



IRS Publishes Final Rules for Providing ERISA Section 204(h) Notices

WHO'S AFFECTED These notice rules apply to: defined benefit plans and money purchase pension plans (including target benefit plans) that are subject to ERISA, and that are amended to significantly reduce benefits. Governmental plans and plans sponsored by churches that elect not to be covered under ERISA ("non-electing church plans") are not subject to these notice rules.

BACKGROUND AND SUMMARY ERISA section 204(h) requires pension plan sponsors to notify participants when plan amendments will result in a significant reduction in the rate of future benefit accruals, early retirement benefits, or retirement-type subsidies. On April 9, 2003, the IRS issued final rules, providing guidance on the content, timing, and distribution of ERISA Section 204(h) notices. In addition, the final rules address the potential consequences of not providing these notices.

While the 204(h) notice requirements have been in effect for over 15 years, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) made some significant changes to these rules. As a result, the IRS released proposed rules in April 2002. Plan sponsors that have followed the proposed rules were considered to be making a good faith effort to comply with the EGTRRA rules.

The IRS final rules generally mirror the proposed 2002 rules, with the a few revisions. The final rules:

- Provide a special effective date for plans that incorporate plan provisions by reference to another document (i.e., collectively bargained plans, including multiemployer plans);
- Provide special notice timing rules for multiemployer plans;
- Clarify how to determine who should receive notices (i.e. "applicable individual");
- Provide more examples on what constitute a significant reduction in benefits; and
- Incorporate the provisions of Revenue Ruling 2002-42, which requires Section 204(h) notices if a money purchase pension plan is merged with or converted into a profit sharing plan.

ACTION AND NEXT STEPS Plan sponsors that are considering plan amendments that may reduce future benefit accruals, early retirement benefits or subsidies should review this publication to determine if and when these notices may be needed. Failure to provide these notices when required may result in continued accruals based on the old formula and the imposition of an excise tax on the plan or plan sponsor.

*Republished December 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business.

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Effective Date

The final Section 204(h) rules generally apply to plan amendments that are effective on or after September 1, 2003.

If a plan document incorporates plan provisions by reference to another document (e.g., a multiemployer plan that refers to the provisions of its collective bargaining agreement), this effective date is delayed to January 1, 2004. A change in the provisions in the referenced document is considered a plan change in the plan document.

Between now and these effective dates, plan sponsors must make a reasonable, good faith, effort to comply with the new rules.

Applicable Plans

Only qualified defined benefit plans and money purchase pension plans (including target benefit plans) are *potentially* subject to these notice rules. Profit sharing plans (including 401(k) plans), stock bonus plans, as well as governmental plans and non-electing church plans are not subject to these notice rules.

Plans that are amended to:

- significantly reduce a participant's rate of future benefit accrual; or
 - eliminate or significantly reduce an early retirement benefit or retirement-type subsidy,
- must provide Section 204(h) notices to “applicable individuals” who are adversely affected by the change.

Timing of the Notice

EGTRRA requires that the Section 204(h) notice be provided within a “reasonable time” before the effective date of the plan amendment. This means that the notice may be given based on an unsigned, proposed amendment, as long as the amendment that is ultimately signed is not substantially different from the proposed amendment.

Under the final rules, “reasonable time” is generally defined as **at least 45 days before the**

effective date of the amendment, with a number of special exceptions.

In the case of a **small plan** (plan with fewer than 100 participants with an accrued benefit as of the effective date of the amendment), the notices must be given **at least 15 days before** the effective date of the amendment.

If the amendment is adopted in conjunction with a **business merger and acquisition**, notices must be given **at least 15 days before** the effective date of the amendment.

If the plan is a **multiemployer plan**, notices must be given **at least 15 days before** the effective date of the amendment.

If the amendment is **the result of a business merger or acquisition** involving a plan-to-plan transfer or merger and the change **involves only the elimination or reduction of an early retirement benefit or retirement-type subsidy**, notices must be given **no later than 30 days after** the effective date.

Applicable Individuals

In general, plan sponsors must provide Section 204(h) notices to:

- Plan participants;
- Beneficiaries;
- Alternate Payees under Qualified Domestic Relations Orders; and
- Employee organizations representing participants (e.g., unions).

However, notices only have to be given to those individuals who are expected to be participants in the plan on the amendment effective date and who may be adversely affected by the amendment. Notices do not have to be provided to individuals who are not participants in the plan as of the date of the change.

The determination of who is an “applicable individual” is made based on the facts and circumstances of the particular situation. In making this determination, the plan administrator must look at a typical business day that is reasonably near to the time of providing notices. That date cannot occur after the latest date for providing notices (generally, 45 days prior to the effective date).

For example, a plan change that will significantly reduce future benefit accruals is scheduled to take effect January 1, 2004. The latest date that the plan administrator may provide the Section 204(h) notice is November 16, 2003. The notice will be sent on November 1, 2003. The plan sponsor determines that October 20, 2003, is a typical business day for identifying the applicable individuals who would be affected by the change on January 1, 2004.

Significant Reduction in Benefits

All plan provisions, before and after the plan amendment, must be considered to determine if a significant reduction in future benefits has occurred. Plan provisions may include participation or eligibility rules of the plan, the benefit formula, service and compensation definitions, actuarial assumptions used in determining the benefit, and normal retirement age.

Notices are not required if there is a change in the plan's vesting schedule or a reduction in certain ancillary benefits. Other types of notice rules may apply in these situations.

For a defined benefit plan, the rate of future benefit accrual is "significantly reduced" if the amount of future annual benefits beginning at normal retirement age (or actual retirement age, if later), accruing for a year are reasonably expected to be reduced. The comparison is made between the future annual benefit payable at normal retirement age (or actual retirement age, if later) before and after the change.

For a defined contribution plan, the rate of future benefit accrual is "significantly reduced" if future amounts allocated to a participant's account are reasonably expected to change. Future allocations include future contributions to the individual account or forfeitures. Changes in investments or investment options are not considered. The comparison is made between the future amounts being allocated to the individual accounts before and after the change.

The **conversion or merger of a money purchase plan into a profit sharing plan** (including a 401(k) plan), is always treated as a "significant reduction" in the future rate of benefit accrual under a money purchase plan. As a result, Section 204(h) notices are required.

An early retirement benefit or retirement subsidy is *not* "significantly reduced or eliminated" if the amendment is made because the pre-amendment benefit creates significant burdens or complexities for the plan and its participants unless the amendment has a greater than de minimus impact on a participant. On the other hand, an early retirement benefit or retirement subsidy *may be* significantly reduced, when the effect of all plan changes are considered. Changes may include amending the eligibility for early retirement, increasing the early retirement reduction factor, or changing the actuarial assumptions used for actuarial equivalence.

For business mergers or acquisitions, a notice may or may not be required depending on specific facts and circumstances relating to the employees' plan coverage and future accruals.

For defined benefit plan terminations, providing a timely notice will prevent the need for the plan sponsor to grant additional benefit accruals from the original intended date of plan termination to a revised date of plan termination, if the date of termination needs to be postponed. The Section 204(h) notice may be provided along with the notice of intent to terminate.

Contents of the Notice

A Section 204(h) notice must include sufficient information to enable the affected individual to understand the effect of the amendment, including the approximate size of the reduction in his or her benefit.

The notice may include more information than is required. However, it may not include false or misleading information. It may not omit any relevant information.

The notice must include:

- A description of the applicable plan provisions before the amendment;
- A description of the applicable plan provisions as amended;

- The effective date of the change; and
- In certain situations, illustrative examples to demonstrate the magnitude of the change.

In general, illustrative examples are optional, if the text of the notice provides enough information to explain the impact on the individual's benefit. Illustrative examples are *required* for cash balance plan conversions, plan changes that exhibit wear-away (i.e., no additional benefits are earned for a period of time), or certain situations that offer the individual a *choice* between the old and the new benefit formula. Examples may be based on reasonable assumptions, which must be identified in the notice.

If *choice* is offered, additional information must be provided so that the individual can make an informed decision within a reasonable time frame. The additional information may be provided in the notice. Alternatively, it may be provided in a separate mailing shortly thereafter but within a reasonable time frame before the deadline for the individual's election.

The regulations provide sample examples of plan changes and illustrations that could be included in the notice. Complex plan changes could require more than one illustration. Individual benefit statements may be used instead of illustrative examples as long as the benefit statements provide the same type of information required under these rules.

Separate notices may be used if a plan change has different effects on different groups of individuals. Each notice (1) must identify the class of individuals being provided the notice and (2) must include information applicable to that class.

Methods of Delivery

The plan administrator may use any delivery method that ensures actual receipt or alternatively, take appropriate measures to ensure the actual receipt of the Section 204(h) notice. Posting the notice on a bulletin board is not now and was never an acceptable delivery method.

The plan administrator may hand deliver the notice or send it to the last known address, using first class mail. The U.S. postmark date stamped on the envelope containing the notice is considered to be the date of delivery.

Electronic delivery is permitted as long as the individual consents to this method of delivery, has timely access to the method of delivery, and is offered a paper copy free of charge. The final rules address the safe harbor requirements for individual consent. If electronic delivery is used and the plan administrator has made every reasonable effort to ensure actual receipt and timely delivery, the date the notice was sent is considered to be the date of delivery.

Acceptable electronic delivery methods include e-mail, Internet or other electronic communications site, DVD, or CD. A computer kiosk is generally not an acceptable method because it is not considered a direct form of communication. Oral communication or a recording is not acceptable.

Failure to Provide Notice

In general, the new rules follow the rules that were in place prior to EGTRRA regarding failures to provide required Section 204(h) notices. However, the new rules added the term "egregious failure" and include a potential excise tax for failure to comply.

A failure is considered "egregious" if (1) providing notice was within the control of the plan administrator and (2) the failure is either an intentional failure or a failure to provide most of the required information to most of the applicable individuals. A failure is intentional if the plan administrator does not promptly provide the required notice or information after discovery of the failure.

If failure to provide notice is "egregious," then all "applicable individuals" would be entitled to the benefit that was provided before the amendment, if larger than the revised benefit.

An excise tax of \$100 per day for each individual for whom the notice requirement was not met may also be imposed. In general this tax would be imposed on the plan sponsor (employer). However, in the case of a multiemployer plan, the tax would be imposed on the plan. No excise tax will be imposed for failure to provide the required notices if the failure is corrected within the 30 days after discovery.

Next Steps

The final rules expand on the examples that were contained in the proposed rules. However, it is impossible to cover every situation. If in doubt as to whether the plan change is a "significant reduction" in benefits, it may be advisable to provide notices to individuals for whom there is *any* reduction in benefit.

The rules state that a Section 204(h) notice will generally satisfy the requirement to provide a Summary of Material Modifications (SMM) regarding a plan amendment; however providing the notice does not necessarily eliminate the need to furnish SMMs. In other words, the plan administrator may be required to furnish a SMM to any other participant or beneficiary covered under the plan who was not required to receive a Section 204(h) notice but who ordinarily would receive a SMM because of changes to the plan.

If you need help preparing a notice or you have questions related to the notice requirements, please contact your Prudential Retirement representative.

Pension Analyst by Prudential Retirement

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Editor: Mitzi Romano (860) 534-2768