ROBINSON & COLE LLP
Employee Benefits & Compensation

Legislation Providing Prescription Drug Benefits Signed Into Law

On December 8 President Bush signed into law the Medicare Prescription Drug Bill. This legislation provides a prescription drug benefit through the Medicare program starting in 2006. Generally, this standard benefit will provide 75% of the cost of coverage for prescription drugs after a $250 deductible is met, up to a maximum of $2,250. Once the $2,250 maximum has been reached, participants will be required to pay the entire cost of their drugs until they are eligible for catastrophic coverage, which is available once the participant has reached the $3,600 out of pocket expense limit. Once the catastrophic limit is reached, the program will pay all costs except for minimum co-payments made by participants. Low-income participants may qualify for additional subsidies.

Until this benefit begins in 2006, Medicare-eligible seniors will be able to buy discount drug cards that will permit them to purchase prescription drugs at a discount. These discount cards are expected to reduce the out-of-pocket costs of prescription drugs by 10 to 20 percent. These cards will be in effect starting next summer and will remain in effect until the prescription drug benefit begins in 2006.

Health Savings Accounts and the Medicare Bill

In addition to addressing precription drug coverage for seniors, the Medicare bill also included a provision establishing health savings accounts ("HSAs") effective January 1, 2004. These accounts, which can be used to pay for out-of-pocket medical expenses, may only be implemented in connection with high deductible insurance plans with deductibles of at least a $1,000 for an individual and $2,000 for a family. Individuals can contribute 100% of the deductible into an HSA, up to a maximum of $2,600 for individual policies and $5,150 for family policies. Qualified medical expenses can be paid from an HSA and unused amounts from one HSA can be rolled over to another HSA within 60 days, so the accounts may be portable from job to job.

HSAs differ from currently available Health Reimbursement Accounts ("HRAs"). For instance, employees generally cannot contribute to HRAs; only employers may contribute to them. Also, rollovers are not permitted for HRAs, while they are permitted with HSAs. Additionally, there are no limits on maximum contributions for HRAs, while HSAs have contribution limits, as described above. Significant guidance from the IRS is needed and expected soon given the effective date of HSAs.

Form 1099 Requirement Addressed in the Medicare Bill

Earlier this year, the IRS provided guidance on the use of debit or credit cards in connection with a Health Reimbursement Account ("HRA") or a Flexible Spending Account ("FSA"). The IRS stated in such guidance that when a debit or credit card is used in connection with these accounts, the plan would have to complete a Form 1099-MISC for any payments of $600 or more to a provider or retailer. The Medicare bill eliminates this reporting requirement for payments made after 2002.

SEC Addresses Mutual Fund Abuse

The SEC has taken steps to address the late trading and market timing abuses in the mutual fund industry. The SEC voted to propose a rule that would require orders to purchase or redeem mutual fund shares to be received by the mutual fund, its transfer agent or a registered securities clearing agency by the time the fund calculates its net asset value for

that day in order to receive that day's price. For most funds, this would mean that fund orders would have to be received by the fund by 4:00 p.m. in order to receive that day's closing price. Any orders received after 4:00 would receive the next day's price.

This rule, if finalized as proposed by the SEC, will have a substantial impact on 401(k) plans. Under most self-directed plans, participants can now make an investment change and receive that day's closing price if the participant submits the investment change before 4:00. Under the proposed rule, participants will not receive the current day's price if the mutual fund does not receive the order before 4:00. Although many 401(k) plan participants do not actively trade their plan account balance, for those who do actively trade, this change will have a substantial effect.

The SEC is also proposing enhanced disclosure requirements that will require funds to disclose their market timing policies, their practices regarding fair valuation of portfolio securities and policies with respect to the disclosure of the funds portfolio holdings.

These changes are only proposed revisions and much more detail will be required before plan sponsors can determine how significant of an impact these changes will have on 401(k) plans.

Last Chance to Terminate Split-Dollar Arrangements

Earlier this year, the IRS issued final split-dollar regulations. Because the regulations impose unfavorable rules regarding the taxation on the equity build-up in split-dollar insurance arrangements on termination, employers should consider whether to continue such arrangements. Under a limited grandfather provision, if a split-dollar arrangement that was entered into before January 28, 2002 is terminated before December 31, 2003 by repayment of the employer's premium advances, the employee will not be taxed on any policy equity. Such a termination will be most helpful for mature split-dollar arrangements with substantial policy equity. If an arrangement does not have substantial equity, an employer should consider reclassifying such arrangement as a loan before December 31, 2003 so that the employee can avoid taxation on the existing policy equity.

EBSA Issues New Reporting and Disclosure Guide

The EBSA has issued a new Reporting and Disclosure Guide that provides plan administrators with general guidance on compliance with ERISA matters, including COBRA compliance.

HHS Clarifies that Stop-Loss Insurers Are Not Business Associates Under HIPAA

Clarifying the privacy regulations under HIPAA, the U.S. Department of Health and Human Services ("HHS") now has specifically stated that stop-loss insurers of self-insured health plans generally are not "business associates" under HIPAA. This position was stated in a letter from HHS's Office of Civil Rights ("OCR") to the Self-Insurance Institute of America. In the letter, OCR stated that stop-loss and excess of loss insurance are "functionally equivalent to reinsurance" and since OCR had already determined that a reinsurer was not a business associate solely because the reinsurer sold a policy or paid a claim, similarly a stop-loss carrier was not a business associate when providing stop-loss insurance. OCR also clarified that disclosing health information to a stop-loss carrier for the purpose of obtaining coverage and paying a claim under the stop-loss policy are health care operations and payment, respectively, and therefore can be done without an individual's authorization. Although stop-loss carriers may not be business associates of a health plan and therefore not required to enter into business associate contracts, the health plan may want to consider entering into confidentiality agreements with such carriers. This is advisable since these carriers are likely to receive a great deal of protected health information from the covered entity health plan, and unlike the health plan or health insurance carriers, stop-loss carriers are not required by the privacy regulations to protect the information received.

Protect the Fiduciaries of Your Self-Directed Plan

If participants in a qualified plan are allowed to self-direct the investment of their plan account, the participants, and not the plan fiduciaries, are responsible for plan investments that they make. Thus, if a participant has elected a fund that performs poorly, he or she cannot claim that the plan fiduciaries have breached their fiduciary duties by failing to invest prudently. However, in order for the plan fiduciaries to be relieved of this potential liability, plan investments must be administered in compliance with Section 404(c) of ERISA. Appropriate plan fiduciaries should regularly monitor the plan's investment options in order to be sure that the detailed requirements of Section 404(c) are satisfied so that plan fiduciaries should not be liable for investment performance.

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