

Here are the employee benefits developments for May 2003 that may be of interest to you. Please review the material and contact us if you want more information regarding a particular subject or if something you read raises a question or concern about your own program or an idea for changing what you are currently doing.

### QUALIFIED RETIREMENT PLANS: MAY 2003 DEVELOPMENTS

**JGTRRA contains no employee benefits provisions.** The Jobs and Growth Tax Relief Reconciliation Act signed into law by President Bush on May 28, 2003, contains no benefits or compensation related provisions. The Senate version of the bill contained several provisions, all deleted, that may appear in other legislation considered later this year, including provisions to regulate executive non-qualified deferred compensation arrangements. The JGTRRA reduction in the tax rate on dividends and capital gain (to a maximum of 15%) may, however, cause investors to rearrange investments that are held in—and out—of tax-exempt plans, in effect, returning to the traditional approach followed by many before the Tax Reform Act of 1986: Emphasize interest-yielding securities inside tax-exempt plans to avoid high tax rates, and emphasize dividend and capital gain-yielding instruments in the taxable portfolio, taking advantage of low tax rates on those components of income.

### Additional plan benefit expenses may now be passed through to participants.

The Department of Labor issued Field Assistance Bulletin 2003-3 on May 19, 2003, on the subject of defined contribution plan expenses. The release discussed the allocation of plan expenses on a pro rata (account balance) basis and on a per capita (per person) basis and the extent to which plan expenses may be charged to an individual participant, rather than to plan participants as a whole. FAB 2003-3 does not discuss whether an expense is a proper plan expense or how such expenses must be documented. Some prior positions of the Department of Labor limiting the ability to pass through expenses to individual participants are significantly changed. Under FAB 2003-3, for example, administrative expenses attendant to hardship withdrawal distributions, check writing expenses for ordinary distributions, and qualified domestic relations order (“QDRO”) determinations may

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be charged to individual accounts of participants. In addition, charging plan administration expenses to the accounts of vested separated participants is allowed, whether or not the accounts of active participants are similarly assessed. The bottom line for plan sponsors is that if you want to assess more charges to plan participants, in the aggregate or individually, the Labor Department has provided guidance telling you how to do it. Plan amendments may be needed so that fiduciaries can be assured they are administering the plan according to its terms when assessing these charges.

**Proposed regulations are issued on “deemed IRAs.”** EGTRRA permits qualified plans to create “deemed IRA” accounts as a supplementary component of the plan, after the regulations are finalized under new Code Section 408(q). Under the proposed regulations, the deemed IRAs must continue to be considered to be IRAs (either traditional or Roth), and subject to IRA rules. An employer interested in providing one-stop retirement savings convenience to its employees may find this feature appealing.

**One-stop convenience in retirement savings programs may also include unrestricted self-directed brokerage accounts in the future.** According to a Charles Schwab vice president, 70% of new 401(k) plans include self-directed brokerage accounts. This trend may be accelerating as a result of the post-Enron criticism of plans offering employer stock as an investment option. These criticisms (and some litigation) increase the concerns of plan fiduciaries about whether or not they are complying with ERISA fiduciary standards regarding the selection and monitoring of investment options and, where applicable, ERISA 404(c) disclosure requirements.

**Thinking about fiduciary concerns, it is difficult for us to be overly alarmed by the use we see of employer stock in 401(k) plans among our clients.** In a lot of cases, the employer stock option has been the best investment around in the last three years and we see few employers imposing severe limitations on the ability of participants to diversify out of employer stock. Nonetheless, there are some precautions any plan permitting self-direction of investments should take, whether or not the plan uses employer stock as an investment option, because these are trying times for fiduciaries: Have a written investment policy statement that makes sense and that includes selection and monitoring criteria for investment options; communicate to participants the desirability of adopting appropriate asset allocation models and help them understand where your investment options fit into typical models; follow through on the performance monitoring function at least yearly, using an outside expert to provide the necessary guidance and structure to the process. As in so many fiduciary functions under ERISA, how you do something (your “procedural prudence”) is just as important as what you do. Congress also has under consideration specific legislative proposals that would make it possible for plans or plan sponsors to hire experts to provide individual investment guidance to participants.

**A court enforces the \$110 per day penalty for failure to provide requested plan documents to the tune of a \$65,000 award in a benefit claim case that the participant lost.** In federal district court in Minnesota (*Keogan v. Towers Perrin et al.*), the court awarded \$65,000 in penalties because the plan administrator did not provide the plan document after it was requested. The facts and the award are a bit extreme, but this is a good reminder to take these requests seriously and to respond to them in good faith.

### EMPLOYEE WELFARE BENEFIT PLANS: MAY 2003 DEVELOPMENTS

**Labor Department proposes new COBRA regulations.** On May 23, 2003, the Department of Labor announced proposed rules clarifying the requirements for notices under COBRA for employees, employers, and plan administrators. The proposal provides guidance and revised model notices for workers and family members. Under COBRA, most group health plans must give employees and their families the opportunity to elect a temporary continuation of their group health coverage when coverage would otherwise end for reasons such as termination of employment, divorce, or death. COBRA requires that certain notices be provided. The plan administrator must give employees and spouses a general notice explaining COBRA when the employee first becomes covered under the plan. Then, when an event occurs triggering the right to elect COBRA coverage, either the employer or the employee and his or her family members must notify the plan administrator of the event. When the plan receives this notice, it must then notify individuals of their COBRA rights and allow them to elect continuation coverage. The proposed regulations would require plans to have reasonable procedures in place for employees and their family members to provide notice of the occurrence of a qualifying event, including time limits as to when such notice must be provided. The proposal would also require plans to notify individuals when their COBRA coverage is terminated earlier than the full time period for which COBRA must be made available.

**IRS issues Revenue Ruling 2003-43, describing how to use debit/credit cards as part of health care flexible spending accounts.** The rules should make possible some significant enhancements in services offered by third-party administrators of health flexible spending accounts (FSAs).

**Laser eye surgery is in, but teeth whitening and aspirin are out.** IRS issued a pair of Revenue Rulings (2003-57 and 2003-58) drawing distinctions about what expenses are deductible under Code Section 213, and therefore reimbursable by a health flexible spending account (FSA), and what expenses are not deductible. The IRS considered breast reconstruction surgery, vision correction surgery, teeth whitening procedures, nonprescription drugs including aspirin, equipment, supplies, and diagnostic devices. If the expense is for diagnosis, cure, mitigation, or treatment or prevention of disease, it is likely to be deductible. If the expense is for cosmetic reasons or for nonprescription drugs, it is unlikely to be deductible. Given the evidence of the health benefits of one aspirin and two glasses of red wine per day, we are not certain the IRS has quite gotten its lines in the right place, yet.

This newsletter is intended to provide information (not advice) about important new legislation or other legal developments in the Employee Benefits area. The great number of legal developments does not permit the issuing of an update for each one, nor does it allow the issuing of a follow-up on all subsequent developments. This newsletter is not legal advice and should not be construed as legal advice. If you need legal advice, please contact your attorney.