SEYFARTH SHAW
MANAGEMENT ALERT

April 2003

204(h) Notice Rules Are Final

The Internal Revenue Service ("IRS") has issued final regulations governing "204(h) notices", the notices ERISA requires to be provided to certain plan participants and beneficiaries of any amendment which provides for (1) a significant reduction in the rate of future benefit accruals, or (2) the elimination of or significant reduction in an early retirement benefit or retirement-type subsidy for benefits in qualified plans subject to the funding requirements of Internal Revenue Code Section 412. The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") changed the content and timing requirements for these notices. 401(k) and other types of profit sharing plans are not subject to the 204(h) requirements.

On April 9, 2003, the IRS' final regulations implemented the EGTRRA changes to the notice requirements. Generally, the final regulations are applicable to amendments with an effective date on or after September 2, 2003. Since most notices must be given 45 days prior to the amendment, this will generally mean that 204(h) notices given after July 19, 2003 must meet the final regulations. Compliance with either the proposed or final regulations will generally constitute good faith compliance with the 204(h) rules for amendments taking effect before September 2.

The final regulations are substantially similar to the proposed regulations issued about a year ago, but contain some notable changes and clarifications highlighted below.

Time for Providing Section 204(h) Notice

Pre-EGTRRA, plan administrators had to provide a 15 day advance notice before the effective date of the plan amendment. EGTRRA replaced this standard with a "reasonable time" standard. Generally, a "reasonable time" is defined as at least 45 days before the effective date of the plan amendment. However, there were several exceptions to the general rule:

- in the case of a small plan (fewer than 100 participants), notice must be at least 15 days before the effective date of the amendment;
- if an amendment is adopted in connection with a business acquisition or disposition, notice must be provided at least 15 days before the effective date of the amendment; and
- if the amendment is the result of liabilities that are transferred to another plan in connection with a transfer, merger, or consolidation of assets or liabilities and that only involves the elimination or reduction of an early retirement benefit or retirement-type subsidy (not the significant reduction of future benefit accrual), notice may be provided as late as 30 days *after* the effective date of the amendment.

The final regulations give multiemployer plans relief -- delaying the effective date of the regulations to January 1, 2004 and providing that the reasonable time standard is 15 days before the effective date of the amendment. Nevertheless, if a change in a collective bargaining agreement provides for a reduction in benefit accrual, that change is considered a plan amendment. Union negotiations will need to take these rules into account and consider providing notice before the collective bargaining agreement is approved or delaying the effective date of changes to allow the 204(h) notices to be distributed.

Content of Section 204(h) Notice

Pre-EGTRRA, §204(h) notices were relatively informal - the only requirement was that the notice had to be understood by the average plan participant. EGTRRA expanded the content requirements. The final regulations, like the proposed, require that notice be written in a manner calculated to be understood by the average plan participant and that it provide sufficient information to allow participants to understand the effect of the amendment. For example, if an amendment reduces the rate of future benefit accrual, the notice must include a description of the benefit or allocation formula prior to the amendment, a description of the benefit or allocation formula under the plan as amended, and the effective date of the amendment. Similarly, for an amendment that reduces an early retirement benefit or retirement-type subsidy, the notice must describe how the early retirement benefit or retirement-type subsidy is calculated both before and after the amendment, and the effective date of the amendment.

The final regulations, however, go on to set a new standard that the content must permit the participant to determine the "approximate magnitude" of the reduction applicable to that individual. In cases where it is not reasonable to expect that the "approximate magni-

tude" of the reduction will be reasonably apparent, the notice must include illustrative examples or individualized benefit statements which will make the "approximate magnitude" of the reduction clear. The final regulations contain examples of what information must be provided with respect to various reductions, including the conversion of a traditional pension plan to a cash balance pension plan.

If participants can choose between benefit formulas, they must be provided with sufficient information to enable them to make an informed choice before the date by which they must make a choice.

Conversion or Merger of Money Purchase Plans

The final regulations confirm Rev. Rul. 2002-42 providing that the conversion or merger of a money purchase plan into a profit sharing or other individual account plan (including a 401(k) plan) requires a 204(h) notice. With EGTRRA changes to plan limits, the separate viability of money purchase plans has diminished. Plan mergers or conversions may make sense, but will entail providing the 204(h) notice.

Review: Consequences of Failing to Provide 204(h) Notice

Prior to EGTRRA, courts generally held that any failure to give the 204(h) notice invalidated the plan amendment. Under EGTRRA, all failures are potentially subject to a $100 per day penalty, but only "egregious" failures will also invalidate the amendment. All intentional failures to provide the notice are considered egregious. Unintentional failures are considered egregious only if the plan administrator fails to provide most of the individuals with most of the information they are entitled to receive. In the case of an egregious failure, the provisions of the plan are applied as if the plan amendment entitled participants to the greater of the benefits to which they would have been entitled without regard to the amendment or the benefits under the plan as amended. These provisions of the proposed amendments were included in the final regulations.

The regulations, however, offer some protection to a plan administrator who reasonably determines, taking into account the statute, administrative guidance, and relevant facts and circumstances, that the reduction is not "significant" as defined in the regulations. In such a circumstance, the failure will not preclude the amendment from becoming effective; but, the administrator will still be subject to the excise tax.

Recap: 204(h) Notice

If a defined benefit plan or money purchase plan, or other plan subject to minimum funding requirements, is amended to reduce benefit accruals or reduce or eliminate early retirement benefits or subsidies, plan administrators must make plans to:

- provide notice at least 45 days before the plan amendment is effective
- have the plan amendment adopted before the change is effective (the final regulations confirm that the notice may be provided before the adoption of the amendment)
- provide content in the notice that explains the changes and their impact/magnitude
- distribute by mail or e-mail (not posting), subject to certain restrictions.

If you have any questions about 204(h) notices and plan amendments, please contact the Seyfarth Shaw employee benefits group attorney with whom you work or any employee benefits group attorney listed on the website at www.seyfarth.com.

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