ROBINSON & COLE LLP
Employee Benefits & Compensation

Final Regulations Issued Regarding Explanation of Optional Forms of Pension Benefits

Plan administrators are required to provide participants in plans that offer an annuity form of benefit with a written explanation of the qualified joint and survivor annuity and qualified pre-retirement survivor annuity forms of benefit. The explanation must inform participants of their right to waive the qualified annuity, the effect of an election waiving the qualified annuity, the right to revoke such election, and the rights of the participant's spouse. ERISA requires that the explanation to be written in a manner calculated to be understood by the average participant. The IRS has issued final regulations relating to the information that the explanation must provide regarding the optional forms of benefit provided under the plan. The regulations do not provide any model language but, consistent with the proposed regulations, require increased disclosures in the explanation.

The regulations impose disclosure requirements intended to enable participants to compare the relative values of each distribution option using easily understandable information. A meaningful comparison must be provided comparing the relative economic values of each optional form of benefit to the value of the qualified joint and survivor annuity or qualified pre-retirement survivor annuity. If a plan provides forms of benefit with actuarial values within five percentage points of each other, those forms can be grouped together for purposes of disclosing their relative value. A plan can use a uniform basis of comparison of relative value for unmarried and married participants if identical benefit options are offered. The comparison will be most helpful to participants when a plan sponsor subsidizes certain forms of benefit.

Instead of providing a statement regarding the financial effect of an optional form of benefit, the explanation can include a chart or other comparable device showing the financial affect and the relative value of optional forms of benefits in a series of examples.

For defined contribution plans that offer an annuity form of benefit, the explanation must simply state that an annuity will be provided to the participant by purchasing an annuity contract from an insurance company with the participant's account balance.

The new rules apply to distributions with annuity starting dates on or after October 1, 2004.

FASB Developments

The Financial Accounting Standards Board has issued a revised Statement regarding employer disclosures about defined benefit pension plans and other post-retirement benefit obligations. The revised Statement is intended to alleviate concerns that users of financial statements have not received sufficient pension information in the past. The revisions do not change how employers measure or recognize post-retirement benefit obligations.

Effective for fiscal years ending after December 31, 2003, employers are now required to disclose the following additional information in any annual disclosure:

• The accumulated benefit obligation of defined benefit plans.

• A breakdown of plan assets held in equity securities, debt securities, real estate and other assets.

• A description of the plan's investment policy and target allocations.

• Projections of the expected future benefit payments for the next five years.

• The estimated contributions for the next year.

• Dates on which plan assets and obligations are measured.

• Key assumptions used by the plan.

In addition to the annual disclosure, employers are required to report pension and other post-retirement benefit costs quarterly. Since quarterly information is required for quarters beginning after December 15, 2003, employers must immediately begin compiling this information if it is not already readily available.

FASB has also issued guidance allowing employers to gauge the effect of the new Medicare prescription drug law on retirement-related benefit obligations for 2003 financial statements. Employers can make a one-time election to delay reporting the effects of the law until the question of how to account for the Medicare drug subsidy is settled.

IRS Shuts Down Abusive Roth IRA Transactions

The IRS has taken steps to shut down abusive tax shelters involving contributions to Roth IRAs that are intended to circumvent the Roth IRA contribution limits. Under IRS Notice 2004-8, a contribution to an IRA through a transaction that disguises the true value of the contribution may disqualify the IRA. These transactions generally involve a taxpayer who owns a business and maintains a Roth IRA that holds all of the shares of another corporation. The taxpayer's business engages in a transaction with the Roth IRA corporation in which property is not fairly valued. The IRS has stated that it will challenge the tax benefits from these transactions and may also assert that the transaction is a prohibited transaction between the Roth IRA and the account owner.

DOL Releases 2003 Form 5500

The DOL has issued Form 5500 for 2003. The Form does not contain any significant changes from the 2002 Form. Plan sponsors should note that the DOL will not be mailing out Forms and Instructions since most plan sponsors use computer generated forms. Plan sponsors will receive postcards encouraging electronic filing and providing information on how to order Forms and Instructions. The DOL has posted the 2003 Form 5500 on its website. The website also provides tips on how to avoid common filing errors.

Two Strikes Against COLI Policies on Rank-and-File Employees

The U.S. Court of Appeals for the 5th Circuit held that Wal-mart's policy of purchasing corporate owned life insurance (COLI) policies for its rank and file employees violated a Texas state law requiring that purchasers of insurance contracts have an "insurable interest" in the subjects of the policy. Under Texas law, a purchaser only has an insuranble interest if the insured is a relative, creditor, or entity, such as an employer, that expects to receive financial benefit from the continued life of the insured.

The court held that Wal-mart did not have a significant enough financial interest in the continued life of its rank-and-file employees to constitute an insurable interest. Wal-mart, which used funds borrowed from COLI policies on rank-and-file employees to fund its employee benefit programs, was sued by the estate of a deceased rank-and-file employee with respect to whom Wal-mart had secured a COLI policy.

Earlier this week, the U.S. Supreme Court declined to hear an appeal of case from the U.S. Court of Appeals for the 6th Circuit addressing whether a company's purchase of COLI policies for thousands of employees constituted a tax-avoidance scheme. The IRS disallowed the tax deduction of American Electric Power and assessed an additional $25

disallowed the tax deduction of American Electric Power and assessed an additional $2[illegible] million in taxes after concluding that the purchase of COLI policies for over 20,000 employees lacked economic substance and constituted a sham transaction. Both the district court and the 6th Circuit found in favor of the IRS.

New Law Broadens Interest Rate Relief on Plan Loans to Individuals Serving in the Military

Under existing law, if a plan participant takes a loan from a qualified plan before entering military service, an interest rate of no more than 6% can be imposed on the loan during the period of military service. Interest in excess of 6% is forgiven. Since the interest rate relief only applies to loans taken before entering military service, if a loan is taken after the participant enters military service, the loan is not subject to the 6% interest rate cap.

The new Servicemembers Civil Relief Act expanded the definition of "military service" for purposes of this law to cover individuals who have served in the National Guard for more than 30 consecutive days.

The new Act also clarifies that a servicemember can either send notice to the plan administrator invoking the interest rate relief or can retain the higher interest rate. In order to take advantage of the 6% interest cap, the servicemember must provide the plan administrator with written notice and a copy of his or her military orders within 180 days after the end of military service. If the servicemember provides the required notice, the interest rate relief is retroactive to the beginning of military service. However, the plan administrator may challenge the request for interest rate relief if the servicemember's ability to pay the current rate of interest is not materially affected by his or her military service.

Benefit Plans Should Clearly Address Coverage for Same-Sex Partners

As a result of recent developments regarding same-sex marriages in Canada, civil unions, and commitment ceremonies, each employer should establish a policy regarding employee benefit coverage for same-sex partners. After establishing a detailed policy, the specific terms of each benefit plan should be examined to ensure that the terms of each plan reflect the employer's policy.

Small Plans Have Less Than Three Months to Comply With HIPAA's Privacy Rule

In less than three months, all health plans that are covered by the Privacy Regulations under the Health Insurance Portability and Accountability Act (the "Privacy Rule") must be in compliance with the Privacy Rule or face potential penalties. Small plans (those with less than $5 million in premiums or claims paid) had an additional year (until April 14 of this year) to comply with the Privacy Rule; larger plans were required to comply with the Privacy Rule by April 14 of last year. Only health plans that have fewer than fifty participants and are self-administered are exempt from the requirements of the Privacy Rule. If you have fifty participants or more in your health plan, or if you use a third party administrator or other provider to administer your plan, you are required to implement the provisions of the Privacy Rule. If you sponsor a fully-insured health plan and you don't receive any individual claims information from your insurer, you may be exempt from most of the requirements of the Privacy Rule. Self-insured plans that use a third party administrator are not exempt from the Privacy Rule.

If you have a flexible spending account ("FSA"), your FSA is likely covered by the Privacy Rule, unless you meet the exemption from coverage because you have fewer than fifty participants and you do not use an outside administrator to assist you with the FSA. If you have a wrap-around benefits plan that includes health benefits and an FSA, there are certain steps you may want to take to effectively address your compliance obligations.

If your plan is covered by the Privacy Rule, the plan must:

1. Analyze the existing uses and disclosures of health information, and if necessary redirect the information flow to comply with the Privacy Rule;
2. Implement policies and procedures for using and disclosing health information;
3. Amend the plan documents to reflect the plan's disclosures to the plan sponsor;
4. Enter into contracts with the plan's business associates (that is, vendors that handle health information);
5. Train the members of your workforce who handle health plan information;
6. Appoint a privacy official and contact/complaint official; and
7. Know when to prepare and use authorization forms.

If you sponsor a small plan that must comply by April 14, 2004, or a larger plan that has yet to implement the Privacy Rule, Robinson & Cole LLP can help you determine the extent of your obligations under this federal law and help you achieve compliance. Please contact us for assistance.

It has come to our attention that many of our clients did not receive this last edition of Benefits enews due to the new manner in which our newsletter was electronically released on January 16. In order to be sure that you are kept informed about these significant legal developments, we are resending the newsletter.

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