ERISA 101: An Overview of the Law Governing Retirement Benefits

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About the Presenter

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Focus of Presentation

This presentation will focus primarily on ERISA as it relates to retirement plans

What is ERISA?

Stands for “Employee Retirement Income Security Act of 1974”

- ERISA was signed into law by President Gerald Ford on Labor Day, September 2, 1974

ERISA is the federal law that regulates employee benefit “plans”, including retirement plans and welfare benefit plans

ERISA has been amended over the years to:

- Provide greater protection to survivors and spouses of pension plan participants;
- Improve pension funding;
- Alter the limits on tax-deductible pension plan contributions, and to ensure that tax-favored plans are broadly based;

The most significant changes to ERISA since its original passage were enacted in the *Pension Protection Act of 2006*

What Type of "Plans" are Governed by ERISA?

Pension Plans

- Provide traditional retirement benefits (i.e. 401(k), 403(b), profit sharing, Employee Stock Ownership Plan ("ESOP"), etc.)

Welfare Benefit Plans

- All other ERISA-regulated benefit plans
- Flexible Spending Plans
- Health and dental plans
- Unemployment benefits

Governmental plans and church plans are **not** governed by ERISA

Why is ERISA Important to You?

- Your retirement savings are vital
- As an employee, knowing and understanding your rights as they relate to your retirement benefits is important
- As a legal professional, understanding the complexities and laws in place to protect both employees and employers of voluntary private pension, retirement, health, and other welfare benefit plans may empower you to assist aggrieved individuals to find the help they need

History of ERISA

In 1958, Congress passed The Welfare and Pension Plans Disclosure Act (WPPDA)

- Required public disclosure of pension plan finances
- United States Department of Labor (DOL) began regulating employee benefits plans upon the passage of the WPPDA

In 1974, ERISA was passed with stricter regulations to protect participants and beneficiaries in employee benefit plans by way of required plan disclosures, information, and notices

What Happened to Underfunded Plans Before ERISA?

- In 1963, Studebaker automobile company terminates underfunded pension plan
- Employers could terminate an unfunded pension plan without being liable for any additional pension contributions
- If there were insufficient assets in the pension plan to pay all claims, participants had no legal recourse to demand that employers use company assets to continue funding the plan

New Protections After ERISA

- ERISA requires companies with defined benefit pension plans to fully fund the benefits that participants have earned
- Prohibits companies from using pension funds for purposes other than paying pensions and retiree health benefits
- Limits the age and length-of-service requirements that firms can require participants to meet to receive a pension
- Requires all private-sector sponsors of defined benefit pension plans to purchase insurance from the Pension Benefit Guaranty Corporation (PBGC)

Key Retirement Plan Terms to Know in ERISA

Plan Administrator (legally defined term under ERISA)

- The entity with primary liability for violations of ERISA
- Typically the employer

Plan administrator

- Commonly used to refer to the HR person or third party administrator in change of administering the entity's benefit plans
- Is not the "Plan Administrator" for ERISA purposes

Plan Sponsor (defined term under ERISA)

- The entity that decides to establish a plan
- Holds the power to terminate a plan or change the benefits within a plan
- Typically the employer

Key Retirement Plan Terms to Know in ERISA

Participant (legally defined term under ERISA)

- Employees, their spouses, and dependents that are covered under the plan

Beneficiary

- A person designated by a pension plan participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit under that plan (e.g., a spouse)

Fiduciary (legally defined term under ERISA)

- Person (individual or entity) that has responsibility to act in the best interest of the benefit plan and its participants
- May be held personally liable for breaches of ERISA fiduciary duty

Key Retirement Plan Terms to Know in ERISA

Vesting

- Earning a nonforfeitable right to a pension benefit
- An employee who has met such requirements is said to have a “vested” or “nonforfeitable” right to benefits
- Voluntary and mandatory employee contributions are always fully vested when received by the plan

ERISA Participation Requirements

ERISA sets limits to the amount of time an employee can be excluded from participating in a pension plan

Generally, an employee can only be excluded from an ERISA pension plan on account of ***age*** or ***service*** if the employee is under age 21 or has not yet completed a year of service

- Year of service = a 12-month period during which the employee has worked at least 1,000 hours

Defined Benefit Plans vs. Defined Contribution Plans

Defined Benefit Plans

- Pays a set amount for a set period of time, typically the life of the employee Company bears the risk of investment performance and must compensate the plan for any shortfalls in funding

Defined Contribution Plans

- The amount ultimately paid to the employee depends on the contributions made and investment earnings/losses
- Plan provides an individual account for each participant that holds deferrals
- Employee bears the investment risk
- The employee or the employer (or both) contribute to the employee's individual account under the plan

Qualified vs. Unqualified Retirement Plans

- Retirement Plans are either tax "qualified" or "unqualified"

Qualified plans

- Benefits provided on a tax-free OR tax-deferred basis
- To remain qualified, Plans must adhere to the strict provisions of the Internal Revenue Code (IRC)

Unqualified plans

- Benefits paid are taxed as wages to the employee
- Plans are not subject to the same strict requirements of the IRC

Common Types of Retirement Plans

- Individual Retirement Accounts (IRAs)
- Roth IRAs
- 401(k) Plans
- 403(b) Plans
- SIMPLE IRA Plans
- SEP Plans
- Profit Sharing Plans
- Defined Benefit Plans
- Money Purchase Pension Plans
- Employee Stock Ownership Plans
- Governmental Plans
- 457 Plans
- 409A Nonqualified Deferred Compensation Plans

401(k) Plans

- Defined contribution plan
- Employee may elect to save part of their salaries and defer paying tax on the amounts deferred and related investment earnings until the money is taken out of the plan
- Companies may make matching or unilateral contributions which are also tax-deferred

403(b) Plans

- Tax deferred retirement annuity available to employees of educational institutions and certain non-profit organizations (501(c)(3))
- Employee contributions are made on a pre-tax basis and investment earnings grown deferred until they are withdrawn, at which time they are taxed as ordinary income

Employee Stock Ownership Plans (ESOP)

- An ESOP is a *defined contribution* plan that provides shares of stock in the sponsoring company to participating employees
- An ESOP is required to invest primarily in employer stock and is permitted to borrow money on a tax-deductible basis to purchase this stock
- Used to retain employees as their retirements grow with the company's success

Individual Retirement Account (IRA)

- An IRA can be either an “individual retirement account” or an “individual retirement annuity”
- There are several types of IRAs:
  - Traditional IRAs, Roth IRAs, SIMPLE IRAs and SEP IRAs
  - Traditional and Roth IRAs are established by individuals.
- Investment gains accrue on a tax-deferred basis.
- Withdrawals are taxed as ordinary income and withdrawals before age 59½ may be subject to an additional 10% tax.
- Contributions to a Roth IRA are not tax-deductible, but distributions from a Roth IRA are tax-free

Profit Sharing Plans

- A profit-sharing plan is a defined contribution plan in which ***all*** contributions are made by the employer
- Contributions do not have to be related to profits
- A company is not obligated to contribute to the plan on a regular basis
- Contributions are typically divided among participants in proportion to their earnings, with larger contributions made to higher-paid workers

Nonqualified Plans

- A nonqualified plan is an employer-sponsored retirement plan or deferred compensation plan that does not meet the tax-qualification requirements under Internal Revenue Code §401
- A nonqualified plan allows an employee to defer the receipt of income until some future year.
- For taxes to be deferred:
  - the deferred compensation arrangement must be entered into before the compensation is earned by the employee;
  - the deferred compensation cannot be available to the employee until a previously agreed upon future date or event; and
  - the amount of the deferred compensation cannot be secured and must remain available to the employer's creditors

Who are ERISA Fiduciaries?

- Every plan governed by ERISA must have one or more named fiduciaries and these fiduciaries must be named in the plan document
- "Fiduciary" is a functional term
- A Fiduciary includes:
  - The Plan Administrator
  - Persons that provide investment advice for a fee
  - Any person who has ***discretionary control*** over plan assets (chooses how to spend money or when money goes out)

ERISA Fiduciary Duties

Fiduciary Duties under ERISA Section 404:

- Acting *solely* in the interest of plan participants and their beneficiaries and with the *exclusive purpose* of providing benefits to them;
- Carrying out their duties *prudently*;
- Following the plan documents (unless inconsistent with ERISA);
- *Diversifying* plan investments; and
- Paying only *reasonable plan expenses*

Duty to Act *Solely* in the interest of Plan Participants and their Beneficiaries

- Duty of loyalty
- The primary responsibility of fiduciaries is to run the plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses
- The duty of loyalty applies in situations where the fiduciary is confronted with a potential conflict of interest
- However, just because an ERISA fiduciary engages in a transaction that incidentally benefits the fiduciary or a third party does not necessarily mean that a fiduciary breach has occurred

Duty to Pay Only Reasonable Plan Expenses

- A plan fiduciary must act with the “exclusive purpose” of “defraying reasonable expenses of administering the plan
- Plan fiduciaries must ensure that arrangements with their service providers are "reasonable" and that only "reasonable“ compensation is paid for services
- Fiduciaries should obtain information sufficient to enable them to make informed decisions about the services, the costs, and the service providers
- After careful evaluation during the initial selection, the plan's fees and expenses should be monitored to determine whether they continue to be reasonable

Duty to Act with the Care, Skill, Prudence, and Diligence of a Prudent Person

- The duty to ***act prudently*** is one of a fiduciary's central responsibilities under ERISA
- Prudence focuses on the *process* for making fiduciary decisions
- If a fiduciary has taken the appropriate procedural steps, the success or failure of an investment can be irrelevant to a duty of prudence inquiry

Duty to Diversify Plan Investments

- This fiduciary duty helps to minimize the risk of large investment losses to the plan
- Fiduciaries should consider each plan investment as part of the plan's entire portfolio
- Fiduciaries will want to document their evaluation and investment decisions

Duty to Follow the Plan Document

- The plan document serves as the foundation for plan operations
- Employers will want to be familiar with their plan document, especially when it is drawn up by a third-party service provider, and periodically review the document to make sure it remains current
- The Plan Administrator must follow the terms of the plan document
  - The Plan cannot provide benefits to an employee that is not eligible, even if the employer wants to extend that employee benefits

Plan Documentation Requirements for Retirement Plans

Plan Document

- Written document that sets forth eligibility requirements, when benefits will be provided, premiums/contributions payable by the employees and employer, etc.
- Each retirement plan must have its own plan document

Plan Disclosure Requirements – Summary Plan Description (SPD)

- The SPD is a *plain language* summary of the provisions of an employee benefit plan that contains the terms of the plan and the benefits offered
- Employers (for example, those with 401(k) plans) are generally required to provide a new participant a SPD within 90 days of when the employee becomes a plan participant
- SPDs be updated every 5 years if revised, or every 10 years if not revised

Plan Disclosure Requirements – Summary Plan Description (SPD)

The SPD includes such information as:

- Name and type of plan
- Plan's requirements regarding eligibility
- Description of benefits and when participants have a right to those benefits
- Statement about whether the plan is covered by termination insurance from the Pension Benefit Guaranty Corporation (Defined Benefit plans *only*)
- Source of contributions to the plan and the methods used to calculate the amount of contributions
- Provisions governing termination of the plan
- Procedures regarding claims for benefits and remedies for disputing denied claims
- Statement of rights available to plan participants under ERISA.

Plan Disclosure Requirements – Summary of Material Modifications (SMM)

- If a plan is altered, participants must be informed, either through a revised SPD, or in a separate document, called a summary of material modifications (SMM)
- Summary of any material modification in the terms of the plan or any change to the information in the SPD
- Similar to the SPD, the SMM must be written in a manner that the average participant can understand
- The material must be furnished within 210 days after the close of the plan year in which the modification was made

Plan Disclosure Requirements – Summary Annual Report (SAR)

- The SAR is a narrative summary of the plan's financial status and summarizes the information on the plan's annual report (Form 5500)
- Filed with the DOL
- **The SAR should contain**:
  - Administrative expenses incurred by the plan;
  - Amount of benefits paid to participants and beneficiaries;
  - Total value of plan assets;
  - A pension plan's compliance with the minimum funding standards; and
  - Right to receive a copy of the full annual report, or any part thereof

Plan Disclosure Requirements – Benefit Statements

- Plan administrators are required to periodically furnish a pension benefit statement to participants and beneficiaries
- For DC Plans, must be provided:
  - Every calendar quarter to participants and beneficiaries who have the right to direct the investments of the account, or
  - Once each calendar year for participants and beneficiaries who have accounts with the plan, but do not have control over the investment in the account
- For DB Plans, must be provided:
  - At least once every three years to any individual who has both a non-forfeitable accrued benefit and is employed by the employer maintaining the plan at the time the statement is furnished

Plan Reporting Requirements

Form 5500

- Informational tax return filed with the U.S. DOL
- Plan sponsors must generally file the return on the last day of the seventh month after their plan year ends
- Required for all pension plans and welfare plans with over 100 participants

Who Administers ERISA?

- The Employee Benefits Security Administration (EBSA) is responsible for administering and enforcing the fiduciary, reporting, and disclosure provisions of Title I of ERISA.
  - Title I sets standards for pension plans of employers engaged in interstate commerce
- Title II of ERISA is administered by the IRS.
- Title III is concerned with jurisdictional matters and with coordination of enforcement and regulatory activities by the DOL and the IRS.
- Title IV covers the insurance of defined benefit pension plans and is administered by the Pension Benefit Guaranty Corporation (PBGC).

Government Oversight

United States Department of Labor (DOL)

- Enforces penalties for failing to comply with required notices and reporting requirements
- Issues regulations interpreting ERISA
- Voluntary Correction Program (VCP)

Government Oversight

Internal Revenue Service (IRS)

- Imposes excise taxes against fiduciaries for prohibited transactions
- Revokes tax-exempt status for non-compliant plans
- Primary focus is pension plans (i.e., whether the plan maintains tax qualified status)

Government Oversight

Pension Benefit Guaranty Corporation (PBGC)

- Insures defined benefit pension plans (and only defined benefit plans), similar to how the FDIC insures bank deposits
- Takes over under funded defined benefit pension plans
- Takes over defined benefit plans during the employer's bankruptcy

Common Plan Administration Issues

Prohibited Transactions

- Transactions that are per se illegal under ERISA
- Does not matter if the transaction is beneficial to the Plan
  - e.g. Employer cannot sell assets to the plan, even if sold at significantly less than FMV

Delinquent Form 5500 filings

- Can file delinquent Form 5500s and pay a significantly reduced fine

Common Plan Administration Issues

Not following the plan document

- e.g not providing matching contributions in a timely manner

Plan not updated to comply with new laws

Not supervising or monitoring plan service providers

- Investment advisors must be given benchmarks and terminated if they fall below benchmarks for too long
- Plan Administrator has a duty to monitor all service providers, even if it outsources its duties

IRS Voluntary Correction Program

Delinquent Filer Voluntary Compliance Program

- Violation of ERISA annual reporting requirements
- Voluntarily pay a reduced penalty amount

Voluntary Fiduciary Correction Program

- Many fiduciary duty breaches are unintentional
- Available for certain types of transactions
- Intended to protect employees and help plan officials understand ERISA protections and regulations

ERISA Preemption

- Preempts most state laws that regulate employee benefit plans
- Does not preempt:
  - State insurance laws

Common ERISA Litigation Matters

- Common Types of ERISA litigation
  - Claims to enforce benefit rights
  - Claims to Redress Breaches of Fiduciary Duty
  - Claims to enforce plan provisions and “other equitable relief”

Claims to Enforce Benefit Rights – ERISA Section 502(a)(1)(B)

- Section 502(a)(1)(B) of ERISA authorizes a plaintiff (*i.e.*, a participant or a beneficiary in an ERISA plan) to bring an action against the plan to recover benefits under the terms of the plan, or to enforce or clarify the plaintiff's rights under the terms of the plan
- Under this section, if a plaintiff's claim for benefits is improperly denied, the plaintiff may sue to recover the unpaid benefit
- A plaintiff may also seek a declaration to preserve a right to future benefits or an injunction to prevent a future denial of benefits

Claims to Enforce Benefit Rights – Remedies

- Section 502(a)(1)(B) provides that a successful plaintiff may receive the benefits the plaintiff would have been entitled to under the terms of the plan
- Compensatory or punitive damages are not available

Claims to Redress Breaches of Fiduciary Duty – ERISA Section 502(a)(2)

- Section 502(a)(2) of ERISA authorizes the Secretary of Labor, a participant, a beneficiary, or a plan fiduciary to bring a civil action caused by a breach of fiduciary duty under Section 409 of ERISA
- Makes a plan fiduciary personally liable for breaches against an ERISA plan
  - Breaching fiduciary must make good to the plan "any losses to the plan resulting from a breach" and restore to the plan any profits made from using the assets of the plan in improper ways
- Subjects such a fiduciary to other relief as a court may deem appropriate, including removal of the fiduciary

Claims to Enforce Plan Provisions and "Other Equitable Relief" – ERISA Section 502(a)(3)

- Section 502(a)(3) of ERISA permits a participant, beneficiary, or fiduciary, to bring a civil action to enjoin any act or practice which violates ERISA or the terms of the plan, or obtain "other appropriate equitable relief" due to an ERISA violation
- Section 502(a)(3) of ERISA has been referred to as a "catchall" provision
- What is "other equitable relief"?

ERISA Trials – The Basics

- ERISA trials are rare, but they do happen.
- Depending on the nature of claims at issue, evidence presented may include complex financial, medical, accounting or actuarial issues.
- Generally bench trials, though some ERISA claims are arbitrated

QUESTIONS

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