ROBINSON & COLE LLP
Employee Benefits & Compensation

IBM Agrees to Settlement Terms in Cash Balance Case

Late last month, IBM agreed to both a floor and ceiling settlement amount with employees and participants in IBM's cash balance defined benefit plan, while retaining its right to appeal the finding of an Illinois District Court that IBM's cash balance plan discriminates against older workers. The District Court must approve the terms of the settlement. IBM has agreed to pay a minimum of $320 million to employees and participants in the cash balance plan. The majority of that amount, $300 million, is payable to participants in the cash balance plan who claim that they received a smaller benefit than younger workers because of their age. The remaining $20 million will be paid to employees who allege they were improperly denied the right to participate in the cash balance plan.

The settlement also provides that if IBM loses its appeal of the District Court's decision, IBM's maximum liability to the cash balance plan plaintiffs will not exceed $1.4 billion. Although this settlement does not provide any resolution of the questions currently facing cash balance plans, IBM's appeal will ultimately provide some insight into how at least one Circuit Court interprets the applicable laws with respect to cash balance plans.

Qualified Plans May Need to be Amended to Provide for Rollovers of Lump Sum Cash Outs

Many qualified retirement plans provide that in the event that a participant’s account balance or accrued benefit is valued at less than $5,000, the participant’s account balance will automatically be distributed upon termination of employment, regardless of whether a participant has consented to the distribution. This “cash out” provision is permissible under IRS rules and is commonly used by plan sponsors to reduce administrative expenses by distributing small account balances. These cash out amounts are generally paid by check to the participant at his or her last known address.

The Economic Growth and Tax Reconciliation Act of 2001 (EGTRRA) added a twist to the cash out rule by requiring that automatic distributions exceeding $1,000, made without a participant’s consent could only be rolled over to an IRA and could no longer be paid in cash. EGTRRA imposed an obligation on the DOL to issue regulations providing safe harbors for plan sponsors to follow in administering the new requirement. The DOL recently issued the final safe harbor, which will require amendments to plans that provide for cash out distributions and wish to fall under the safe harbor.

Under the safe harbor, plan administrators can continue to make cash out distributions of $1,000 or less without a participant’s consent. However, in the event that a participant is entitled to a distribution of more than $1,000, a lump sum cash out distribution can no longer be made directly to a participant unless the participant affirmatively elects to receive the distribution. In the event that a participant does not elect to receive a distribution of more than $1,000, the distribution must be made to an IRA.

If a plan sponsor wishes to continue to cash out distributions under $5,000 and take advantage of the safe harbor, the plan sponsor must amend the plan to provide that distributions of more than $1,000, but less than $5,000, will be rolled over to an IRA in the event that a participant does not consent to receive the distribution. Rollovers can be made to a bank, institutional IRA sponsor or to a deemed IRA component of the plan. If a plan administrator follows the DOL’s guidance in selecting the IRA sponsor and the IRA's investments and enters into an agreement with the IRA provider that satisfies the safe harbor requirements, he or she will be deemed to have met ERISA’s fiduciary duties with respect to the investment of the cashed out amount. The DOL’s safe harbor requires that the rolled

over funds be invested in an investment product designed to preserve principal and provide a reasonable rate of return, such as a money market fund. Additionally, the fees charged to the IRA may not exceed the fees charged by the IRA provider to other comparable IRAs. Plan sponsors that choose to provide for such rollovers should consider the time involved in the process of selecting a new provider.

If a plan sponsor does not wish to continue to cash out distributions under $5,000 and to comply with this new rule, the plan sponsor may amend the plan to reduce the automatic cash out amount to $1,000. Any participant with an account balance of greater than $1,000 will not receive a distribution unless they consent. However, reducing the cash out amount of a defined benefit plan would probably increase the plan's PBGC premium, which is based on the number of plan participants, including terminated vested participants.

The new rollover requirement applies to all distributions made on or after March 28, 2005. As a result, qualified plans must be amended before March 28, 2005, to comply with the new safe harbor requirements. In addition to amending the qualified plan, the Summary Plan Description must be updated to include the plan's cashout/rollover rule.

Department of Labor Issues Proposed Regulations on USERRA

The DOL has issued Proposed Regulations providing guidance to servicemembers and employers with respect to the interpretation of employers' obligations under the Uniformed Services Employment and Reemployment Rights Act (USERRA), the federal law which protects employees who enter the military service. The proposed rules clarify the DOL's interpretation of several USERRA requirements.

The proposed regulations make clear that USERRA protects only federal service. For example, the National Guard can be called up by a governor for duty such as riot control in a state. Such service for a state is not protected as only federal duty is covered by USERRA. The regulations also state that protected military service includes an individual's period of attendance at a military service academy, such as West Point.

USERRA does not specify how employers should administer employee elections to continue health care coverage. The proposed rules state that if an employer uses reasonable procedures to administer employee elections to continue health care coverage and to pay for such coverage while on military service, the employer will be considered to have satisfied USERRA's obligations.

USERRA protects employees' rights to employee benefits during the period of military service. USERRA provides that employees can make up pre-tax deferrals, and receive any corresponding employer matching contribution under a 401(k) plan. Since elective deferrals that are eligible for matching contributions can only be made if an employee has enough compensation from the employer to make up the lost deferral, the regulations allow such an employee to make after-tax contributions in order to receive the maximum available matching contribution.

The DOL is accepting comments on the proposed regulations and final regulations are

forthcoming.

Reminder for Sponsors of 401(k) Safe Harbor Plans

Sponsors of 401(k) safe harbor plans are required to provide written notice of the safe harbor provisions to plan participants on an annual basis. Such notices must be provided on or before December 1, 2004 for the plan year beginning January 1, 2005. The notice must:

- Describe how the safe harbor contribution is calculated under the plan.
- State the condition under which plan contributions will be made and that the safe harbor contributions are fully vested.
- Explain the timeframes and administrative requirements of making salary reduction elections.
- Note the type and amount of contribution that can be deferred under the plan and outline the withdrawal and vesting provisions of contributions under the plan. These items can be crossed referenced in the Summary Plan Description.
- Provide the name, address and telephone number of the contact person where the participant can obtain additional plan information.

This is an archive of past issues. As a result, it may contain information that is not current.

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