ROBINSON & COLE LLP

Employee Benefits & Compensation

IRS Withdraws Proposed Cash Balance Rules on Nondiscrimination

On April 7, 2003, the IRS issued an Announcement withdrawing the portion of the recently issued proposed cash balance rules addressing nondiscrimination in cash balance plan conversions. The nondiscrimination provisions had been heavily criticized for limiting the ability of employers to provide "transition relief" to older workers who could be adversely affected by a cash balance conversion. Traditional forms of transition relief, such as providing older workers with a choice between the prior defined benefit plan and new cash balance plan or providing a retirement benefit for such workers that is equal to the greater of the individual's benefit under the old plan formula or under the new plan, could have run afoul of the proposed rule prohibiting discrimination in favor of highly compensated employees. The IRS intends to release new proposed nondiscrimination rules for cash balance plans addressing these issues.

The IRS has not withdrawn the portion of the proposed cash balance rules relating to age discrimination. Hearings on the age discrimination portion of the cash balance rules were held on April 9 and 10, 2003. Critics of the age discrimination provisions of the rules claim that they do not do enough to protect older workers who could potentially receive lesser benefits under a cash balance plan than they would have received under the employer's traditional defined benefit plan. Proponents of the new regulations argue that the majority of workers benefit under cash balance conversions, and that employers are not obligated to provide employees with the same rate of benefit accrual throughout their employment. Now that the hearings are completed, we will all be interested to see how the IRS handles these rules going forward.

Final Rules Issued on Notice of Benefit Reduction

The IRS has finalized regulations regarding when and how participants must be notified of a change that will significantly reduce benefit accruals in a defined benefit pension plan or a money purchase pension plan. Plan Administrators are required to provide notice of a plan amendment when the amendment includes a significant reduction in the rate of future benefit accruals or eliminates or significantly reduces an early retirement benefit or retirement-type subsidy.
The regulations reiterate that notice is required when a money purchase pension plan is converted into a profit sharing plan even though profit sharing plans are not subject to these rules.

Generally, participants must be given 45 days advance notice of an applicable plan change. When a change is made in connection with a business transaction, to a small pension plan with fewer than 100 participants, or to a multi-employer plan, only 15 days advance notice is required.

The notice must be written in a manner calculated to be understood by the average plan participant and it must provide sufficient information, including examples, to allow participants to understand how the amendment affects them.

The final regulations are effective for plan amendments effective on or after September 2, 2003.

Employer Found Liable for Failure to Provide Summary Plan Description

In the case Leyda v. Allied Signal, Inc., the Second Circuit Court of Appeals found that an employer violated ERISA's requirement to provide participants with summary plan descriptions (SPD). The employee, Charles Leyda, participated in a group life insurance plan. Allied Signal purchased Mr. Leyda's employer and replaced the existing group life insurance plan with a new plan. Allied Signal distributed SPDs to employees at meetings held concerning the new plan and SPDs were left at the Stratford, Connecticut facility where Mr. Leyda worked. Mr. Leyda did not attend the meetings and did not obtain an SPD. He enrolled in the new plan and elected coverage which he incorrectly believed would provide him with the same amount of life insurance coverage as he had under the old plan. Mr. Leyda died thereafter.

Mr. Leyda's wife, the beneficiary of his life insurance benefits, alleged that Allied Signal had

violated ERISA by failing to provide Mr. Leyda with an SPD that would have disclosed the lower benefit under the new plan. She contended that he relied on the old plan to his detriment, believing that he had more life insurance coverage than he in fact was entitled to. The trial court found that although Allied Signal's method of distributing notice of the scheduled meetings to employees was likely to result in full distribution of the meeting notices, notice of availability of the document does not equate to receipt. This method was not reasonably calculated to result in actual distribution of the materials to all employees because it was not reasonable to assume that all employees would attend the meetings and it did not take into account reasonable factors (such as a busy schedule) that would lead employees to miss the meetings. Additionally, because attendance was not taken at the meetings, Allied Signal had no way of knowing how many employees had failed to attend. Accordingly, the trial court awarded Mrs. Leyda the difference between Mr. Leyda's assumed coverage and the actual amount of coverage.

However, the trial court did not award Mrs. Leyda attorneys' fees.   Mrs. Leyda appealed the denial of attorneys' fees, asserting that there is an ERISA presumption in favor of awarding attorneys' fees to a prevailing plaintiff. The Court of Appeals stated that when determining whether attorneys' fees should be awarded in an ERISA case, a court should consider the offending party's culpability or bad faith, the ability of the offending party to satisfy an award of attorneys' fees, whether an award of attorneys' fees would serve as a deterrent, the relative merits of each party's position, and whether the action confers the common benefit on a group of participants. The trial court found that Allied Signal's actions did not reflect a high degree of culpability and that they had made a good faith, although failed, attempt to comply with ERISA's disclosure requirements. The Court of Appeals found the trial court's rationale to be sound and approved its denial of attorneys' fees.

Form 5500 Filing Requirements for Schedule SSA Changed … Again

Schedule SSA to Form 5500 is used by plan sponsors to report participants with vested deferred benefits. The Schedule only allows room for four participants to be reported. The Instructions for the 2002 Form 5500 state that a copy of page two of Schedule SSA is the only acceptable manner of reporting additional participants. As a result of comments received regarding the difficulty in complying with this burdensome requirement, the IRS has announced that plan sponsors can report additional participants in an alternative manner. As in prior years, plan sponsors can use non-standard attachments to report deferred vested participants on Schedule SSA.

Court Approves Plan Design that Excluded Hourly Employees

In Bauer v. Summit Bancorp, the Third Circuit Court of Appeals upheld an employer's qualified plan design that specifically excluded hourly employees from plan participation. The plaintiff in this case, John Bauer, worked for Summit for many years as an hourly employee. He also worked as a salaried employee for almost four years. When Mr. Bauer retired, his pension benefit was based only upon his service as a salaried employee. Mr. Bauer brought suit against Summit alleging that the exclusion of hourly employees from plan participation violated the minimum participation requirements of the Internal Revenue Code. The Court ruled in favor of the plan sponsor and stated that employers are not required to provide any particular benefits to any particular group of employees. Therefore, since the plan specifically excluded hourly employees, and since the plan did not otherwise violate any of the non-discrimination requirements of the Internal Revenue Code, the Court ruled in favor of the plan sponsor.

This ruling is consistent with past cases that support the ability of plan sponsors to design a plan's eligibility requirements in any manner that is non-discriminatory and does not violate the general eligibility requirements of the Internal Revenue Code.

HIPAA Privacy Rules Come Into Effect April 14, 2003

Employer self-insured health plans are covered entities subject to all of the requirements of the HIPAA Privacy Rules. The compliance date for most plans is April 14, 2003. Covered entities should have by April 14:

- Policies and procedures in place to implement compliance
- Trained affected employees
- Provided participants with a Notice of Privacy Practices
- Amended plan documents and certified to the plan that the amendment was adopted
- Entered into business associate contracts with many outside vendors to whom protected health information is disclosed
- Appointed a privacy officer to oversee compliance
- Established a contact officer to receive complaints
- Instituted physical, technical and administrative safeguards for protected health information
- Created a document retention process for documentation related to protected health information and for documents required to be implemented by HIPAA's Privacy Rules.

Plans that qualify as small health plans have an additional year in which to comply with the Privacy Rules. The Privacy Rules define a "small health plan" as a health plan with annual receipts of $5 million or less. UnderHHS published guidance, receipts mean total income, plus the cost of goods sold, as defined on federal tax return forms, but with certain exclusions. Health plans should calculate these receipts based on the process the Small Business Administration uses for calculating annual receipts found at 13 C.F.R. 104. ERISA group health plans that are exempt from filing an income tax return should use alternative methods to determine annual receipts. Fully insured health plans should use the amount of total premiums they paid for health insurance in the plan's last fiscal year. Self-insured plans should use the total amount of health care claims paid on behalf of the plan by the plan sponsor during the plan's last full fiscal year. The guidance does not specifically include costs for plan administration in the calculation. Plans that use both insured and self-insured mechanisms should combine the two measures to determine their total annual receipts.

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