



# WRMarketplace

An AALU Washington Report

This *WR Marketplace* is created exclusively for AALU members by experts at K&L Gates and the AALU staff, led by **James E. Earle, Matthew R. Jones, Richard H. Nettles, and Rebecca Liu.**

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**TOPIC: New DOL Rules on Disability Claims May Impact Retirement and Deferred Compensation Plans.**

**MARKET TREND:** New DOL rules may require changes to qualified retirement plans, deferred compensation plans, or supplemental retirement plans (SERPs) that have certain benefits-related provisions, including vesting provisions, that are affected by a participant’s disability.

**SYNOPSIS:** New DOL rules became effective on April 1, 2018 regarding claims procedures for disability benefits offered in employee benefit plans. The rules apply not only to long-term and short-term disability plans, but may also apply to 401(k) and other qualified retirement plans, as well as non-qualified deferred compensation plans and SERPs. The new rules provide additional procedural safeguards for participants who make a claim under a plan about a determination as to their status as disabled. The new rules do not apply to a plan that determines disability status by reference to a separate determination made by the Social Security Administration or the company’s long-term disability plan carrier.

**TAKEAWAYS:** Companies should check their retirement and deferred compensation plans to see if they include a disability definition and disability benefits that fall within the scope of the new rules. If so, the company should consider updates to its claims procedures, or potentially consider whether the disability provisions could or should be changed. Care should be taken to ensure that any plan changes are permitted and would not have any unintended consequences under certain “grandfather” rules (such as for IRC Section 162(m), if applicable).

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## **New DOL Rules**

Earlier this year, after fits and starts, the Department of Labor (“DOL”) announced that its final rule amending the claims procedure requirements for plans providing disability benefits would become effective April 1, 2018.<sup>1</sup>

For plans that are covered by the new rules (see below), the plan must include separate disability claims procedures that meet specified standards. Key changes reflected in the new rules include (1) enhanced content for benefit denial notices; (2) expanded rights for appeals decisions based on new information; (3) policies that ensure that claims adjudicators and medical and vocational experts are free from conflicts of interest; (4) expedited availability of judicial remedies when claims procedures are not followed; (5) rights to appeal rescissions of coverage; and (6) preparation of claims and appeals decisions in a culturally and linguistically appropriate manner.

For additional details, see our WRMarketplace alert from March 1, 2018.

## **The New Rules May Apply to Retirement and Deferred Compensation Plans**

The new rules apply to any plan that is subject to the Employee Retirement Income Security Act of 1974 (“ERISA”) that (1) conditions the availability of a benefit to the claimant on a showing of disability; and (2) requires the plan administrator (or its delegate) to make a determination regarding the claimant’s disability.

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<sup>1</sup> See 81 Fed. Reg. 92,316 and 82 Fed. Reg. 56,560. After additional consideration, the DOL announced on January 5, 2018 that the rules would take effect as planned on April 1, 2018. For additional information, see the DOL FAQs at: [www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/faqs/benefit-claims-procedure-regulation](http://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/faqs/benefit-claims-procedure-regulation).

Qualified retirement plans, including 401(k) plans, may be considered to provide a disability benefit within the scope of these rules if, for example:

- the amount of benefits is different for a termination due to disability as compared to other reasons for termination (e.g., retirement);
- special vesting provisions apply in the case of disability (e.g., full vesting); or
- the time or form of benefit payments are different in the case of disability (e.g., a lump sum instead of installments, or a right to take periodic partial lump sums).

The special claims procedures would not apply, however, if the plan’s definition of “disability” is based on a determination of disability by the Social Security Administration or by the company’s long-term disability plan carrier. In these cases, there is not a discretionary determination regarding disability made by the retirement plan administrator. The following examples illustrate the types of definitions that may be inside or outside the scope of these rules:

<b>Subject to Disability Claims Procedures</b>	<b>Not Subject to Disability Claims Procedures</b>
<p>Disability” means the inability of the Participant to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death, or which has lasted or can be expected to last for a continuous period of not less than 12 months. The Administrator shall have authority to determine if a Disability has occurred.</p>	<p>“Disability” means an incapacity that has resulted in qualification of a Participant to receive long-term disability benefits under the Company’s Long Term Disability Plan. If the Participant is not covered by the Company’s Long Term Disability Plan, the Participant is considered to have a Disability if the Participant’s incapacity results in a determination by the Social Security Administration that the Participant is entitled to a Social Security disability benefit.</p>

The same analysis applies to non-qualified deferred compensation plans and SERPs for employees. Although these “top hat” plans are exempt from most of ERISA’s substantive requirements, the claims procedure requirements still apply.

Note that plans covering only non-employee directors should not be within the scope of the disability claims procedure rules. ERISA only applies to plans covering employees.

A plan covering only non-employee directors is therefore not subject to ERISA, including ERISA's claims procedure requirements.

### **Update Claims Procedures if the New Rules Apply**

ERISA's claims procedures benefit both employers and employees. By properly following the claims procedures, courts will generally give deference to the decision of the plan administrator. For an employee to successfully challenge the decision of the plan administrator, the employee usually must show that the decision was "arbitrary and capricious" -- a difficult standard to meet.

To receive the benefit of the rule, the plan and summary plan description must comply with the new rules. If the new rules are simply ignored, the company may face heightened exposure if an employee later challenges a plan administrator's disability determination in court.

Although the new rules became effective April 1, 2018, it is not too late to act. If the new rules apply to a plan, the company will need to review the claims procedures set forth in the plan document and communicated in the summary plan description (if applicable). The new rules will likely require changes to those provisions to comply with the updated requirements. There is no corrective filing or fee required to fix documents now. But each day that goes by will increase the risk that a disability-related claim might arise, and absent the update to the plan and communications, the company may be at risk that the decisions regarding the claim will not be given deference by the courts if challenged.

### **Alternative: Changing the "Disability" Definition**

For a retirement or deferred compensation plan within the scope of these rules, as an alternative to updating the claims procedures, the company could consider amending the plan's "disability" definition to link the definition to a Social Security Administration or long-term disability plan determination. This change would then take the plan out of the DOL special disability claims procedure rules.

Making such a change may not be possible or practical, however, for several reasons:

- Qualified retirement plans, including 401(k) plans, have rules that limit the ability to change accrued benefits, vesting schedules, or certain protected "optional forms of benefit" (like special distribution rules) with respect to benefits that have already accrued. A change to the "disability" definition might be subject to these restrictions. It might be possible to change the definition as to future

accrued benefits or future participants, but this might be viewed as impractical or confusing to communicate and administer.

- Deferred compensation plans and SERPs will not be limited by these qualified plan requirements, but will likely require the consent of each affected participant at the time of the change.
- For public companies, which are subject to Internal Revenue Code Section 162(m), balances in deferred compensation plans and SERPs that were “written binding contracts” as of November 2, 2017 may be “grandfathered” under “old” 162(m) as a result of the Tax Cuts and Jobs Act. [See our previous WR Marketplace alert](#). Care should be taken when making changes to the “disability” definition to ensure that the changes are not considered a “material modification” that would eliminate the ability to rely on the grandfather rules.
- A similar issue could arise for older deferred compensation plans and SERPs that are grandfathered under Internal Revenue Code Section 409A. Before any change is made, the company should check with its legal counsel about any grandfather rules or other unintended consequences of a plan change.

## **Conclusion**

The new DOL claims procedures, which offer procedural benefits to participants seeking disability benefits under employee benefit plans, have taken effect. In response, companies should review their plans as soon as possible to see if and to what extent they are affected by the new rules. This may include 401(k) and other retirement plans, as well as deferred compensation plans and SERPs, if there are benefits that could depend on whether the participant is disabled. Companies should then take appropriate action to comply with the new rules, either by updating the relevant claims procedures or, if permitted and desirable, revising the relevant “disability” definition.