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EMPLOYEE BENEFITS DEVELOPMENTS APRIL 2008

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Employee Benefits

Participant Contributions to Small Plans: DOL Proposes 7-Day Safe Harbor

The general rule is that an employer must deposit participant contributions (e.g., 401(k) contributions) with the employer's plan on the earliest date the contributions can be reasonably segregated from the employer's general assets, but in any event no later than the 15th business day of the month following the month in which the employer receives or withholds the contributions. The general rule, however, still leaves many employers uncertain as to just how soon they must forward participant contributions to the plan, and the Department of Labor (DOL) has determined that it is in the interest of both plan sponsors and plan participants alike to establish a rule providing a higher degree of certainty with respect to when deposits of participant contributions are considered timely.

With that in mind, the DOL, on February 29, published proposed regulations that would establish a safe harbor period of seven business days within which an employer may deposit participant contributions. Deposits of participant contributions made within the 7-day safe harbor are deemed to comply with the general contribution timing rule. Initially, the safe harbor rule is supposed to be available only to plan sponsors of small plans (i.e., plans that have fewer than 100 participants at the beginning of the plan year). The DOL stated that it is unclear whether large plans have the same need for a safe harbor period. However, when the regulations are finalized, the DOL may extend the safe harbor to large plans if the DOL receives information and data to support a conclusion that large employers and their plan participants would benefit from a safe harbor rule.

Other highlights of the proposed regulations are:

- The 7-day safe harbor would apply to both contributory group welfare and pension plans covered by ERISA, including 401(k) plans.
- The proposed regulation would modify the regulations to expressly subject participant repayments of plan loans to the same deposit timing rules generally applicable to participant contributions.
- The safe harbor rule would be effective on the date final regulations are published. Before the effective date, the DOL will not assert a violation of the participant contribution regulations against a small plan so long as participant contributions

and plan loan repayments are transferred to the plan within the 7-day safe harbor period. (73 Fed. Reg. 11,072)

Foreign Same-Sex Marriage Recognized in New York State

The Supreme Court of the State of New York Appellate Division, Fourth Judicial Department recently held that a same-sex marriage, validly entered into outside New York, is entitled to recognition in New York State. The full effect of this ruling on employee benefit plans is not yet entirely clear.

The facts of this case are straightforward: a same-sex couple was legally married under Canadian law in the Province of Ontario on July 5, 2004. Based on the marriage, on July 7, 2004, the plaintiff applied for spousal health care benefits from her employer, Monroe Community College. The plaintiff filed suit after the application was denied. The court ruled that her marriage abroad is entitled to recognition in New York State, even though a same-sex marriage would have been invalid if solemnized in New York.

Having concluded that the plaintiff's marriage is entitled to recognition in New York, the court further ruled that Monroe Community College violated New York's Human Rights Law (Executive Law Section 296(1)(a)). This state law forbids an employer from discriminating against an employee "in compensation or in terms, conditions or privileges of employment" because of the employee's sexual orientation. This ruling entitles the plaintiff to monetary damages related to the denial of benefits.

In the wake of this ruling, public employers such as municipalities and school districts should review their plans to confirm that they do not discriminate against legally married same-sex couples.

While the facts of this case involved a governmental employer, it will also impact private sector plans. What constitutes a "marriage" is a matter that is decided under state law. Therefore, where New York State law applies, an employee benefit plan's definition of the term "spouse" will include same-sex couples legally married under the laws of another jurisdiction such as Ontario and Massachusetts.

Under the federal Defense of Marriage Act, which is applicable in determination of marital status for purposes of federal law, a spouse must be a person of the opposite sex. Therefore, spousal rights under the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA) are not required to be extended to same-sex couples. Thus, a plan could explicitly define the term "spouse" to exclude same-sex couples and not violate federal law. For plans subject to ERISA, ERISA's preemption provisions may therefore apply to avoid New York State's requirement to provide benefits to same-sex spouses.

Plans not subject to ERISA, such as church plans and private employer plans (including policies providing certain types of benefits not subject to ERISA), would not be able to utilize the preemption argument. These plans and policies should be reviewed for compliance with New York State law. (Martinez v. County of Monroe, N.Y. App. Div., No. 1562 CA 06-02591)

Collecting Delinquent Plan Contributions

In February, 2008 the Department of Labor (DOL) issued Field Assistance Bulletin 2008-01, dealing with delinquent contributions to employee benefit plans. Apparently this bulletin was issued after the DOL discovered through its investigations that a number of institutions serving as plan trustees had established agreements that purported to relieve the

trustee of responsibility to monitor or collect delinquent plan contributions. The bulletin asserts that it is a trustee obligation under ERISA to collect plan contributions. Trustees may allocate these responsibilities and assign collection responsibilities to a particular trustee or other fiduciary. The bulletin states that any named or functional fiduciary with authority to appoint plan trustees must ensure that the obligation to collect contributions is appropriately assigned to a trustee or to another investment manager. A failure to establish reasonable, systematic, and diligent procedures to collect plan contributions is viewed by the DOL as a possible prohibited transaction, in addition to a breach of fiduciary responsibility. This is an area where existing trust agreements may need revisions if there are disclaimers of responsibility and a delegation of collection duties.

New HIPAA Guidance Affecting Supplemental Health Plan Coverage
In Field Assistance Bulletin No. 2007-4 and Notice 2008-23, the Department of Labor (DOL) and the Internal Revenue Service (IRS), respectively, provide guidance addressing the application of certain provisions of the Health Insurance Portability and Accountability Act (HIPAA) to health plan insurance policies maintained by employers to "supplement" benefits under the employer's primary group health plan.

By way of background, HIPAA prohibits discrimination on the basis of any health factor, requires mid-season enrollment when an employee (or dependent) loses coverage or when an employee gains a dependent through marriage, birth, or adoption, and mandates the issuance of certificates of creditable coverage when a covered individual's health plan coverage comes to an end. HIPAA provides an exception from these requirements for Medicare supplemental insurance, medical coverage which supplements TRICARE, and "similar supplemental coverage provided to coverage under a group health plan."

The Field Assistance Bulletin and IRS Notice set forth a safe harbor under which supplemental health plan coverage will be excepted from the HIPAA requirements referenced above. Under this guidance, a health insurance policy that is intended to be supplemental to an employer's primary group health plan must meet four requirements to fall within the safe harbor:

- The policy must be underwritten by an insurer which is separate from the insurer providing the primary coverage. The separate insurer cannot be owned or controlled by the insurer providing primary coverage;
- The policy must be designed to cover gaps in coverage under the employer's primary group health plan (e.g., co-pays, deductibles, and co-insurance amounts);
- The cost of the supplemental insurance policy, determined using the applicable COBRA premium, may not exceed 15 percent of the cost of the employer's primary coverage; and
- The supplemental coverage may not differentiate among individuals in eligibility, benefits, or premiums based on a health factor.

The guidance specifically provides that compliance with the above requirements constitutes a safe harbor. The supplemental coverage is not required to meet these requirements in order to qualify for the exception from HIPAA requirements. However, the guidance issued by the DOL indicates that supplemental coverage that does not meet the safe harbor "may be subject to enforcement actions by the Department."

IRS Provides Guidance on Cash Balance Conversions
In Revenue Ruling 2008-7, the IRS addressed the application of the accrual rules under Internal Revenue Code Section 411 (b)(1) with respect to certain cash balance conversions that provided for a "greater of" formula as part of the conversion process. The accrual rules are intended to prevent "back loading," which occurs when a defined benefit plan provides a much faster rate of benefit accrual later in a participant's period of service. Applying the existing rules to a "greater of" benefit formula proved difficult. Under Revenue Ruling 2008-7, the IRS generally permits each of the "greater of" formulas to separately satisfy the accrual rules. The Revenue Ruling provides retroactive relief for plan years beginning before January 1, 2009 for plans (i) that had a favorable determination letter as of February 19, 2008, (ii) for which a remedial amendment period has not expired, or (iii) that are waiting for a determination letter as the cash balance determination letter moratorium reaches conclusion.

CASES:

State Law Cannot Require Child Support Payments from Pension Plan without QDRO
Overturning a lower court decision based on Texas state law, the U.S. Court of Appeals for the Fifth Circuit held that an ex-spouse must submit a qualified domestic relations order (QDRO) before payments may be made from a participant's qualified retirement plan benefits to satisfy child support arrearages. In 2002, a pension plan participant's first ex-wife served his employer with a Notice of Child Support Lien filed in the county court, and demanded payment from his pension benefits. Several additional orders followed, directing the company to withhold the pension benefits to pay his child support obligations. Following each submission, the company responded that the orders were not sufficient under the Employee Retirement Income Security Act (ERISA) and that a QDRO would be required to pay the benefits. Despite offers of help, no QDRO was submitted to the plan.

In the meantime, the participant's second marriage failed and, in 2004, the participant's second wife obtained a domestic relations order awarding her a 70% interest in the participant's pension benefits. Faced with competing claims to the same benefits, the company contended that it could not honor either claim because it had not received a court order sufficient under ERISA that addressed the competing claims. The case ultimately ended up in the district court, which held, as a matter of Texas state law, that the pension benefits were subject to the child support lien and that the claims of the first ex-wife therefore took precedence. The court did not address the plan's obligations under ERISA. The decision was appealed, and the Fifth Circuit reversed the lower court, finding that the court had erred in failing to address the parties' rights and obligations under ERISA, which prohibits a pension plan from distributing benefits to a third party claimant unless it has been presented with a valid QDRO. The court remanded the case to the district court to determine the disposition of the competing claims under ERISA. (Taliafferro v. Goodyear Tire & Rubber Co. (5th Cir., 2008))

More Perils in Employer Stock
As a recent case illustrates, holding employer stock in a 401(k) plan provides fiduciary challenges in many circumstances. In this instance, publicly traded employer stock had been an investment choice in the company's 401(k) plan. Following a bankruptcy filing, a plan amendment was adopted to prevent any new contributions into the employer stock fund under the 401(k) plan. An independent fiduciary was engaged to manage the employer stock fund and address potential conflicts of interest arising out of the bankruptcy reorganization. After consulting with various financial and legal advisors, the independent trustee decided to eliminate the employer stock fund from the plan. The trustee began selling the employer stock and reached an agreement with a buyer to sell a substantial block at a premium to its currently traded price. Following

this divestiture, a group of plan participants sued the trustee, alleging that it had breached its fiduciary responsibilities by eliminating the employer stock, that the stock had been trading in an efficient market and should not have been sold absent evidence of an imminent collapse of the stock price, and that the trustee failed to consider the potential future value of the employer stock. In reaching a decision in favor of the trustee, the court rejected the theory that the existence of an efficient stock market somehow supported the retention of the employer stock fund in the 401(k) plan. While the trustee action to eliminate the employer stock fund even at a premium was vindicated, it illustrates the risks involved in holding employer stock in 401(k) plans. (Bunch v. W.R. Grace & Co. (D. Mass., 2008))

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