-related communications to participants.

Changes to an employee's premium payment election under a Code Section 125 cafeteria plan is permitted during the plan year if the employer increases the employee's share of the premium cost of a benefit. If the cost to the employee is significantly increased, the employee may revoke his or her election and elect another, similar coverage option that costs less. If there is no other coverage option, the employee may drop coverage.

Conversion to an individual policy of life insurance generally is available if group term life insurance coverage is terminated other than for failure to pay premiums. The employer should inform employees of this right to convert 15 days before or after the date of the termination. The maximum time for conversion is 31 days following the date of the termination.

Collective Bargaining Obligations

Remember that benefits are part of an employee's terms and conditions of employment and, therefore, are a mandatory subject of bargaining where the employer has a represented workforce. Proposed changes to benefits for union employees should be discussed in advance with union representatives.

If you have any questions about this memorandum, please contact Amelia M. Klein in our Albany office (518-533-3217, aklein@bsk.com) or any of the other members of our Employee Benefits and Executive Compensation Practice Group listed below.

In Central New York, call 315-218-8000 or e-mail:

Susan L. Dahline	sdahline@bsk.com
Stephen C. Daley	sdaley@bsk.com
Brian K. Haynes	bhaynes@bsk.com
Richard D. Hole	rhole@bsk.com
Ted Lewkowicz	tlewkowicz@bsk.com
Aaron M. Pierce	apierce@bsk.com

In Buffalo / Niagara Falls call 716-566-2800 or e-mail:

Darcie A. Falsioni	dfalsioni@bsk.com
John C. Godsoe	jgodsoe@bsk.com

On Long Island, call 516-267-6300 or e-mail:

Terry O'Neil	toneil@bsk.com

In New York City, call 646-253-2300 or e-mail:

Michael P. Collins	mcollins@bsk.com

In the Rochester Region, call 585-362-4700 or e-mail:

Robert H. Kirchner	rkirchner@bsk.com