EMPLOYEE BENEFITS ALERT

Save The Trees: Electronic Plan Administration Made More Practical

By Russell D. Shurtz

The Department of Labor ("DOL") recently issued final regulations that expand the ability of employers to use electronic media (such as E-mail) to satisfy ERISA's disclosure requirements. The rules also provide a "safe harbor" for using electronic media to satisfy ERISA's record-retention requirements. The rules apply to all ERISA pension and welfare benefit plans—including group health plans—and become effective on October 9, 2002.

Distributing Documents Electronically. Under the prior rule, a safe harbor was available for all ERISA plans to provide summary plan descriptions (SPDs), summaries of material modifications (SMMs), and summary annual reports (SARs) to plan participants at their workplace. The new rule expands the safe harbor to permit electronic distribution of more types of plan-related documents, to more types of individuals, and at locations beyond the workplace.

Electronic media can now be used to distribute all documents that Title I of ERISA requires plan administrators to give participants and their beneficiaries. This opens the door for electronic distribution of COBRA notices, QDRO notices, QMCSO notices, investment information related to ERISA 404(c), HIPAA notices of creditable coverage and benefit determination notices given under ERISA's claims procedure requirements.


Russell D. Shurtz

Under the prior rules, the safe harbor allowed electronic distribution only to participants who had effective access to electronic documents at their workplace. The new rules expand this requirement to now permit electronic disclosure for employees who work at home or on the road, so long as they have effective access to the company's electronic information systems. Electronic disclosure can also be made to beneficiaries and others, such as alternate payees, who affirmatively consent to the disclosure after being given a "clear and conspicuous" notice about their rights.

Substantial Cost Savings. In releasing the more favorable regulations, the DOL stated: "We expect participants and beneficiaries to benefit through improved timeliness, quality and accessibility of information that will flow from instant, on-line availability and access tools such as hot-links and search queries. Plan sponsors will save on expenses from the elimination of printing and mailing costs associated with traditional paper disclosures."

The DOL estimates that in the first year alone the new rules will result in $66 million in savings across the country. Plan sponsors should evaluate whether they can share in these cost savings. Specifically, employers that are currently using E-mail or other electronic means to send SPDs, SMMs or SARs should consider distributing other plan-related documents electronically as well. They should also consider conforming their current electronic distribution practices to the new safe harbor rules. For those plan sponsors that have not yet begun using electronic media, now is an excellent time to examine the potential cost savings made available by the new guidance.

Recordkeeping Safe Harbor. ERISA Section 107 requires plan administrators to retain plan-related records for six years. ERISA Section 209 requires employers to maintain records that are sufficient to determine the benefits owed to employees. The new rule provides a safe harbor for satisfying these recordkeeping obligations via electronic media. These requirements are deemed satisfied if the following five conditions are met: ❶ the electronic recordkeeping system has reasonable controls to ensure the integrity, accuracy, authenticity and reliability of the electronic records; ❷ the electronic records are maintained in reasonable order, in a safe and accessible place, and in such a way that they can be readily inspected or examined; ❸ the electronic records are readily convertible into legible and readable paper copy; ❹ the electronic recordkeeping system is not subject to any restriction that would compromise any person's ability to comply with any reporting or disclosure requirement under ERISA; and ❺ adequate record management practices are established and implemented (such as labeling, secure storage, backup, quality assurance, etc.).

Generally speaking, once plan records are transferred to an electronic form that satisfies the five requirements above, the original paper records may be destroyed. ■

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Good News: IRS Suspends 5500 Requirements for Some Plans!

By Sue O. Conway

Good news for some plan administrators!

In a surprise move, the IRS recently announced the suspension of the Form 5500 annual report and Schedule F filing requirements for the following benefit plans:

Sue O. Conway

- Cafeteria Plans (Section 125)
- Educational Assistance Plans (Section 127)
- Adoption Assistance Plans (Section 137)

This relief applies to all plan years, even prior years for which a Form 5500 and/or Schedule F were not (or have not yet been) filed.

Keep in mind that this relief only applies to the IRS filing requirements under Code Section 6039D. Form 5500 annual reports (but not Schedule F) must still be filed for employee welfare benefit plans subject to ERISA reporting requirements, (i.e., employer health and welfare plans that have 100 or more participants or plans of any size that are "funded." A plan is "funded" when its benefits are paid from a trust or plan account, not through insurance or the general assets of the employer).

This suspension announcement should come as particularly good news for employers with cafeteria plans who may have overlooked, or been unaware of, the Form 5500 filing requirement. ■

Delinquent Form 5500 Correction Program Now Made Easier

By Sue O. Conway

Employers and plan administrators now have more reason than ever to file delinquent Form 5500 annual reports. The Department of Labor ("DOL") recently announced changes to its Delinquent Filer Voluntary Compliance Program. These changes reduce the penalties for late Form 5500 filings and simplify the delinquent filing procedures. By doing this, the DOL hopes to encourage plan administrators who have failed to file complete and timely annual reports to voluntarily comply with the ERISA filing requirements. The new program went into effect on March 28, 2002.

Under the new program, the per-day penalty for delinquent Form 5500 filings has been reduced from $50 to $10 a day, regardless of the size of the plan. The maximum penalty for a single late Form 5500 annual report is now $750 instead of $2,000 for a small plan (under 100 participants) and $2,000 instead of $5,000 for a large plan (100 or more participants). The revised program also includes a new "per plan" cap that limits the late filing penalty to $1,500 for small plans and $4,000 for large plans, regardless of the number of late Form 5500 annual reports filed for one plan at the same time.

Previously there was no cap for a plan with multiple years of delinquent filings. Administrators of "top hat" nonqualified retirement plans who have not made the one-time filing with the DOL, required by law when a plan is established, can voluntarily make that filing now with a payment of $750 rather than the $2,500 payment required under the old voluntary compliance program. As a result of these changes, plan administrators should review their employee benefit plans to determine whether filings need to be made. The program is only available to a plan administrator who has not received notice from the DOL of a failure to file a timely annual report. Once such a notice is received, all bets are off and the DOL has the authority to assess civil penalties of up to $1,100 a day for delinquent filings. ■

Interested in Reducing Health Care Costs? Defined Contribution Health Plans

By Eliza R. McCart

Health care plans anticipate 10 to 12 percent cost increases for 2002. A recent report released by the American Benefits Council indicates that health benefits for an entry-level worker five years from now will cost a company nearly half of an employee's salary. Drug costs are increasing at rates of 18 to 25 percent or more per year. Managed care is reaching its saturation point in health care cost control. As all of these factors converge, many employers are searching for new strategies that will complement their managed care plans or replace them altogether. The most innovative strategy is known by several names: defined contribution health plans ("DC health plans"), consumer-driven health plans and self-directed health plans.

A central component of these plans is personal care accounts, where employers allocate funds for employees to use in paying plan deductibles and IRS-approved medical expenses. Accounts for the employer's annual defined contribution are typically self-insured medical reimbursement accounts under Code Section 105. They have been called "savings accounts," "personal care accounts," or "health care accounts," and unused balances in such accounts typically may be carried over from year to year. This feature makes the fund more of a

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health care fund as opposed to a Code Section 125 "use it or lose it" spending account. To encourage wellness and prevention, employers sometimes include a "first-dollar wellness benefit" funded by the employer. Some funds simply expect preventive and wellness benefits to be drawn out of the employee's personal account.

Tax treatment of DC health plans is of paramount concern for employers. Tax treatment of Flexible Spending Accounts ("FSAs") and Medical Savings Accounts ("MSAs") is clear under Sections 125 and 220, respectively, of the Internal Revenue Code. However, tax treatment of Personal Care Accounts ("PCAs") remains unclear.


Eliza R. McCart

PCAs are employer-funded accounts that allow for unused contributions to be carried over from year to year. Under this model, employers credit pre-tax dollars to segregated employee accounts. This is generally done as a bookkeeping entry; there is no actual transfer of funds. Employers can design their plans so funds can be used for health care expenses after termination of employment (including retirement), or so funds are forfeited upon termination. There is no cash option and funds must be used for IRS-approved medical expenses only.

Employers and PCA product designers cannot rely on Code Section 125 to achieve their goals for PCAs. Since employees must forfeit FSA funds remaining at the end of the year, they cannot use FSA funds to purchase insurance, and FSA funds are not portable. Rather, PCAs stem from a "fresh interpretation" of Code Section 105. This interpretation appears to overcome the limitations of FSAs. Consultants and employers maintain that DC health plans are fundamentally different from FSAs, asserting that these models are self-insured medical reimbursement plans governed by Code Section 105. PCAs are being structured without "use-it-or-lose-it" requirements, allowing for employer-contributed funds to be carried over indefinitely. Employees are also using PCA funds to purchase insurance and some employers allow employees to take their PCAs with them upon termination.

Thus far, the IRS has not issued official guidance on PCAs. The IRS has indicated that guidance will be available as soon as this summer. Bill Sweetnam, Benefits Tax Counsel, Department of Treasury, has indicated that this guidance will address (1) carryover of unused money at the end of the year; (2) interaction of PCAs with FSAs; and (3) tax treatment of PCAs. He indicated that the guidance may also comment on HIPAA and COBRA implications in the PCA context. Informally and privately, the IRS has indicated it will not apply the use-it-or-lose-it rule to DC health plans, and many feel there is no public policy reason for the IRS to do so. What the IRS actually decides remains to be seen. However, it is likely that the IRS will not answer all of the unanswered questions surrounding PCAs. Notwithstanding this uncertainty, employers that are concerned about skyrocketing health care costs should keep a close watch on DC health plans. ■

Appreciating Your Employees by Implementing a Stock Appreciation Rights Plan

By Christopher W. Chappus

Are you looking to provide your employees with an incentive to focus their attention on the company's overall performance, reward key executives for their contribution to the company or increase employee morale? Then maybe a stock appreciation rights plan (an "SAR") is your answer. SARs are often used when a company is closely held or, due to its ownership structure, stock options, restricted stock, or stock awards are not feasible. An SAR often involves granting participants hypothetical shares of company stock ("phantom stock") that at some future date will vest and may be redeemed for a cash payment equal to the difference between the stock price on the date granted and the date redeemed. This provides participants with an interest in increasing the value of company stock, without actually conferring upon them ownership of any stock.

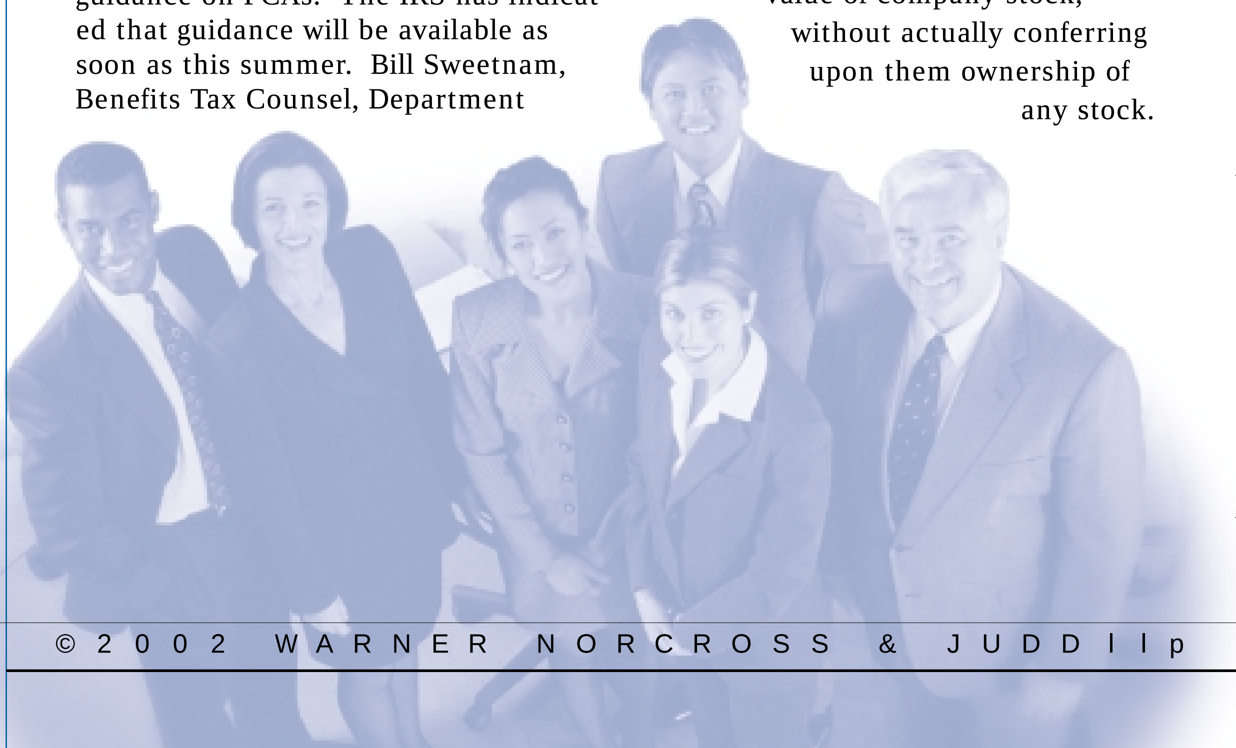
"reward key executives for their contribution to the company or increase employee morale"

SARs operate by granting a participant a certain number of shares of phantom stock, which at or after a designated time entitle the participant to receive the appreciation in value of those shares through a cash payment by the company. Depending on the plan's structure, a participant may be entitled to receive distributions of company stock in relation to their shares of phantom stock or, alternatively, distributions will be reinvested to acquire additional phantom shares.


Christopher W. Chappus

Participating in an SAR plan provides a participant with an opportunity to recognize large gains without any capital investment and delay tax until payment is made. Adopting an SAR plan benefits the company by enticing employees to focus on the long-term growth in value of the company's shares, without diluting company stock. Furthermore, by setting vesting dates a few years into the future, the company creates an additional incentive for participants to remain employed or risk losing their stock appreciation rights upon termination.

As with all forms of compensation, SARs have their disadvantages. For instance: (1) an SAR remains valuable only if shares of company stock increase in value, thus limiting its retentive value; (2) the company's accounting expenses are open-ended and not predetermined; and (3) a participant's gain might not be attributable to his or her individual efforts to the company. However, the structure of SARs is largely within the company's discretion, which gives it freedom to address specific company concerns and reduce some of the disadvantages associated with these plans. For example, if retention is a concern, the company can create vesting periods based solely on continued employment with the company, or if performance is stressed, the company may set performance incentive standards that must be achieved before the stock appreciation rights will vest. As with almost all equity-based compensation plans, a plan may be crafted to provide for payouts in the form of stock instead of cash. If a stock appreciation rights plan sounds right for your company, or if you have any questions regarding other forms of executive or equity-based compensation programs, please feel free to contact me or your WNJ attorney to discuss these matters further. ■



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Some Small Retirement Plans Now Must Have Audited Financials

By Vernon P. Saper

Retirement plans with less than 100 participants at the beginning of a plan year ("small plans") have been exempt from the ERISA requirement of preparing audited financial statements and furnishing an accountant's opinion as part of the Form 5500 Annual Report. Under new Department of Labor regulations, this exemption will no longer apply unless one of the following alternatives is met:

Vernon P. Saper

❶ At least 95% of plan assets constitute "qualifying plan assets." For this purpose "qualifying plan assets" include:

a. Employer securities;
b. Participant loans;
c. Assets held by a bank, insurance company, mutual fund or stockbroker;
d. Assets which are subject to participant investment direction, if the participant receives an annual statement from an institution listed in "c" describing the assets and their value.

❷ The ERISA fiduciary bond purchased for the plan is in an amount equal to at least 100% of the value of "non-qualifying plan assets." The bonding requirement is in addition to the existing ERISA bonding requirement of at least 10% of plan assets. Thus, if more than 5% of plan assets are non-qualifying, this bonding requirement must be met, or an independent accountant must be engaged.

The following examples may be helpful:

Example 1. A small plan has 100% of its assets held by a bank trustee (or insurance company, mutual fund or stockbroker). The accountant's opinion and audited financial statements will not be required since more than 95% of the assets are "qualifying."

Example 2. An individual acts as trustee of a small plan with a total of $1,000,000 in plan assets. $800,000 consists of stock, bonds and mutual funds held by a stock broker. The additional $200,000 is an interest in a real estate limited partnership. Since more than 5% of assets are "non-qualifying," either the plan must have a fiduciary bond of at least $200,000 (the value of the non-qualifying assets), or engage an independent accountant as part of the Form 5500 Annual Report.

Finally, in addition to meeting one of the alternatives, a small plan must provide additional information to participants as part of the Summary Annual Report.

These new rules are effective for plan years beginning after April 17, 2001—which means they are already in effect for calendar year plans. To continue to qualify for the accountant's exemption, a small plan should immediately review its assets, and, if necessary, the amount of its ERISA bond. Please call us if you need additional information. ■

Need More Information?

Visit our webpage at: www.wnj.com

Mark Your Calendar

Human Resources Update
Tuesday, October 8, 2002

Morning Program
8 a.m. - 11:30 a.m.
Employee Benefits

Afternoon Program
1 p.m. - 4:30 p.m.
Employment & Labor

Crowne Plaza
5700 28th Street SE
Grand Rapids, Michigan

Details and registration information will be mailed in August.

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