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Recent Legislative and Regulatory Provisions Require That Employers Pay Close Attention to Their Employee Benefits Plans. This Newsletter Identifies Key Benefits Concerns for the Spring of 2003.

EMPLOYEE BENEFITS 2003—ACTION ITEMS

By Steven J. Friedman and Daniel W. Srsic

Recent legislative and regulatory initiatives have given employers a good deal to concern themselves with this year in the stewardship of their employee benefit programs. The purpose of this ASAP is to discuss areas that employers should pay close attention to in 2003.

NEW CASH BALANCE PLAN OPPORTUNITIES FOR EMPLOYERS

- The IRS has recently proposed regulations that establish guidelines for employers wishing to convert traditional defined benefit pension plans to cash balance plans. Before these regulations were issued, there was concern that the IRS would consider many cash balance conversions as running afoul of age discrimination rules.
- Cash balance plans are gaining in popularity because annual pension accounting expenses and cash outlays under these plans are less volatile than under traditional pension plans. Also cash balance plans, when contrasted with pension plans, permit benefits to accrue more evenly for both older and younger workers.
- Since these regulations have not yet been finalized, further guidance is expected this year. Employers likely will want to wait until this guidance is issued before redesigning their pension benefits.

HIPAA COMPLIANCE

- Employers sponsoring health plans with $5 million or more in annual receipts must comply with the privacy provisions of the Health Insurance Portability and Accountability Act ("HIPAA") by April 14, 2003 (for all other employers, the compliance date is April 14, 2004).
- After April 14, 2003, the U.S. Department of Health and Human Services will begin enforcing HIPAA's privacy provisions, and employers also will be at risk of lawsuits, and potentially class actions, brought by private plaintiffs.
- HIPAA places substantial compliance burdens on employers sponsoring self-insured health plans or administering their health-related benefit programs in-house. Employers sponsoring insured arrangements also may be obligated to comply with HIPAA if their benefits personnel have contact with employee health information.
- All employers subject to HIPAA are required to do the following: (i) designate a privacy officer; (ii) prepare HIPAA privacy policies and procedures; (iii) provide HIPAA training to in-house benefits administrators; (iii) notify employees of their HIPAA privacy rights; (iv) implement privacy safeguards for employee health information; (v) negotiate "business associate" contracts which require third-party service providers to provide HIPAA privacy protections; and (vi) amend all health plans to implement HIPAA's privacy safeguards.

RETIREMENT PLAN AMENDMENTS

- Employers that utilize an off the shelf "prototype" plan document must amend their plan documents for tax law changes and under other legislative changes (known as "GUST"); this process generally must occur by the end of September 2003. Accordingly, employers must verify that any prototype plan documents have been amended or that the amendment process has begun.
- For all tax-qualified retirement plans, the IRS has issued guidance on distribution requirements which will require an amendment in 2003 (if it has not been prepared already).

"CATCH UP" CONTRIBUTIONS TO 401(K) PLANS

- Since 2002, employers have been amending their 401(k) plans (and certain other plans which permit employee deferrals) to permit employees age 50 or over to defer more than the normal limits into the plan ($2,000 for 2003 and increasing $1,000 annually until a cap of $5,000 is reached in 2006). This is a big plus for older employees that generally costs employers nothing (in most cases, this extra deferral is exempt from plan discrimination testing, and employers can exclude the catch up contributions from a matching program).
- For employees age 50 and over, the value of the increased retirement plan accruals that may be attributed to "catch up" contributions is considerable. Thus, an employer sponsoring a plan in which "catch up" contributions are permissible should consider offering this benefit if it has not already done so.

SPDs/CLAIMS PROCEDURES

- Effective January 1, 2003, retirement and welfare plan summary plan descriptions (SPDs) were required to be amended to reflect recent changes in the law. We expect the DOL to be conducting SPD plan audits to assure that employers have complied with this deadline. Additionally, SPDs must now contain new rules which substantively change the procedures that apply to employees who wish to contest a denied benefits claim. In particular, the claims procedures applicable to medical plan claims have been radically changed (time periods for employers to adjudicate claims have been greatly shortened). Therefore, employers must not only have proper documentation reflecting the new rules but must be properly implementing these new rules.

DOL AUDIT/DEPOSITS OF EMPLOYEE DEFERRALS

- ERISA provides that the maximum time employers may take to deposit employee deferrals into a 401(k) plan (or other plans which permit employee deferrals) is the 15th business day of the month following the month that the deferrals were otherwise payable to the employee in cash.
- Despite this explicit statutory provision, the DOL has taken the position that this time frame is an outside limit and that employers are required to deposit money into plans more expeditiously if they have the means to do so. The DOL has begun an aggressive audit program targeting this issue. Compounding this problem (and likely in part, in response to the DOL position), we are aware of plan auditors refusing to issue "clean" letters to plans which have not deposited employee monies in the most timely manner (i.e., if an employer's practice is to deposit monies within 4 days the employer is stuck with 4 days as its outside limit).
- Accordingly, employers must examine their systems and procedures to handle employee deferrals to avoid DOL enforcement actions and related pitfalls.

SARBANES/OXLEY ISSUES

- Employers are affected by the very broad provisions of the Sarbanes legislation passed last year, which among other things restricts loans to executive officers/directors which are made or "arranged" by an employer.
- This prohibition may extend to the cashless exercise of stock options, split dollar insurance arrangements and even 401(k) loans, however, it is unclear how far the prohibitions contained in this legislation extend. In particular, there is significant debate over whether executive officers would be prohibited from taking loans from their qualified plan accounts under Sarbanes, on the premise that while the loan program is "arranged" by the employer as a plan design matter, the loan comes from the qualified plan trust, an entity separate from the employer. Many cashless exercise and split dollar programs are being changed and some employers have restricted access to plan loans for executive officers.
- The Sarbanes law also changed the rules applicable to plan "blackout periods" in connection with the conversion to a new plan recordkeeper or trustee or a change in plan investments. These rules are particularly important in connection with the administration of 401(k) plans.

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NEW DEFERRED COMPENSATION OPPORTUNITIES FOR TAX-EXEMPT EMPLOYERS

- A change in the tax law has opened new opportunities for tax-exempt employers to offer deferred compensation benefits. Historically, tax-exempt employers could offer to their high paid employees few options with respect to deferring compensation (apart from 403(b) or 401(k) deferrals) as the rules governing these plans (contained in section 457(b) of the Internal Revenue Code) prohibited deferrals if applicable limits had been met under other plans. These rules have now been changed; 457 plans may now be established irrespective of deferrals made under other plans. These plans are (with the exception of church plans) only for high paid employees.
- Accordingly, tax-exempt employers with highly compensated employees should reexamine their deferred compensation options for those individuals.

INCREASE IN COST OF HEALTH PROGRAMS

- Most employers are experiencing an increase in the cost of health coverage and are currently exploring mechanisms to reduce these costs, for example, implementing higher employee co-pays and deductibles, prescription drug formularies, and defined contribution health programs.
- Employers that are implementing pre-tax employee contributions for health coverage should be aware that the employer must have in place a Section 125 cafeteria plan in order for the pre-tax treatment to apply.

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