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COMPENSATION AND BENEFITS
Benefits e-News
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Benefits e-News: A Value Added Service from Robinson & Cole LLP

Benefits e-News is a monthly electronic newsletter reporting on recent changes in the law affecting employee benefits and other developments affecting plan sponsors and their employees. Benefits e-News provides web links to the Internal Revenue Service, the United States Department of Labor, the United States Department of Health and Human Services HIP HIPAA web site, and the Pension Benefit Guaranty Corporation. Benefits e-News is easy to navigate. To access a web link, position your cursor on the link and click your mouse. To return to Benefits e-News, click the back button on your browser.

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SEC Issues Proposed Rules on the Prohibition of Insiders from Trading During Plan Blackout Period

The Sarbanes Oxley Act, which was enacted in July, prohibits directors and executive officers from transferring company stock during any benefit plan blackout period involving company stock if such stock was acquired by the director or executive officer in connection with his or her service for the company. This Act was passed as a response to the recent insider trading and accounting scandals and is intended to equalize the treatment of insiders and rank and file employees with respect to their ability to engage in transactions involving company stock during a benefit plan blackout period. The SEC has proposed rules clarifying this new prohibition and has requested comments on the rules.

The proposed rules clarify certain key terms used in the Act, such as 'director', 'executive officer', and 'individual account plan'. The blackout period restrictions apply to individual account plans under ERISA. The definition provided under ERISA clearly includes pension plans, 401(k) plans, profit sharing plans and stock bonus plans. The proposed rules would clarify that for purposes of the prohibition on directors and officers from trading during a

blackout period, the restriction would apply to nonqualified deferred compensation arrangements as well.

The Act requires directors and executive officers, as well as the SEC, to be provided with notice of the blackout period. The proposed rule sets forth the required content of the notice, which includes: the reason for the blackout period; a description of the plan transactions to be suspended during the blackout period; a description of the class of equity securities subject to the blackout period; the actual or expected beginning and ending dates of the blackout period; and the name, address, and telephone number of the person designated to respond to inquiries about the blackout period. Directors and executive officers must be provided with the notice at least 15 days in advance of the blackout period. This notice must be in a graphic form reasonably accessible to the recipient. The 15-day notice requirement is excused under the proposed rule where the issuer makes a determination that circumstances preclude compliance with a notice requirement. The SEC states that issuers should rely on this exception only in rare circumstances. The proposed rule states that notice to the SEC is to be provided on Form 8-K. The new rules are proposed to become effective January 26, 2003.

IRS Holds that Restorative Payments Made as Settlement of Litigation are Deductible

The IRS has held in Private Letter Ruling 200241046 that restorative payments made to a plan by the employer to settle litigation are deductible as ordinary business expenses, provided such payments are made to settle litigation arising from the employer's ordinary conduct of its business. The employer requesting the ruling offered employer stock as an investment option in its 401(k) plan. Accounting irregularities led to restatement of financial results and a significant decline in the value of the employer's stock. The decline in stock value resulted in several class action suits by participants. The employer settled the suits by making restorative payments to the accounts of those individuals who invested in employer stock and suffered losses. The IRS held that losses in stock value leading to the class action suits were the direct result of the employer conducting its business, and that the restorative payments made to settle such suits were deductible as ordinary business expenses.

New Mortality Table Required in 2003

In 2003, a new mortality table must be used by defined benefit plans in determining the present value of plan benefits. If the plan document specifically refers to the prior table, the plan may need to be amended by December 31, 2002 to incorporate the new table, which can be incorporated by reference toRevenue Ruling 2001-62. A plan that only refers to the relevant Code Sections will not need to be amended. The adoption of this new mortality table is not considered to be a reduction in benefits and advance notice to participants is not required.

Failure to Divest Plan of Employer Stock Was Not a Breach of Fiduciary Duty

The United States District Court of the Northern District of California recently ruled in McKesson v. HBOC, Inc. in favor of plan fiduciaries in a class action suit alleging breach of fiduciary duties. McKesson sponsored a qualified plan that had an ESOP component. McKesson merged with HBOC and the companies' qualified plans were merged. After the plan merger, McKesson-HBOC announced that HBOC had engaged in illegal accounting practices. Consequently, the stock price dropped, resulting in losses of over $800 million to McKesson plan participants. Employees alleged that the McKesson plan fiduciaries had breached their fiduciary duties by maintaining an investment policy permitting the investment of all company contributions in company stock, by failing to diligently investigate how the McKesson plan would be impacted by the merger, by failing to prudently invest plan assets, and by failing to divest the plan of company stock after the accounting irregularities were announced. The employees also alleged that HBOC had violated its fiduciary duties by not disclosing the accounting irregularities before the merger. The court dismissed all of the employees' claims. The court held that the plan fiduciaries had not breached their fiduciary duties by failing to divest the McKesson plan of company stock after the merger as the fiduciaries could not have sold the company stock or disclosed the accounting irregularities without violating securities laws. This ruling is contrary to the position taken by the DOL in its Amicus Curaie brief in the Enron class action suit, in which the DOL states that an insider's duty to "disclose or abstain" under federal securities laws does not immunize insiders from claims that that they failed in their conduct as ERISA fiduciaries. It remains to be seen whether or not the court in the Enron case will adopt the position of the DOL or the position of the McKesson court. However, the court stated that fiduciaries "may not blindly follow an ESOP's directive to invest in company stock." Fiduciaries continue to have the obligation to invest prudently even though a plan authorizes the investment of plan assets in company stock. The court gave the employees the opportunity to amend their complaint against McKesson to state facts supporting their allegation that the plan fiduciaries had breached their duties by continuing to invest in company stock after the merger and by requiring company contributions to be made in company stock.

2003 COLA Adjustments

The IRS recently issued the 2003 Cost-of-Living Adjustments for retirement plans. The most significant changes for 2003 are: (1) the amount that employees can elect to defer under 401(k) plans, 403(b) annuities and SEPs is increased from $11,000 to $12,000 (this increase also applies to deferrals for deferred compensation plans of state and local governments and tax exempt organizations); and (2) the amount that employees over age 50 can contribute as a catch-up contribution is increased from $1,000 to $2,000. The dollar limits that will remain unchanged for 2003 are: (1) $160,000 cap on annual benefits under a defined benefit plan; (2) $40,000 cap on annual additions for a defined contribution plan; (3) $200,000 annual compensation limit; (4) $130,000 amount for determining who is a key employee in a top-heavy plan; and (5) $90,000 amount for determining who is a highly compensated employee.

The social security taxable wage base, which establishes the amount of income subject to FICA, is increased from $84,900 to $87,000.

The PBGC maximum benefit guarantee for retirees in underfunded defined benefit plans terminating in 2003 will be $3,665/month and $43,977/year.

ONLY FIVE MONTHS LEFT TO COMPLY WITH HIPAA'S PRIVACY RULES

April 14, 2003 is right around the corner, and that's the date most covered entities must comply with the Privacy Rules under HIPAA. Covered entities are health plans, health care clearinghouses, and health care providers who conduct certain transactions electronically. While the Privacy Rules don't apply to employers per se, they do impact employers who sponsor a health plan or who have on-site medical providers who may fit the definition of a "covered entity" under the Privacy Rules. If you haven't yet examined your benefits and operations to determine whether you must comply with the Privacy Rules, now is the time to undertake that task. If you are a small health plan you may have an additional year, until April 14, 2004, in which to comply.

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