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ERISA@40: Happy Birthday, ERISA!

This is the fourth in our series of articles celebrating the 40th birthday of the Employee Retirement Income Security Act. Today is the day! ERISA was signed into law by President Gerald Ford on September 2, 1974 — Labor Day. This landmark law regulates many aspects of employer-sponsored retirement and welfare benefit plans. On ERISA's birthday, we reflect on whether the Act met its goals — we give it a report card, and we invite you to share your opinions in our ERISA 40th Birthday Survey.

In this article: Background | How did ERISA do with these Goals? | In Closing | Please Take Our Survey

Background

Our first article in this multi-part series, ERISA@40: A History Lesson, looked at the evolution of private sector retirement plans in the US and emerging federal regulation of those plans up to the date that ERISA was inked. Framed in this light, the key goals of ERISA were to provide for:

- Disclosure and reporting of financial and other information for plan participants and government regulators
- Standards of conduct, responsibility, and obligations for plan fiduciaries
- Pre-emption of state law and ready access to federal courts
- Vesting for employees with significant periods of service and anti-cutback protections, as well as service crediting rules for plan participation and for benefit accruals
- Minimum funding standards and plan termination insurance for retirement plans

ERISA's Report Card	
Disclosure and reporting	**B**
Fiduciary rules	**B**
Pre-emption of state law and ready access to federal courts	**A**
Vesting	**B**
Funding and PBGC	**A**

How did ERISA do with these Goals?

ERISA ushered in vast improvements in the protection of participants, even if some did call it names behind its back —"Every Rotten Idea Since Adam," for example. Overall, we assign ERISA a grade of **B**. Where ERISA falls short is that some of its rules create ambiguities and leave the responsible parties — sponsoring employers, plan service providers, and plan fiduciaries — without clear and concise direction, which has led to inaction and fear of liability.

Disclosure and Reporting of Financial and other Information

Some reporting and disclosure requirements existed before ERISA was enacted, such as the [Form 4848] that retirement plans had to file with the IRS. The Welfare and Pension Plans Disclosure Act of 1958 required plan descriptions and financial reports to be filed with the DOL and made available to plan participants. To further its goal of increasing transparency, ERISA imposed more demanding requirements and created additional reporting obligations with IRS, DOL, and the newly minted Pension Benefit Guaranty Corporation (PBGC). Information reported to the agencies, on Form 5500, included an audited financial statement, an actuary's report on the funded status of the plan, and identifying information about plan fiduciaries and service providers. Participant disclosure included statements of accrued benefits, summary plan descriptions and summary of material modifications, as well as summary annual reports that restate certain Form 5500 information. Plan documents had to be available for inspection, and copies of related plan documents had to be provided upon request for a reasonable charge.

Then and Now

The Form 4848, as well as the original Form 5500 and other ERISA forms, were originally filled out in pencil or ink by hand, and the financial information was added up mentally or with a large desktop calculator. Then it was off to the IRS via the Post Office. Now, it's typed and filed electronically, and the summing happens automatically!

With the initial ERISA framework in place, Congress frequently revisited disclosure obligations and imposed additional requirements over the years including:

- COBRA notices and summaries of benefits and coverage for health plans
- Annual funding notices for defined benefit plans
- Blackout notices for participant-directed defined contribution plans
- Notice of the right to divest out of employer securities in defined contribution plans that offer employer securities as an investment option

Speaking of COBRA …

Our August 27, 2014 **ERISA@40: ERISA, COBRA, and the ACA** explored the benefits of COBRA and how it's likely to change in the face of the ACA.

The count now stands at 14 subsections in the main "duty of disclosure" section of ERISA versus three subsections in the original legislation.

Grade. We give the disclosure and reporting requirements a **B** for this report card. Although much good and useful information is now provided to participants and beneficiaries, there is much that could be trimmed and simplified. The summary annual report, for example, is reminiscent of the financial privacy statements banks and other firms are required to produce in that it discloses little of interest to most recipients. In addition to trimming, a more expansive view of what it means to "furnish" the required information would allow for a better grade. Participants would be well served by a law that accommodates employer efforts to embrace new technologies and communication approaches. In 2006, Congress took a step in the right direction by adding internet-based disclosure of Form 5500 information in the Pension Protection Act.

Another area that can be improved is the readability of model notices issued by the regulatory agencies. Even though most participant disclosures are supposed to be geared toward the average person, plans often rely on model notices that are written in highly legal and technical language that is hard for the reader to grasp. Would an on-line menu-driven SPD make more sense than a paper SPD? Would participants gain a better understanding of their benefit options using gamification?

Standards of Conduct, Responsibility, and Obligations for Fiduciaries

Growing reserves of money to meet benefit promises sometimes invites mischief. ERISA did not invent the term "fiduciary" by any means, but it did clarify a number of rules for plan fiduciaries, including that:

- Plans must be in writing and name the fiduciary.
- The plan fiduciary can be held personally liable for breaches of duty and has a duty to follow the written plan terms unless they are contrary to ERISA.
- Plans must set and maintain funding policies, and procedures for allocating administrative responsibility.
- Assets must be held in trust for the exclusive benefit of employee-beneficiaries.
- Fiduciaries must act with the same care that a "prudent man" would apply to the situation.
- Fiduciaries must steer clear of prohibited party-in-interest transactions, and are prevented from self-dealing and receiving kickbacks — ERISA's "prohibited transaction" rules.
- Plan investments must generally be diversified so as to minimize the risk of large losses — unless it is clearly prudent not to diversify.
- Plans must obtain a surety bond to insure against bad actors.

Before ERISA, violations of prior law prohibited transaction rules resulted in the disqualification of the plan's trust and led to adverse tax consequences for plan participants. ERISA eliminated this drastic remedy — that hurt the participants and beneficiaries as well as the transgressor — in favor of excise tax and other penalties on the party-in-interest.

Grade. We give ERISA a **B** on the report card for these fiduciary rules. The overarching principles are mostly effective at establishing high standards of conduct among fiduciaries. Unfortunately, ambiguities in the law have left much of the heavy lifting up to the regulators and courts to fill in gaps with their interpretations. After 40 years of DOL guidance and court cases creating exceptions, the role of plan fiduciary has become much more complex.

Then and Now

A dog-eared copy of ERISA published by Prentice-Hall, Inc. was a handy reference for composing this publication. Prentice-Hall's pension service is now Research Institute of America (RIA). Other 1974 key publishers in the benefits world, Commerce Clearing House (CCH) and Bureau of National Affairs (BNA), are still around, though both have been acquired by other publishers (CCH by Wolters Kluwer in 1995, and BNA by Bloomberg, LP in 2011). In 1974, these were all paper-based services. In 2014, online access and paper resources are commonly available.

Pre-emption of State Law and Ready Access to Federal Courts

ERISA imposes national standards for employee benefit plans by superseding the "patchwork" of state laws that relate to employee benefit plans (other than those that regulate insurance, banking or securities). Our second article in this series took a look at ERISA preemption, in particular, how it has played out for health plans pre- and post-ACA. See our August 20, 2014 ERISA@40: ERISA Preemption and the ACA. ERISA also lets participants and beneficiaries bring a civil action to recover benefits due to them, clarify their rights to future benefits, or to address

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Popular Culture 1974

One of the best-selling books during the week ERISA was signed: *Jaws* by Peter Benchley

A high-grossing movie in the summer of 1974: "Chinatown"

A top song the week ERISA passed: "It's Only Rock 'n Roll (but I Like It)" by the Rolling Stones

any breach of fiduciary responsibility. ERISA generally gave the US district courts the exclusive jurisdiction over these rights. In the excepted cases, suit can also be brought in state courts of competent jurisdiction.

Grade. One set of national standards and regulation for benefit plans is a key benefit of ERISA for employers. The administration of benefit plans would be immeasurably complicated if states and local governments were permitted to regulate. Additionally, generally limiting ERISA actions to federal courts went a long way towards harmonizing results. With a limited number of courts involved, application of the law is much more uniform than it would have been if left at the state and local level. Our report card gives ERISA an **A** on these issues**.**

Vesting for Employees with Significant Periods of Service

Before ERISA imposed vesting standards, pension plans had free reign to set their own requirements and many had very restrictive standards.

ERISA required full vesting at normal retirement and vesting for those who leave employment before their normal retirement date using one of three schedules: 10-year "cliff," 15 year graded, or Rule of 45. Profit sharing, stock bonus, and money purchase plans could also opt for class year vesting in which the contribution for a particular year is fully vested by the fifth plan year after the year of the contribution.

The ERISA vesting rules also introduced break-in-service rules so that a plan could not require a restart after a short absence. In addition, ERISA brought us the accrual rules to combat backloading. Without these rules, plans could undermine the vesting promise by minimizing early service accruals and providing the richest accruals when retirement is near.

Grade. Overall, the ERISA pension vesting rules earn a **B** on our report card. The rules do a good job of protecting the reasonable expectations of employees and eliminating the view that pensions were mere gratuities. We do not assign the highest grade, however, because the backloading rules are narrowly drawn based on traditional retirement formulas instead of principle-based rules that would more readily accommodate hybrid designs.

Then and Now

ERISA established a new professional credential — Enrolled Actuary — and an organizational structure with rules for enrollment and disenrollment of individuals — the Joint Board for the Enrollment of Actuaries. Donald Grubbs, who led Buck's Washington office for many years, was EA #1.

Minimum Funding Standards and the PBGC

Employers were encouraged to fund defined benefit plans in the pre-ERISA period by the carrot of deductions, and were required to fund current accruals and interest on past service liabilities as a qualification matter. Participants lost benefits if the plan terminated with insufficient assets. ERISA addressed this problem with new minimum funding requirements and the establishment of the PBGC.

Under the new funding minimums, actuarial valuations had to be performed at least once every three years. In addition to paying the plan's "normal cost," the employer had to pay down liabilities and losses on prescribed schedules. ERISA accommodated funding waivers via an approval process that is still in place today. In addition, ERISA included excise tax penalties of 5% on the amount of accumulated funding deficiency (which was later raised to 10% for single employer plans), followed by a 100% penalty if not ultimately corrected.

Then and Now

Early ERISA employee records at Buck were typically collected with large reels of magnetic tape. Reports were prepared with electronic typewriters. Now PCs and laptops are on every desk! And the records are stored on hard drives in the cloud.

George B. Buck, founder of Buck Consultants, had a hand in the development of computing with his **verifying punch**.

Grade. Assuring participants that they would actually receive the benefits they were promised — benefits that are really deferred compensation for work currently performed — easily earns an **A** on our ERISA report card. Without the ERISA funding mandates, some private plans may have ended up in the same boat as many state and local government plans. Without PBGC, many participants would have lost benefits. Indeed, they report on their website that "Today, PBGC has responsibility for the pensions of 1.5 million people in more than 4,500 single-employer and multiemployer pension plans that could not pay promised benefits. PBGC pays $5.5 billion annually in pension benefits, either directly or through financial assistance to multiemployer plans."

While the funding rules have changed over the years, the basic principle that promises should be backed by dollars stands the test of time. ERISA initially limited an employer's liability to 30% of net worth — on a controlled group basis. That concept fell short when employers saw it could be a bargain, so, the grade could lose some points on that score. But the forethought of the rules for mergers and transfers of assets that prevent redirecting assets to favored groups was good for extra credit!

In Closing

Overall, ERISA has done a satisfactory job meeting its goals. Perhaps one measure of its success is that legislative proposals today in Congress do not contemplate repealing ERISA. Instead, they focus on incremental changes — ranging from tweaks to the minimum funding rules (like last month's extension of MAP-21 interest rates) to revisions of the PBGC's authority to impose liability on defined benefit plan sponsors undergoing a substantial cessation of operations (considered by a Senate committee earlier this summer). (See our August 1, 2014 and our July 25, 2014 *Legislate* publications for more information.)

Please Take Our Survey

We'd be delighted if you would share your opinions on ERISA by taking our 2014 ERISA 40th Birthday Survey — if you haven't already done so. The results of this survey will be featured in an upcoming ERISA@40 article.

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