ROBINSON & COLE LLP
COMPENSATION AND BENEFITS
Benefits e-News
Benefits e-news is an electronic newsletter reporting recent legal developments in employee benefits.

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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.

We hope that you find Benefits e-News to be informational and helpful. If you know of others who would like to receive this online newsletter (or if you would like to discontinue receiving Benefits e-News), please click here and send us an email message. If there are certain topics that you would like covered in future issues, please let us know.

Waiver of 60-Day Rollover Period

Rollovers of qualified plan distributions previously had to be made within 60 days of receipt of the distribution. EGTRRA amended this rule to permit the IRS to waive this requirement in certain cases. The IRS has now issued guidance on the waiver of the 60-day period.

The Ruling requires taxpayers to apply to the IRS in cases where the rollover was not timely made for reasons of hardship. In such cases, the IRS will issue a Ruling waiving the 60-day requirement where the failure to do so would be against equity or good conscience. In such cases, it will consider all relevant facts and circumstances in determining whether or not to grant a waiver. Specifically, the IRS will consider: (1) errors committed by a financial institution; (2) the inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error; (3) the use of the amount distributed (for example, in the case of payment by check, whether the check was cashed); and (4) the time elapsed since the distribution occurred.

Taxpayers do not need to apply to the IRS for a waiver if a financial institution receives funds on behalf of a taxpayer prior to the expiration of the 60-day rollover period, the taxpayer follows all necessary procedures for depositing the funds into an eligible retirement plan within the 60-day period and, solely due to an error on the part of the financial institution, the funds are not deposited into the plan within the 60-day period. In such cases, the Ruling provides for automatic approval if the funds are deposited into an eligible retirement plan within one year from the beginning of the 60-day rollover period.

Guidance Issued on Deemed IRAs

EGTRRA added a new provision allowing plan sponsors to include deemed IRAs in their qualified plans. Under this provision, a plan sponsor can permit employees to make voluntary contributions to a separate IRA within the qualified plan. The IRS recently issued guidance and a sample plan amendment that can be used by employers to amend a plan to include deemed IRAs. The IRA rules, not the qualified plan rules, will apply to these separate accounts. However, the funds will be subject to ERISA requirements, including fiduciary obligations and claims procedures.

A plan sponsor cannot offer deemed IRAs until the plan document is amended to provide for the accounts. However, a plan that permits deemed IRA contributions before January 1, 2004 does not need to be amended to provide for the accounts before that date.

DOL Provides Guidance Regarding the Selection of Annuity Providers by Defined Contribution Plan Sponsors

The DOL has issued an Advisory Opinion providing additional guidance on the selection of annuity providers by defined contribution plan sponsors. Guidance regarding the selection of annuity providers was previously published in Interpretive Bulletin 95-1. The DOL clarified that defined contribution plan sponsors, as well as defined benefit plan sponsors, must follow the guidance set forth in the Bulletin if the plan offers an annuity form of distribution. The selection of an annuity provider in connection with benefit distributions is a fiduciary act. Therefore, in making a selection, fiduciaries must act prudently and solely in the interest of participants and beneficiaries.

Fiduciaries have an obligation to conduct an objective and thorough search for qualified providers. The DOL stated that unless fiduciaries have the requisite expertise necessary to evaluate annuity providers, an expert should be retained to assist in the annuity selection process. The DOL also stated that while it may be appropriate for a fiduciary of a defined contribution plan to take cost into account as a factor in selecting an annuity provider, a lower cost would never justify the purchase of an unsafe annuity even if the annuity would pay a higher amount to the participant or beneficiary than a safer annuity.

COBRA Coverage - Troublesome Ruling Related to Divorce

In a Ruling the IRS has clarified plan sponsors' COBRA obligations when an employee eliminates group health plan coverage for his or her spouse in anticipation of a divorce. Group health plans are required to offer COBRA continuation coverage to a spouse upon divorce or legal separation if the spouse loses coverage under the health plan as a result of the divorce or legal separation. The IRS stated that if an employee eliminates health plan coverage for his or her spouse in anticipation of a divorce, the spouse does not have to be offered COBRA continuation coverage before the date of divorce. However, the plan must make COBRA continuation coverage available to the spouse as of the date of divorce even though the spouse was not in fact covered under the plan as of the date of divorce.

This Ruling creates a problem for plan sponsors in that they now need to monitor coverage changes involving a spouse so that they will be in a position to timely offer COBRA coverage to a former spouse upon divorce from the employee. Also, if a spouse ceases to be covered and subsequently is divorced, the plan sponsor will need to make a judgement whether that cessation was "in anticipation" of divorce.

EGTRRA Permits Retroactive Increase in Compensation Limit for Former Highly Compensated Employees

The amount of annual compensation that can be taken into consideration in calculating a plan participant's benefit was increased by EGTRRA from $170,000 to $200,000 effective in 2002. The IRS has released a Ruling clarifying that a plan can be amended to apply this increase retroactively in calculating the accrued benefit of former highly compensated employees who do not have service with the plan sponsor after the EGTRRA increase.

Before making any amendment pursuant to this Ruling, plan sponsors should consider how such a change would impact any non-qualified plans, since affected employees may have received a benefit under the non-qualified plan that has taken compensation into account in excess of the prior lower compensation limit.

Reimbursement for Sex-Change Operation Denied Due to Lack of Medical Necessity

The Second Circuit found in favor of the plan sponsor in the recent case of Mario v. P & C Food Markets. The plan sponsor of a self-funded health plan denied reimbursement for a participant's sex-change operation and related hormone therapy due to lack of medical necessity. The court upheld this denial on the grounds that the plan administrator had conducted a thorough investigation as to the medical necessity of sex-change operations before concluding that they were not medically necessary.

The court's reasoning highlights the importance of procedural prudence in administering benefit plans. This decision indicates that if a plan administrator conducts a meaningful investigation on the merits of a claim before making its determination and memoralizes the

reasons for denial, courts in the Second Circuit will be hesitant to second guess the plan administrator's decision.

Marital Settlement Agreement Containing a Secuity Interest Does Not Violate ERISA

The IRS has issued a Private Letter Ruling providing guidance on the creation of a security interest as part of a marital settlement agreement. Generally, plan participants are not allowed to assign a portion of their plan benefit. However, assignment is permitted for a qualified domestic relations order (QDRO) that satisfies certain specific requirements. The Ruling addresses a unique QDRO where the alternate payee was assigned a portion of her spouse's qualified plan benefits as security for the participant's marital property obligations apart from the plan. The security interest would be presented to the plan administrator in a QDRO. Because it was an assignment of a right pursuant to a QDRO, the IRS permitted the grant of the security interest.

PWBA to Become EBSA

The President's Budget requests a 10% increase for the Employee Benefits Security Administration in the Department of Labor (formerly the Pension and Welfare Benefits Administration). With these additional resources, EBSA expects to restore, protect or recover about $500 million in pension plan assets. This funding will provide additional enforcement to safeguard workers' retirement savings and other benefits in the wake of corporate fraud cases. Funding will also be used to expand compliance assistance efforts to educate employers and pension plan administrators on their responsibilities under the new pension laws.

President Bush Proposes New Personal Reemployment Accounts

President Bush has announced a proposal giving states $3.6 billion to fund "Personal Reemployment Accounts" intended to assist displaced workers in obtaining employment. These accounts would provide up to $3,000 to an unemployed worker to use for job training, child care, transportation, moving costs or other expenses associated with finding a job. Workers who obtain employment within 13 weeks will be allowed to retain the leftover funds from this account as a reemployment bonus.

Proposed Legislation Impacts Retirement Plans

Several pension reform bills have already been introduced in Congress in 2003. The proposed legislation is broad and could impact plan sponsors in many ways. The proposed legislation includes liberalized diversification requirements for company stock held in qualified plans, a joint trusteeship requirement for many plan trusts, and protection for participants who participate in traditional pension plans that are converted to cash balance

plans. The legislation also targets perceived abusive off-shore rabbi trusts that shield trust assets from creditors. The potential impact of proposed legislation should be taken into consideration in establishing new benefit programs.

Security Rules Delayed Further

The U.S. Department of Health and Human Services missed their own deadline of December 27, 2002 for issuing final security rules under HIPAA. The Security Rules are the third part of HIPAA's Administrative Simplification provisions, along with the Transaction and Code Set Standards and the Privacy Rules. The Security Rules establish standards for protecting electronic health information. The proposed rules were issued in 1998 and final rules were widely expected before the end of the year. Industry sources report that the delay is due to the Administration's efforts to make the regulations as workable as possible. At press time, the rules had been sent to the Office of Management and Budget for review. DHHS rules are generally issued on the last Friday of the month, so it is possible that the Security Rules will be released on January 31, however further delays are possible, as well.

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