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ERISA@40: Then and Now

This is the seventh in a multi-part series of articles celebrating the 40th birthday of the Employee Retirement Income Security Act. 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. The series looks back to explore how the employee benefits industry has evolved, highlights lessons learned, and looks forward to what employers may expect in the future.

This article outlines key changes to ERISA in the last 40 years. It also examines what participants in our ERISA@40 survey think about the law, the challenges they have faced in the last 40 years with the changing employee benefits landscape, and what they think lies ahead.

Evolution of ERISA and Benefits Law over the Last 40 Years

In our first article in this series, we provided a history lesson on the events leading up to the enactment of ERISA in 1974. Since then, Congress has amended, expanded, and modified ERISA to react to changing times. These changes, coupled with those to the Internal Revenue Code (Code), have dramatically altered the landscape of employer-sponsored benefit plans. We discuss several key changes below.

Introduction of the 401(k) Plan

One of the most significant changes to the retirement arena was the introduction of the 401(k) plan. With an effective date of January 1, 1980, the Revenue Act of 1978 added section 401(k) to the Code, permitting the use of salary reductions as a source of pre-tax plan contributions. Previously, cash or deferred arrangements known as CODAs allowed deferral of compensation, generally employer-paid bonuses that employees could elect to defer or take in cash. Companies such as Johnson & Johnson, PepsiCo, JC Penney and Honeywell were among the first to

What do you think?

Our survey respondents identified the creation of 401(k) plans as having the most significant effect on employers who sponsor defined contribution plans.

Some respondents, however, questioned whether employees are saving enough under such plans:

"Since the evolution of 401(k) plans, the employer average of a 3% match just is not enough. Employees are stretched thin and cannot afford to put away the 10 to 15% needed for a secure retirement."

offer a 401(k) plan to their employees. Additionally, the same legislation introduced the concept of flexible spending accounts, allowing employees to receive reimbursement for medical expenses in pre-tax dollars.

Expansion of Health Coverage Protections

Prior to the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), workers could find themselves without employer-sponsored health coverage if they faced a life event, such as loss of a job, death, divorce, or a reduction in hours. COBRA changed all that by requiring employers to offer continuation coverage under the employer's health plan under certain circumstances. COBRA mandates special notice and election rights with respect to a loss of employer-provided coverage, and limits the amount that the employee may be required to pay for the coverage.

Eleven years later, the Health Insurance Portability and Accountability Act of 1996 (HIPAA) made it easier to change employers without losing health coverage by limiting the ability of an employer to exclude new hires' coverage for pre-existing conditions. HIPAA also provided additional opportunities to enroll in a group health plan if other coverage is lost or certain life events occur. Additionally, HIPAA set forth a number of privacy-related rules aimed at protecting individuals' medical records and other personal health information.

Survey says …

The top overall developments with the most impact on health plans, according to our survey respondents, are the Affordable Care Act (ACA) and ever-increasing health coverage costs.

Apart from the ACA, our survey respondents identified HIPAA and COBRA as important developments in employer-sponsored health plans.

Protection for Spouses, Older Workers

Recognizing that many women are unable to save for retirement at the same rate as their male counterparts given the increased likelihood of taking time off to raise a family, and in response to concerns that working women were not receiving a fair share of pension benefits, the Retirement Equity Act of 1984 was enacted. Key provisions include lowering the minimum age for plan participation and the establishment of Qualified Domestic Relations Orders (QDROs) to protect spousal interests in retirement benefits upon dissolution of a marriage. The law also provides for mandated spousal consent to waive survivor benefits, and prevents break in service rules from applying during a maternity or paternity leave.

To protect older workers, ERISA was amended by the Omnibus Budget Reconciliation Act of 1986 (OBRA '86) to prevent the denial of plan entry based on age or the freezing of benefits for participants over age 65. OBRA '87, in turn, amended funding rules governing under- and over-funded plans, increased PBGC premiums, and established variable rate surcharges for unfunded plans.

What do you think?

Additional protections for participants can increase regulatory complexity for plan sponsors, an issue that was repeatedly raised by survey respondents. For example:

"The changing laws/regulations are complicated and often unclear. This increases the need for ERISA counsel (expensive and time consuming); employee communications; and increased staff to ensure compliance."

Focus on Health Issues for Women and Children

The Newborns' and Mothers' Health Protection Act of 1996 (NMHPA) prohibited certain group health plans from limiting the hospital stay following childbirth to less than two days for vaginal birth or four days for Cesarean sections.

Named after Janet Franquet, who was denied coverage for reconstructive surgery after a mastectomy in 1997, the Women's Health and Cancer Rights Act of 1998 (also known as Janet's Law) requires a plan or insurer that covers mastectomies also to cover, on the same terms as other medical care, reconstructive surgery on the affected breast, surgery on the other breast to achieve symmetry, prostheses, and any physical complications of mastectomy.

21st Century Changes to ERISA

The focus of retirement changes to ERISA in the last ten years has been on increasing retirement readiness with reductions in vesting schedules, diversification and increased funding requirements, and additional benefits for implementing auto enrollment. Changes in healthcare during that period include the Affordable Care Act (ACA), changes to the rules governing mental health coverage, and the use of genetic information.

Survey says …

Our survey respondents identified the Pension Protection Act of 2006 as having the most impact over the last 40 years on defined benefit plan sponsors. The two runners up were volatility exposed by increased accounting transparency and demographic changes in the workforce — such as fewer long-term workers.

The Pension Protection Act of 2006 (PPA) established new funding requirements for certain defined benefit plans, restricted accruals and lump sum distributions for some underfunded plans, and required an annual funding notice. For defined contribution plans, the increased contribution limits under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) became permanent, safe harbor plan Qualified Automatic Contribution Arrangements were established to support automatic contribution arrangements, non-spouse beneficiaries became eligible for rollover distributions, and the six-year graded or three-year cliff vesting requirement was applied to all employer contributions. In addition, diversification requirements for defined contribution plans with employer securities were added.

What do you think?

One of our survey respondents had the following observation about turnover, defined contribution plans, and retirement readiness:

"Very few people are at a job more than seven to ten years. And, while defined contribution plans were designed in part to counteract that decrease in creditable service, the reality is that too many people are taking distributions and paying tax. For example, a 27 year old who hopefully was saving enough to get a company match, would change jobs and look at their 401(k) balance as an opportunity to pay down credit card or school loan debt or buy a car. That same person at 35 may be looking at home improvements and ultimately ruining the leverage of time by taking distributions."

The Genetic Information Nondiscrimination Act (GINA) was enacted in 2008, prohibiting group health plans and health insurers from genetic predisposition discrimination in health insurance and employment coverage or cost. Employers may not use genetic information when making hiring, firing, or promotion decisions.

In the same year, the Mental Health Parity Act and Addiction Act of 2008 (MHPAEA) prohibited group health plans from imposing lower annual or lifetime dollar limits on mental health benefits than they impose on other medical/surgical benefits. However, under this law, plans may still impose other limits, such as on the number of outpatient visits or hospital stays, even if they did not impose these limits on other medical conditions.

In 2009, the Children's Health Insurance Program Reauthorization Act (CHIPRA) authorized states to use CHIP funds to offer a premium assistance subsidy to eligible low-income children who are covered under a qualified employer-sponsored plan. CHIP, or Children's Health Insurance Program, provides health coverage to uninsured children who do not qualify for Medicaid.

The ACA was signed into law in 2010, bringing major changes to the US healthcare system generally, and employer-sponsored group health plans, in particular. Individuals without access to employer-provided coverage were offered new healthcare options in public marketplaces, with protections from pre-existing condition exclusions and subsidies for middle- and lower-income individuals. Beginning with 2014, individuals were required to obtain health coverage that meets certain baseline requirements, or pay a tax penalty. The ACA also introduced the employer shared responsibility requirement — requiring certain large employers to pay a penalty if affordable coverage is not offered to full-time employees. A key provision of the health reform law has yet to be implemented: the excise tax on high-cost plans that is first effective beginning in 2018.

A Case for Electing ERISA

ERISA defines a church plan as a plan established or maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches that is exempt under Code section 501. A church plan is only subject to ERISA if the plan sponsor makes an election to be subject to ERISA. The Young Men's Christian Association Retirement Fund Plan is in fact a church plan. Unlike most church plans, the plan sponsor has elected to comply with ERISA. Min Chung Lee, in-house counsel for the YMCA Retirement Fund and Susan Caputo, Director of Marketing shared with us why. ERISA pre-emption was cited as one of the key reasons. ERISA supersedes any and all state laws as they relate to benefit plans. Following federal laws as opposed to state laws facilitated their communications and servicing of the different locations. It is very important to the YMCA as an employer that its participants are protected in retirement, and they wanted to design the best possible plan.

The plan, which began in 1922, has always operated as a church plan. It offers a rich retirement benefit and provides for distribution of contributions as annuities to optimize the potential for participants to have enough funds in retirement — employee contributions may be taken in a lump sum subject to certain conditions. The plan is innovative and provides options whereby a benefit can be paid to the beneficiary in the event the participant dies before receiving the full value of their account. One impressive achievement of the Fund is that the participant account balances have never had a negative return in any year of operation.

Although electing to formally comply with ERISA in 2006 by restating the plan document accordingly, the plan had been substantially complying with ERISA for most of its existence.

Eye Witness Accounts of the Last 40 Years

Apart from the statutory changes to ERISA and employee benefits law outlined above, participants in our survey noted a wide range of changes in the 40 years since ERISA was enacted that directly and indirectly impact employee benefits, including:

- Increased employee turnover and the decline of "career" employees
- Technological advances transforming workplaces, products, and service offerings, with the pace of changes accelerating each year
- Steadily increasing competition due to globalization, with employers responding by cutting costs and maximizing efficiencies wherever possible
- A graying workforce that might not be able to retire because they have not saved enough

Several participants expressed particular concern with increased employee turnover and the increasing prevalence of defined contribution retirement plans. In particular, they worried that workers are far too tempted to cash out retirement savings each time they leave an employer.

Survey participants were split on the most significant consequence if ERISA were to be repealed. Some thought the lack of state law pre-emption would be the biggest loss, while others cited the loss of the minimum funding rules for defined benefit retirement plans and the end of the PBGC's pension insurance system. Some worried that employers would return to longer entry and vesting periods for retirement plan participation.

Most Notable Challenges

What do you think?

One of our survey respondents had the following comment on the cost of medical innovation:

"Modern medical science creates wondrous and hugely expensive treatment options. While technology in other fields drives down cost, this is not the case in health care — costs of new medicines and treatments are constantly rising. People are living longer and that taxes both government benefits and private retirement benefits."

The top challenges observed by survey participants since ERISA's enactment were administrative complexity, designing effective employee communications, and balancing the needs of large, diverse workforces. Some also lamented the decline of defined benefit retirement plans and expressed concern that some participants still are not prepared to successfully navigate defined contribution plans — particularly in terms of investment selection and monitoring.

For present-day challenges, compliance with the ACA ranked high — with the impending excise tax on high-cost coverage mentioned. Steadily increasing healthcare and coverage costs were also cited as a worry. For defined benefit retirement plans, survey participants expressed concern with the ability to continue closed plans given challenges with nondiscrimination testing.

With tax reform a likely hot topic in the next Congress, we also asked survey participants what would happen if the favorable tax rules for employer provided retirement and health coverage were repealed. Participants predicted that employers would drop both types of plans, and, for those

Survey says …

Frustration with regulatory complexity was expressed repeatedly by survey participants.

One participant even suggested that tax preferences for employee benefits be eliminated — observing that without the tax preferences, there wouldn't be "so many rules to get in the way!"

employers that retained plans, that fewer employees would participate. Some expressed concern that employers would drop plans without a corresponding increase in cash wages — leading to decreased retirement savings.

If I Were King for a Day … and the Next 40 Years

We asked survey participants what one thing they would change about employee benefits if they were in charge. Some focused on allowing more employee choice among benefits offered — dreaming of a "super" cafeteria plan that would allow expanded choices ranging from more traditional benefits such as retirement, health, and life and disability insurance, to new choices such as pet insurance, laundry and dry cleaning services, car insurance, and concierge services. One survey participant lamented nondiscrimination requirements designed to ensure that tax advantaged plans benefit a broad range of employees. Others expressed a wish to empower employees to design their own plans within budgetary parameters set by the employer — and without the straitjacket of existing government regulations. Another common theme was a desire for better education, advice, and modeling tools that would enable participants to understand the long-term implications of today's savings decisions.

Other survey participants wished for a reinvigorated defined benefit pension system. Some paternalistic respondents wished for an end to lump-sum distributions from retirement plans, as well as retirement and health coverage offerings designed and sponsored by the federal government — as opposed to our employer-based system that exists today.

We also asked participants about their expectations for future challenges over the next 40 years. Some participants focused on technology — predicting continued advances in robotics and artificial intelligence that will transform workplaces and employee communications, while also expressing concern for the resulting disappearance of entry-level and low-skilled jobs. Others focused on the changing nature of the employee-employer relationship, and predicted a rise in the independent contractor model — with employees demanding more choice among benefits and easier portability of retirement and health benefits.

What do you think?

Frustration was expressed by survey respondents on the benefit limits for tax-qualified retirement plans. Concern was voiced for highly paid employees for whom Social Security will only replace a small fraction of their income.

On the wish list for improvements to defined contribution plans is the ability to buy chunks of an annuity as an investment choice. The survey respondent observed: "the advantage of doing this is you don't get hammered by annuity conversion/interest rates at the time you retire."

Concern was also expressed about retirement readiness and its impact on managing a workforce: "Folks who do not save enough and cannot afford to retire — may be hard to manage employee attrition. ERISA needs to be better in getting people to transition into retirement."

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In Closing

Much has changed in the past 40 years in the employee benefits arena. In the retirement realm, defined contribution plans have emerged as the predominant plan type. But with these plans have come challenges in ensuring a secure and adequate retirement for employees. A key trend to watch in the future is the "DBing" of defined contribution plans. This will come in the form of innovations in plan design and legislative and regulatory proposals that encourage or require defined contribution plans to mimic or replicate characteristics of defined benefit plans — for example, automating defined contribution plan decisions such as how much to save, where to invest, and how much to take out during retirement. In the area of health, significant changes are unfolding right now — with the first year of implementation of many of the ACA's reforms drawing to a close. Key challenges in the years ahead will be compliance with that law's excise tax on high-cost plans and whether the next Congress is able to make significant changes to the health reform law.

Health and Welfare Benefit Plans

While ERISA provides anti-cutback protections to participants in retirement plans, sponsors of welfare benefit plans are generally permitted to reserve the ability to unilaterally reduce — or eliminate — welfare benefits, such as retiree medical coverage.

Check out earlier ERISA@40 articles:

[ERISA@40: A History Lesson]

[ERISA@40: ERISA Preemption and the ACA]

[ERISA@40: ERISA, COBRA, and the ACA]

[ERISA@40: Happy Birthday, ERISA!]

[ERISA@40: ERISA, Nixon, and the ACA]

[ERISA@40: Revisiting a Key Concept]

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