ERISA: BASIC TRAINING

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INTRODUCTION

The Employee Retirement Income Security Act of 1974 ("ERISA") was instituted to protect and regulate employee retirement and welfare benefits. Through a complicated statutory structure, rules are set forth regarding the nature and amount of benefits that may be furnished to employees and the enforcement of those rules by application of federal law.

I. STATUTORY STRUCTURE.

A. *ERISA*. The statute is found at 29 U.S.C. § 1001 et. seq. ERISA also, however, has a life of its own referred to by most commentators as the "Act." When referring numerically to provisions of ERISA, practitioners almost uniformly refer to the Act sections rather than the U.S.C. sections. In this outline, I will refer to the Act sections. The provisions of ERISA are generally governed by the U.S. Department of Labor ("DOL").

B. *The Internal Revenue Code.* ERISA practitioners must also be aware of the provisions of the Internal Revenue Code (the "Code") that apply to the same employee benefits as does ERISA and which generally dovetail with the provisions of the Act. These provisions deal with the timing and amount of the deduction an employer receives for contributions to employee benefit plans and the tax effects to the employees, or more specifically, the participants. The Code also imposes penalties when the tax provisions of ERISA (and corresponding Code sections) have been violated. The tax provisions of ERISA are generally governed by the Internal Revenue Service (the "IRS"). The DOL and the IRS have created a division of labor between them that dictates which agency will deal with particular issues.

II. APPLICATION OF ERISA.

A. *Plans to which ERISA Applies.* ERISA applies to almost all "employee benefit plans." Act § 4(a). An "Employee Benefit Plan" is defined as either a "welfare plan" or a "pension plan." Act § 3(3).

1. A "Welfare Plan" is defined as "any plan, fund or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services, or (B) any benefit described in section 302(c) of the Labor Management Relations Act, 1947 (other than pensions on retirement or death, and insurance to provide such pensions)." Act § (3)(1).

2. A "Pension Plan" is defined as "any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program – (i) provides retirement income to employees, or (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond." Act § 3(2).

3. These definitions are very broad and will cover almost any type of plan. Although the application of ERISA is very broad, the rules of the Code will also come into play. Generally, Pension Plans are subject to all the provisions of ERISA. Welfare Plans are subject to most provisions other than the discrimination standards applicable to qualified pension plans.

B. *Plans to which ERISA Does Not Apply.* Act §4(b). ERISA does not apply to:

1. Governmental Plans. These are plans established by any federal or state government (or political subdivision therof), and any agency or instrumentality of such a plan. Act § 3(32). Notable Exceptions to ERISA: IPERS and Federal Government Pensions.

2. Church Plans. This is any plan established and maintained by a church or convention or association of churches exempt from tax under section 501 of the Internal Revenue Code. A church plan in which substantially all of the participants are employed in connection with an unrelated trade or business is not exempted. Act § 3(33).

3. Workers Compensation and Unemployment Compensation Plans.

4. Plans Maintained outside of the United States for the primary benefit of nonresident Aliens.

5. Excess Benefit Plans. Under Act § 3(36), an excess benefit plan is defined as "a plan maintained by an employer solely for the purpose of providing benefits for certain employees in excess of the limitations on contributions and benefits imposed by section 415 of the Internal Revenue Code of 1986 on plans to which that section applies, without regard to whether the plan is funded. Code § 415 imposes limits on the benefit an individual may receive from a defined benefit plan, basically the lesser of 100% of the employee's compensation or a specific amount ($140,000 in 2001). It also imposes a limit on annual contributions to defined contribution plans of $40,000 (for 2002).

C. *Types of Plans Covered by ERISA.* Some of the types of benefit plans covered by parts or all of ERISA are as follows:[1]

1. Qualified Retirement Plans. A qualified plan is one that meets the requirements of ERISA and of Code § 401(a). If the qualification standards are met, and continue to be met during the operation of the plan, contributions by the employer to the plan are deductible, but the employee does not recognize any income until he or she begins to receive benefits. The money contributed to the plan is held in a trust for the participants' and is paid out in accordance with the terms of the plan, usually at the retirement of the participant.
   a. Defined Benefit Plans. A defined benefit plan is one which the participant is granted a benefit at retirement, such as the right to receive a monthly benefit of 50% of the participant's final monthly compensation. This benefit is most often paid out as a monthly benefit for the life of the participant or the joint life of the participant and the participant's spouse.
   b. Defined Contribution Plans. In a defined contribution plan, each participant has an account to which the employer and/or the employee contributes. At the time the participant retires or terminates employment, the employee's vested percentage of the value of his or her account is distributed to him or her, either in a lump sum or over a period of time, depending on the terms of the plan and the participant's election. The money in these types of plans is also held in trust. The participants' account may be invested by the trustee of the trust or directed by the participants, again depending on the terms of the plan. There are several types of defined contribution plan, including:

      (1) Profit Sharing Plans.
      (2) 401(k) Plans.
      (3) Stock Bonus Plans.
      (4) Employee Stock Ownership Plans ("ESOPS").
      (5) Money Purchase Pension Plans.

[1]The different types of plans, although covered by parts or all of ERISA, are primarily defined in the Internal Revenue Code.

2. Non-qualified Deferred Compensation Plans. A non-qualified deferred compensation plan is one in which an employee, or a select group of highly paid employees are granted deferred income benefits or allowed to defer their own income. These plans are not intended to and do not meet the qualification requirements of Code § 401(a), and thus originated the catchy name "non-qualified plan." Because of that, the employer does not receive a deduction for amounts set aside to pay benefits in the future from the non-qualified plan, and the general rules of constructive receipt apply to the issue of when the benefits are includible in the participant's income, and thus, deductible by the employer. See also Code § 83. ERISA, however, does still apply to non-qualified plans, with the exception of the excess benefit plan discussed above. If, however, the plan is "unfunded and . . . maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees" those plans are exempt from the provisions of parts 2, 3 and 4 of ERISA. These parts deal with discrimination in coverage, participation, vesting and benefit accrual, funding standards, and fiduciary obligations. To be unfunded, the general standard is that the amounts set aside must be subject to the general creditors of the employer. Even if a plan is exempt as an unfunded deferred compensation plan, it will be subject to the reporting and disclosure requirements of Part 1 of ERISA and the administration and enforcement provisions of Part 5 of ERISA. The DOL has issued guidance under Act § 110(b) which allows sponsors of non-qualified plans to file a one time statement with the DOL that includes the name, address and taxpayer id # of the employer, a declaration that the employer maintains the plan primarily to provide deferred compensation for a select group of management or highly compensated employees and a statement of the number of such plans and the number of employees in each. The plans must be available to the Department of Labor upon request. The declaration should be mailed within 120 days of the plan's effective date to : *Top Hat Plan Exemption, Pension and Welfare Benefits Administration, Room N-5644, U.S. Department of Labor, 200 Constitution Avenue N.W., Washington, DC*

3. Welfare Plans. Welfare plans provide for employee benefits, and include the following:
   a. Health Plans (both insured and self-insured plans).
   b. Disability Plans.
   c. Vacation Plans.
   d. Prepaid Legal Service Plans.

e. Cafeteria Plans.

D. *Overview of ERISA Provisions*.

1. Reporting and Disclosure.

a. Annual Report. Act § 202(b)(4), 103, 104. Both pension and welfare plans are generally required to file annual reports on the IRS Form 5500. Non-qualified plans are not required to file annual reports.

b. A summary annual report must also be distributed every year to participants receiving benefits under the plan. The required contents of the SAR are found at 29 C.F.R. § 2520.104b-10(d).

c. Summary Plan Description. Act § 102(a)(1). An SPD must be distributed to participants within 90 days after the plan is established. For the required contents of a SPD, see Act §102(b).

d. Summary of Material Modifications. Act § 102(a)(1). If there is a material modification in the terms of a plan, the summary must be provided to participants within 210 days after the end of the plan year in which the change occurred. In the case of some health plans, the change must be communicated to participants within 60 days of the change.

2. Participation and Vesting. These rules *do not apply* to welfare benefit plans, top hat plans, and individual retirement accounts.

a. Minimum Participation Standards. Act § 202. *See also* IRC § 410(a). A plan may not exclude persons who are twenty-one years of age or older. Depending on the vesting schedule of the plan, it may not exclude persons who have been employed for more than one year and have completed 1000 hours of service in that year. If the vesting schedule allows participants to be 100% vested upon entry into the plan, the "waiting period" may be extended to two years. The plan may require the employee to wait till the next "entry date" until becoming a participant, but there must be an entry date of at least once every six months.

b. Minimum Vesting Standards. Act § 203. *See also* IRC § 411. Generally, a participant's benefit must vest over a graduated period of no more than seven years, or on a "cliff vesting" period of five years. If a plan is classified as "top heavy" (if 60 percent of the contributions or benefits are allocated to the "key employees"), the vesting schedule is more strict. Again, if the plan requires a two year wait for participation, the participants' benefits must be fully vested immediately after participation.

c. Requirement that the Plan provide for qualified joint and survivor annuities and preretirement survivor annuities. Act § 205. *See also* IRC § 401(a)(11).

d. Benefit commencement at the time the participant reaches a certain age. Act § 206(a)

e. Requirement that benefits under a plan not be assigned or alienated, except for Qualified Domestic Relations Orders (QDRO's). Act § 206(d). *See Also* IRC § 401(a)(13).

3. Funding Standards. Act §§ 301 and 302. Defined Benefit Plans and Money Purchase Plans must be properly funded. Failure to meet the funding standards can cause penalties and possibly an excise tax. Generally, the funding standards will not apply to defined contribution plans, such as 401(k) and profit sharing plans.

4. Fiduciary Duties.

a. The plan must be a written document, and must provide for a "named fiduciary." Act § 402(a). Section 402(b) lists the required elements of the written plan, including the procedure for establishing and carrying out the funding policy, the procedure for allocation of responsibilities in administration of the plan, to provide a procedure for amending the plan, and identifying those who have the authority to amend the plan, and to specify the basis on which payments are made to and from the plan.

b. Unless a plan provides benefits solely through insurance contracts, all assets of an employee benefit plan are generally required to be held in trust. Act § 403.

c. Act § 404 provides a laundry list of fiduciary duties of all plan fiduciaries (defined in Act § 402 as "a fiduciary who is named in the plan instrument, who is identified as a fiduciary"). That includes administering the plan solely in the interest of the participants and their beneficiaries, and general fiduciary standards, such as the duty of loyalty, following the prudent investor and prudent person rules, diversification of investments, and following the

provisions of the plan and trust documents. Act § 404(c) provides for "self-directed investments" in individual account defined contribution plans. Most 401(k) plans now allow for this self-direction. If the rules are not followed, the plan administrator and trustees may be liable for losses in investment performance in these individual accounts. There are detailed rules dealing with these requirements, which includes the nature and type of investment alternatives that must be offered to participants. ERISA Regs. § 2550.404c-1.

d. Act § 405 provides for Liability for Breach by a Co-Fiduciary. If a fiduciary does not personally breach fiduciary duties, but participates knowingly in such a breach by another fiduciary, or undertakes to conceal an act or omission of another fiduciary, or if that fiduciary enables the other fiduciary to breach its duties, the co-fiduciary will be liable to the same extent as the "breaching fiduciary."

e. Act § 406 provides for a prohibition against prohibited transactions between the plan and a "party in interest". *See also* Code § 4975. A "party in interest" is defined in Act § 3(14), and is a very complex definition. Generally, it includes the plan administrator, officer, trustee, custodian, counsel, or employee; a person providing services to the plan, the employer, and the owner of 50% or more of the employer. The prohibited transactions are those that constitute a direct or indirect sale or exchange, or leasing, of any property between the plan and a party in interest; the lending of money or other extension of credit between the plan and a party in interest. In addition, a plan may not hold employer securities or property constituting over 10% of the fair market value of the aggregate employer securities or property held by the employers. Act § 407. There are exceptions to this rule, however, primarily with respect to holding of employer stock by ESOPs and stock bonus plans, along with certain individual account plans. In addition, Act § 408 provides exceptions to the prohibited transaction rules, which include loans to participants in the plan, if the proper guidelines are followed. Act § 408 (b)(a); ERISA Regs. § 2550.408b-1(b). Generally, loans must be in an amount no more than the lesser of (i) one-half of the participant's account balance, or (ii) $50,000. The loan must be paid back over no more than a 5 year period (more if it is allowed to be secured by a loan against the participant's personal residence), and the interest rate must be commercially reasonable (which is generally prime plus a point or two). Other "group exemptions" are allowed, such as for rental of office space and providing services, and the statute also provides a mechanism for requesting a private exemption.

f. Act § 409 imposes liability for breach of fiduciary duty. That liability is personal, and cannot be charged against the plan. Act § 410 prohibits exculpatory provisions in the plan document, but a plan is allowed to purchase liability insurance to cover such losses. All fiduciaries handling funds of the plan must be bonded. Act § 412. The statute of limitations against a fiduciary is six years from the date of the breach or three years from the time the plaintiff has actual knowledge of the breach, whichever is shorter. Act § 413.

5. Administration and Enforcement.

a. Act § 501 imposes criminal fines (up to $5,000 for an individual and $1,000 for a non-individual) and imprisonment (up to one year) on any person who *willfully* violates the provisions of ERISA relating to reporting and disclosure.

b. Act § 502 imposes civil penalties of different amounts for different actions. Actions against a fiduciary may be brought by a participant or beneficiary. All actions, *other than claims for benefits*, must be brought in the federal district court and are governed by federal law. The Secretary of Labor may also bring action to enforce the provisions of ERISA.

c. Act § 503 provides that each employee benefit plan must include a claims procedure which is provided to participants and which outlines procedures for processing participant claims and allows a review of adverse determinations of participant claims. In addition, it is unlawful for any person to take retaliative action against a participant for exercising his rights under ERISA. Act § 510.

d. Act § 506 provides the basis for coordination of responsibility for enforcement of ERISA among the Department of Labor, the Internal Revenue Service and any other federal agency, including the Attorney General's office.

e. Act § 514 provides that the provisions of ERISA "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan. This provision is discussed in greater detail below.

6. COBRA - Health Continuation Coverage. Act § 601 through § 609.

a. Continuing health coverage, at the employee's cost (no more than 102% of the premium), must be offered to employees after a "qualifying event."

b. A qualifying event is one of the following: (1) the death of the covered employee; (2) the termination or reduction of hours of the covered employee's employment; (3) the divorce or legal separation of the covered employee from the employee's spouse; (4) the covered employee becoming entitled to medicare benefits; (5) a dependent child ceasing to be a dependent child; or (6) the employer's bankruptcy. The COBRA requirements apply to employers with 20 or more employees. Notice of an employee's rights must be given within 30 days of the qualifying event, and the employee is given no less than 60 days following the termination of coverage because of the qualifying event to elect to continue coverage. The continuing coverage must be available for 18 months after termination of employment or after bankruptcy of the employer. In case of the death, divorce, dependent coverage, or medicare coverage, the continuing coverage must be available for 36 months. If an employer has fewer than 20 employees, federal COBRA will not apply, but Iowa COBRA will. See Iowa Code Chapter 509B.

7. HIPAA - Group Health Plan, Portability, Access and Renewability Requirements. Act § 701 through 734.

a. This legislation, effective for plan years beginning after June 30, 1997, sets limits on exclusions of participants in group plans on account of preexisting conditions. Generally, only preexisting conditions treated within 6 months of enrollment may be excluded, and even then, may only be excluded for up to 12 months.

b. A health plan may not provide differing eligibility or premiums based on the health status of the employee, and may not require hospitalization after childbirth of less than 48 hours for a normal childbirth, or 96 hours for a cesarean section.

III. **ERISA LITIGATION**

A. *ERISA Preemption - in General.* As stated above, ERISA provides that "except as provided in subsection (b) of this section, the provisions of this subchapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 4(a) and not exempt under section 4(b). Generally, subsection (b) provides that "nothing in this title shall be construed to exempt or relieve any person from any law of any State which regulates insurance,

banking or securities." This is called the "savings clause." Historically, the Supreme Court has been quite broad in its application of the preemption clause, providing that state laws which apply to or may apply to employee benefit plans are not enforceable. Pilot Life Ins. Co. v. Dedeaux, ,481 U.S. 41 (1987); Metropolitan Life Ins. Co. v. Massachusetts, 471 U.S. 724 (1985). Since then, there have been many cases which have interpreted the very broad reach of ERISA preemption (the Pilot Life has been cited over 2,300 times in the U.S. Supreme Court and U.S. Courts of Appeals Courts alone). The general rule, however, is that whenever there is a claim that in any way relates to an employee benefit plan, federal, and not state, law will control. Recent cases, however, have noted that the relation must be relatively direct. *NOTE:* Special Preemption rules apply to the applicability of HIPAA. See Act § 731.

B. *Consequences of ERISA Preemption.*

1. Jurisdiction of State and Federal Courts. The Federal district courts have exclusive jurisdiction of civil actions, except for claims for benefits. The Federal and State courts have concurrent jurisdiction over benefit claims. Act § 502(e)(1), 29 USCS § 1132(e)(1). Regardless of the court, an ERISA cause of action must be pled.

2. Removal to Federal Court. If a benefits claim is brought in state court, the defendant may in most cases choose to remove the case to Federal Court. Massachusetts Mutual v. Taylor, 481 U.S. 48 (1987); see also 28 USCS § 1441(b). If no federal ERISA claim has been made, the lawsuit is subject to dismissal if based on an employee benefit plan.
3. Damages. In an ERISA claim, only actual damages and reasonable attorneys fees may be recovered. Punitive damages are not available under ERISA. Massachusetts Mutual v. Russell, 473 U.S. 134 (1985).

C. *Exhaustion of Remedies.* Although ERISA has no specific provision requiring a participant to exhaust administrative procedures before going to court, the courts have generally inferred that there is such a requirement, primarily based on the requirement that ERISA plans must have a claims procedure. Amato v. Bernard, 618 F.2d 559 (9th Cir. 1980). See also, in the 8th Circuit, the following cases: Layes v. Mead Corporation, 132 F.3d 1246, 1252 (8th Cir. 1998); Kincaid v. Southwestern Bell Corp. Sickness & Accident Disability Benefit Plan, 111 F.3d 67 (8th Cir 1997). The Eighth

Circuit has required exhaustion of remedies, however, only when the plan requires it. Conley v. Pitney Bowes, 34 F.3d 714 (8th cir 1994). *NOTE:* Not all circuits require exhaustion of administrative remedies in all cases. Review the plan document and the cases before giving up on a case where administrative claims were not filed. When a client has a potential claim, however, and it's not too late, be sure to go through the employer appeals process.

D. *Standard of Review.* In Firestone Tire and Rubber Company v. Bruch, 489 U.S. 101 (1989), the Court established the appropriate standard of review of claims decisions made by employers or administrators. The court ruled that in a plan where the document did not give the administrator discretion to make eligibility determinations, the court would not defer to the administrator's determination and would rule on a *de novo* basis. On the other hand, it appears that if the plan grants discretionary powers to the administrator, a deferential standard would apply, and the administrator or fiduciary's action will be overturned only if the action was arbitrary and capricious. As is always the case with ERISA questions, the standard of review question has been rehashed and reformulated by the different circuits, which have each put their own twists on the Supreme Court Case. In addition, if an administrator or fiduciary has a conflict of interest, "the area of discretion to which deference is paid must be confined narrowly to decisions for which a conflicted fiduciary can demonstrate that it is operating exclusively in the interests of the plan participants and beneficiaries. Brown v. Blue Cross & Blue Shield, Inc., 898 F.2d 1556 (11th Cir. 1990), *cert. denied,* 498 U.S. 1040 (1991). In that case, the court held that the fiduciary "bears the burden of dispelling the notion that its conflict of interest has tainted its judgment." Id. See also Armstrong v. Aetna Life Insurance Company, 128 F.3d 1263 (8th Cir 1997); Buttram v. Central States, Southeast and Southwest Areas Health & Welfare Fund, 76 F.3d 896 (8th Cir 1996).

IV. **CONCLUSION.** The length of this outline is *prima facie* evidence of its insufficiency as anything other than a starting point in looking for any answers under ERISA. The law itself is complicated; it has been interpreted by many courts in many ways, and it must be interpreted in connection with other laws, particularly the Internal Revenue Code. Wonderful research materials, articles and CLE outlines can be found through the ABA website: www.abanet.org - look under Labor and Employment Law as well as under Taxation and Employee Benefits.