



Spring 2002

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Employee Benefits Law

Department of Labor Issues Final Regulations for Electronic Communication and Record-Keeping

On April 9, 2002, the Department of Labor issued final regulations relating to electronic communication and record-keeping by ERISA pension and welfare benefit plans. The rules provide a framework for benefit plan sponsors to use technology to improve the efficiency and effectiveness of both plan administration and plan communications with participants and beneficiaries. Set forth below is a summary of the expanded rules, and an overview of how they create new opportunities for using electronic distribution methods for ERISA plan documents and notices.

Background

As proposed, the availability of the electronic disclosure safe harbor was limited to participants who have effective access to electronically furnished documents at their work place. Furthermore, the types of documents that administrators could distribute electronically were limited to summary plan descriptions ("SPDs"), summaries of material modifications ("SMMs") and summary annual reports ("SARs").

Summary of the Final Regulation

The final regulations' safe harbor permits using electronic media (i.e., email, internet or intranet posting) to distribute practically all documents that ERISA requires plan administrators to make available to participants and beneficiaries. The safe

harbor is available for electronic distribution of:

- SPDs, SMMs and SARs;
- Individual benefit statements;
- Investment-related information;
- COBRA notifications;
- Qualified domestic relations order notifications;
- Qualified medical child support order notifications;
- Information concerning participant loans; and
- Information required to be furnished or made available for inspection under ERISA sections 104(b)(2) and 104(b)(4).

The final regulations do not bless more paper-intensive plan actions such as spousal consent or execution of loan agreements.

Plan sponsors are not required to follow the safe harbor requirements. However, electronic disclosures meeting the conditions of the safe harbor are deemed to satisfy the general disclosure requirements of a plan sponsor to disclose certain material to participants and beneficiaries.

Expanded Safe Harbor Permits Electronic Delivery Outside the Workplace

The expanded safe harbor includes electronic delivery of plan information beyond the workplace to participants, beneficiaries and other persons entitled to disclosures permitting the furnishing of documents through electronic media to "any location where a participant is reasonably expected to perform his or her duties as an employee." Thus, the safe harbor extends to employees who work at home or who may be

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traveling, provided they have ready access to the employer's information system.

The final regulation also permits furnishing electronic documents to participants, beneficiaries and other persons entitled to disclosure under ERISA if they consent to receive the documents electronically. The safe harbor establishes conditions that are intended to ensure the adequacy of the information systems for the individuals to whom disclosures will be made. For example, the individual to whom documents will be furnished must provide an address for the receipt of documents electronically and confirm that he or she has the ability to

access information in the electronic form that will be used to transmit the furnished documents. This requirement serves as evidence that the administrator has taken appropriate and necessary measures to ensure that the individual actually receives the furnished documents.

The final regulations eliminate the requirement that participants have the opportunity to readily convert documents from electronic form to paper form free of charge. However, if ERISA requires a plan administrator to furnish a document without charge to participants and beneficiaries, plan

administrators availing themselves of the safe harbor must furnish a paper version of a document transmitted electronically without charge. On the other hand, if an administrator is permitted to impose a reasonable charge for a document, the administrator may impose a reasonable charge for furnishing a paper version of the document under the revised safe harbor.

The final regulations on electronic disclosure take effect on October 9, 2002, and apply as of the first day of the plan year beginning on or after that date for the electronic record-keeping requirements.

Design Opportunity for Defined Contribution Plans under EGTRRA's New Limits

EGTRRA increased the limits on contributions to a defined contribution plan in several ways:

- The limit on includible compensation was increased to \$200,000.
- The limit on deductible employer contributions was increased to 25% of payroll, no longer including employee's elective deferrals.
- The individual limit on maximum contributions was increased to the lesser of \$40,000 or 100% of compensation.

Many plans have incorporated these new limits into their plan documents, but may not have yet taken advantage of another design opportunity—the ability to increase the plan's limit on the percentage of compensation contributed as elective deferrals.

Prior to EGTRRA, many employers limited elective deferrals to 15% of compensation in order to avoid running afoul of the limitation on deductible contributions. Now that the deduction limit does not apply to elective deferrals, there is no reason for the plan limit to mirror this deduction limit.

Increased 401(k) plan limits ultimately benefit nonhighly-compensated employees (NHCEs), who must participate at much higher percentages in order to contribute the same dollar amounts as their highly-compensated employee (HCE) counterparts. For example, a participant who is paid \$40,000 may previously have been limited to elective deferrals of 15%, or \$6,000. If the 401(k) plan increases its elective deferral limit, the participant's effective limit is the dollar limit on elective deferrals imposed by Code §402(g) (\$11,000 for 2002).

Employers may also want to reconsider their matching contribution formula. For example, instead of offering 50% of the first 6% of compensation, a 401(k) plan might encourage NHCEs to participate at higher levels by changing the matching formula to 25% of the first 12% of compensation (perhaps with a "true-up" provision to continue benefiting HCEs at current matching contribution levels).

A higher plan elective deferral limit also should make it easier to pass the ADP test. HCEs will still be subject to the dollar limit on elective deferrals (\$11,000 in 2002), and so will be unlikely to reach high percentages of contributions, particularly with the increase in includable compensation (\$170,000 to \$200,000). Non-HCEs, on the other hand, may very well choose to defer high percentages of their paychecks without risk of reaching either the Code §415 contribution limit or the dollar limit. Even if a relatively small number of non-HCEs defer in high percentages, a 401(k) plan will see a dramatic increase in the non-HCE group's average deferral percentage.

For practical purposes, an increased 401(k) plan elective deferral limit should not be increased to 100%. The maximum percentage should be a percentage of compensation that still allows funds for items such as cafeteria plan elections, loan repayment deductions, taxes and garnishments. Many 401(k) plans are increasing their elective deferral limits to 25%, 50%, even 75% of compensation.

IRS Publishes Final Minimum Distribution Regulations

On April 17, 2002 the Internal Revenue Service issued final regulations under Code Section 401(a)(9), which address the required minimum distributions ("RMDs") for qualified plans and individual retirement accounts. The final regulations clarify the 2001 proposed regulations, which simplified the original 1987 proposed regulations. The final regulations apply for purposes of determining RMDs for calendar years beginning on or after January 1, 2003. For 2002, taxpayers may rely on the final regulations, the 2001 proposed regulations, or the 1987 proposed regulations. The changes from the proposed regulations are as follows:

New Life Expectancy Tables

For defined contribution plans, the final regulations continue to provide that the RMD is determined by dividing the participant's account balance by an applicable distribution period. The mortality tables used for determining the applicable distribution period have been updated to reflect current life expectancy, producing longer applicable distribution periods and, therefore, smaller RMDs.

Simplified Calculation of RMDs

The final regulations add other rules generally intended to simplify the calculation of the RMD:

- If the minimum distribution for a participant's first distribution on April 1 is not made by the end of that year, that amount is not subtracted from the account value used to calculate the minimum distribution for the second distribution year.
- Contributions and distributions made after December 31 of a calendar year are disregarded for purposes of determining the RMD for the following year.

- A separate account or segregated share may be created at any time for different beneficiaries, but post-death distributions may be determined separately for each separate account or segregated share only if the accounts or shares have been established by December 31 of the calendar year following the calendar year in which the participant (or surviving spouse, if applicable) dies. Separate investments are permitted for separate accounts.
- The marital status of the participant is determined on January 1 of each year for lifetime distributions.

Determining Designated Beneficiary

At the end of the year following the employee's death when a designated beneficiary must be determined, if more than one designated beneficiary exists and the account or benefit is not divided between them, the designated beneficiary may still be the beneficiary with the shortest life expectancy. However, in the interest of allowing adequate time to calculate and distribute the minimum amount, the final regulations changed the date for determining the designated beneficiary from December 31 to September 30 of the year following the participant's death.

The final regulations retain the rule allowing the underlying beneficiary of a trust to be treated as a designated beneficiary for RMD purposes when the trust is named as the beneficiary of a retirement plan or IRA. The final regulations now require that by October 31 of the year following the year of the participant's death, the required trust documentation must be provided to the plan administrator, IRA custodian or IRA Trustee.

Reporting Requirements for IRAs

Notice 2002-27 was published at the time the final 401(a)(9) regulations were issued. The Notice requires an IRA custodian or trustee to provide a statement to the owner, alerting the owner of the distribution he or she must take. This requirement is effective beginning in 2003, and the statement to the IRA owner is due by January 31 each year.

Proposed and Temporary Regulations Introduced

The rules for determining minimum distributions under defined benefit plans and annuity contracts have been modified and issued in temporary form. Taxpayers may rely on the temporary regulations until they are finalized. The more significant changes are as follows:

- The option to calculate the minimum required distribution from a defined benefit plan under the account balance method is eliminated, except in the case where the plan pays the participant's entire vested interest in a lump sum.
- A period certain under an annuity distribution is permitted as long as the period is not longer than the period under the uniform distribution table for the employee's age in the year in which the annuity starting date occurs, regardless of who is the designated beneficiary (or even whether the participant has a designated beneficiary).



EGTRRA & USERRA Seminar
Salt Lake City, Utah
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Presented by Sheldon Smith
and Bryan Benard.
See our **Upcoming Speaking Engagements** for details.

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Upcoming Speaking Engagements

June 19, 2002 Irene Gallagher

Lorman Education Services
Human Resource Fundamentals*

"Use of Retirement, Welfare, and Fringe Benefits as a Component of Total Compensation"
Four Points Hotel Cherry Creek, 600 South Colorado Blvd., Denver, CO, 303-757-3341

June 20, 2002 Sheldon Smith & Bryan Benard EGTRRA & USERRA

Marriott City Center, 230 South State Street, Salt Lake City, UT, 4-6:30 p.m.
R.S.V.P. by June 14 to Kate Miller at 1-800-250-1840 or kbmiller@hollandhart.com

July 11, 2002 Irene Gallagher

Lorman Education Services
Human Resource Audits*

"Auditing Employee Benefit Plans"

Executive Tower Hotel, 1405 Curtis Street, Denver, CO, 303-571-0300
*Other Holland & Hart attorneys will be presenting at both Lorman seminars.
For more details and to register online go to www.lorman.com or call 1-800-678-3940.

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(<http://www.hollandhart.com/newsitem.cfm?ID=325>) for details
about the Department of Labor's Form 5500 "Delinquent Filer
Voluntary Compliance Program," plus other great employee
benefits law information, and quick links to these and other
internet resources:

- Department of Labor's website: <http://www.dol.gov>
- The Pension & Welfare Benefits Administration (PWBA):
<http://www.dol.gov/pwba/welcome.html>
- April 2002 Issue of IRS Employee Plan News:
<http://www.irs.gov/pub/irs-utl/se402.pdf>



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