DELIVERING STRATEGIC SOLUTIONS ACCA'S 2000 ANNUAL MEETING

"ERISA BASICS AND HOT TOPICS"

Program No. 406
Tuesday, October 3, 2000
4:00 — 5:30 p.m.

American Corporate Counsel Association
Annual Meeting
October 2000
Washington, D.C.

Kathleen A. Murray
Vice-Chair, ERISA Subcommittee
ACCA Labor and Employment Law Committee
Senior Counsel, Fireman's Fund Insurance Company
777 San Marin Drive, Novato, California 94998
415-899-2954 (tel) 415-899-8922 (fax)
kmurray@ffic.com

ERISA BASICS

The following summarizes selected provisions of the Employee Retirement Income Security Act of 1974 (ERISA), the federal law that sets minimum standards for pension and welfare employee benefit plans in private industry.

I. Background of ERISA.

- A. ERISA was adopted in 1974 to protect pension rights in the wake of Studebaker and other pension debacles that left long term employees with no pension rights.
- B. ERISA preempts state laws relating to employee benefit plans with the following exceptions:
  1. Any law which regulates insurance, banking or securities ("savings clause") <u>but,</u> despite this savings clause, states cannot regulate an employee benefit plan or trust as an entity engaged in the business of insurance, banking or securities ("deemer clause");
  2. Any applicable criminal law;
  3. State qualified domestic relations orders (QDRO's);
  4. Hawaii healthcare laws;
  5. Multiple Employer Welfare Arrangements ("MEWAs") to which special preemption rules apply.

I. ERISA Statutory Framework.

- A. ERISA does not require an employer to establish a pension or other benefit plan, but sets the minimum standards for employers who do establish such plans.
- B. The Four Titles of ERISA
  1. Title I: The "Labor" Title (In general, regulated by Department of Labor, Pension and Welfare Benefits Administration ("PWBA")
     - a. Reporting and Disclosure Requirements
     - b. Participation and Vesting Rules
     - c. Funding
     - d. Fiduciary Responsibility
     - e. Administration and Enforcement
     - f. COBRA
     - g. Group Health Plan Rules: Portability (HIPAA) Women's & Newborns Act, Mental Health Parity, Mastectomy
  2. Title II: The "Tax" Title (Regulated by Internal Revenue Service, Tax Exempt and Governmental Entities Division ("TEGE")
     - a. Participation, Vesting, Funding and Administration
     - b. Other Amendments to the Internal Revenue Code
  3. Title III: Jurisdiction, Administration and Enforcement
     - a. Department of Labor
     - b. Department of the Treasury
     - c. Pension Benefit Guarantee Corporation ("PBGC")
  4. Title IV: Plan Termination Insurance for defined benefit plans and certain other plans (Regulated by Pension Benefit Guarantee

4. Title IV: Plan Termination Insurance for defined benefit plans and certain other plans (Regulated by Pension Benefit Guarantee Corporation ("PBGC")
    a. Plan termination rules
    b. Insurance guarantee provisions

II. Plans Covered Under ERISA.

A. Scope of ERISA Coverage
1. Over 6 million private employee benefit plans
2. Plans cover 150 million people (workers, retirees, beneficiaries)
3. Control over $4.3 trillion in assets

B. ERISA applies to employee "pension plans" and "welfare benefit plans" established or maintained by an employer or by an employee organization engaged in commerce or in any industry or activity affecting commerce or a plan established by both such an employer and employee organization.

C. Pension Plans
1. Qualified Plans
    a. Defined Benefit Plan
    b. Defined Contribution Plan
2. Non-Qualified Plans
3. IRS Determination Letter

D. Employee Welfare Benefit Plans
1. Includes plans providing sickness, accident, disability health or certain vacation benefits, apprenticeship or other training programs, or day care centers, funded scholarship funds or prepaid legal services.
2. IRS Determination Letter for Trusts of self-funded welfare benefit plans.

E. Exceptions to ERISA Coverage
1. Governmental Plans (United States, state or local government or an agency of one of them and Railroad Retirement Act plans);
2. Church Plans maintained by tax exempt churches or church associations (unless elect coverage);
3. Plans maintained solely to comply with workers' compensation or unemployment compensation or disability laws;
4. Plan maintained outside the U.S. primarily for nonresident aliens;
5. Payroll practices;
6. On premises facilities, such as recreation, dining or first aid facilities (but day care centers are covered by ERISA);
7. Holiday gifts, such as turkeys or hams;
8. Hiring halls;
9. Remembrance funds for flowers, obituary notices or small gifts;
10. Strike Funds;
11. Industry Advancement Programs;
12. Certain group or group-type insurance programs where:
    a. No contribution is made by employer or employer organization;
    b. Participation in the program is completely voluntary for employees or members;
    c. Sole functions of the employer is to permit insurer to publicize and collect premiums without employer endorsement;
    d. Employer or employee organization receives no consideration other than reasonable compensation for administrative services in connection with payroll deductions or dues checkoffs.
13. Unfunded scholarship and tuition and education expense refund programs.

F. Limited ERISA Coverage: "Top Hat" Plans
1. Unfunded plans for highly compensated employees and top management.
2. Must make a one-time filing (within 120 days of the plan's adoption) with the DOL.
3. Exempt from Title 1 of ERISA.

III. Reporting and Disclosure.

A. Reporting By Plan Administrator
1. Form 5500 Annual reports. For 1999 plan years and later, file Form 5500 with PWBA of DOL (previously filed with IRS) through ERISA Filing Acceptance System (EFAST). See www.efast.dol.gov.

2. Welfare benefit plans covering fewer than 100 participants that are fully-insured, self funded or a combination of the two are exempt from the requirement to file Form 5500.

B. Disclosure: Plan administrator is responsible for providing to participants and beneficiaries receiving benefits under the plan within specified time frames:
1. Automatically and without charge
    a. Summary Plan Description (SPD) within 90 days of becoming a participant or first receiving benefits (or within 120 days of the plan becoming subject to ERISA);
    b. Updated SPD's as they are available;
    c. Summary of any change in the SPD or any material modifications to the plan;
    d. Summary Annual Report ("SAR") summarizing (in specified language) the information contained in the Form 5500 Annual Report.
2. Within 30 days of receipt of written request the plan sponsor must provide:
    a. Copies of the plan documents including plan document, SPD, trust agreement, contract, bargaining agreement or other documents under which the plan is established or operated);

a. Copies of the plan documents including plan document, SPD, trust agreement, contract, bargaining agreement or other documents under which the plan is established or operated);

b) Latest annual report Form 5500 (may charge reasonable costs of copying); and

c) Statement of total accrued pension benefits

4. Methods of Delivery
   a. Mailing to address provided by participant or beneficiary receiving benefits, or to the last known address or
   b. Personal delivery
   c. Electronic means (if plan administrator takes measures to ensure actual receipt of the documents and each participant or beneficiary receives notice that the document is being delivered electronically and is given notice of the right to receive a paper copy free of charge).

d) English Language Requirements. If a certain % of participants (5% if less than 100 participants or 10% if 100 or more participants) are literate only in the same non-English language, the plan administrator must give these participants an SPD containing a notice written in their own language informing these participants of the right to receive assistance to understand their rights under the plan.

C. IRS and DOL impose penalties for noncompliance with reporting and disclosure rules.

IV. Participation and Vesting Rules.

Title I of ERISA, part 2 contains the minimum standards that an employee pension plan must satisfy. Substantially identical requirements are imposed by the Internal Revenue Code. The IRC provisions apply to "qualified" pension, profit sharing and stock bonus plans (Code 401(a)), annuity plans (403(a)) and bond purchase plans (405(a)). The rules include:

A. Minimum Participation Rules
   1. Employees must become eligible after
      a. One year of service or at age 21, whichever occurs last; and
      b. Completion of at least 1000 hours of service in a consecutive 12 month period specified in the plan document:
         1. Hour of Service is generally defined as each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer during the applicable computation period
         2. Elapsed Time Method of Crediting Service is an alternative to counting hours of service. Under the elapsed time method, an employee's statutory entitlement with respect to participation, vesting and benefit accrual is determined generally with reference to the total period of time which elapses while the employee is employed.

2. Numerous other minimum participation rules apply.

B. Minimum Vesting Rules
   1. Employee Contributions: The benefits attributable to an employee's own contributions are fully vested at all times
   2. Employer Contributions: The plan sponsor may adopt one of the following minimum vesting schedules as follows (or provide more rapid vesting):
      a. 5 year Cliff Vesting
      b. 7 year Graded Vesting

Years of Service	Nonforfeitable%
3	20%
4	40%
5	60%
6	80%
7 or more	100%

   3. Break in Service Rules specify how time off work is to be calculated
      a. Special rules apply for absences due to maternity/paternity leave relating to pregnancy, birth or placement for adoption of a child as well as under the Uniform Services Employment and Re-Employment Rights Act of 1994 ("USERRA").

4. Numerous other minimum vesting rules apply.

C. Minimum Funding Rules. Minimum funding standards exist for defined benefit plans, money purchase pension plans and target benefit plans (a hybrid between a defined benefit plan and a money purchase pension plan).

V. Fiduciary Responsibility.
   A. Who is a Fiduciary?
      1. An ERISA fiduciary is any person who is
         a. A named fiduciary; or
         b. Identified as a fiduciary in the plan instrument; or
         c. Meets one or more of the following functional tests:
            1. Exercises any discretionary authority or control over the plan's management;
            2. Exercises any authority or control over the management or disposition of the plan's assets;

      2. Exercises any authority or control over the management or disposition of the plan's assets;
      3. Renders investment advice for a fee or other compensation with respect to plan funds or property; or
      4. Has any discretionary authority or responsibility in the plan's administration.
   2. Settlor Functions (Non Fiduciary Functions)
      a. Settlor Functions. Certain actions by fiduciaries are not considered fiduciary functions and are not subject to fiduciary duties to participants and beneficiaries.
      b. Examples of settlor functions include deciding to adopt or terminate an employee benefit plan and the adoption of a plan amendment.
   3. Ministerial Functions (Non Fiduciary Functions)
      a. Persons performing ministerial functions only are not considered plan fiduciaries.
      b. Examples of ministerial functions include application of rules to determine eligibility for participation or benefits; calculation of service and compensation for benefit purposes; preparing communications to employees; maintaining records; preparing reports for governmental agencies; calculating benefits; explaining the plan benefits to participants; collecting and applying contributions; processing claims; and making recommendations to others concerning plan administration.

B. Standard of Fiduciary Conduct
   1. Basic ERISA Fiduciary Duty: To act solely in the interest of the plan's participants and beneficiaries.
   2. The fiduciary must act in accordance with these additional requirements:
      a. Exclusive Purpose. Fiduciary must act with the exclusive purpose of providing benefits to participants and beneficiaries and defraying the reasonable expenses of administering the plan;
      b. Prudence. Fiduciary must act with the skill, prudence and diligence, under the circumstances then prevailing, that a prudent person acting in like capacity and familiar with such matters would use conducting an enterprise of like character under like circumstances;
      c. Diversification. Fiduciary must diversify the investments of the plan to minimize the risk of large losses, unless under the circumstances, it is clearly not prudent to do so; and
      d. Consistent with Plan Documents. Fiduciary must act in accordance with the documents governing the plan to the extent the documents are consistent with ERISA.
   3. ERISA prohibits a fiduciary from:
      a. Dealing with plan assets in the fiduciary's own interest or for the fiduciary's own account;
      b. Acting in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or its participants or beneficiaries; or
      c. Receiving any consideration for the fiduciary's own personal account from any person dealing with the plan in connection with any transaction involving plan assets.

C. Prohibited Transactions
   1. ERISA and the Internal Revenue Code prohibit certain transactions between a retirement plan and a "party of interest" to the plan, without regard to whether or not the transaction is fair or of benefit to the plan
   2. Who is a "Party in Interest?"
      a. Any fiduciary, counsel or employee of the plan;
      b. A person providing services to the plan;
      c. An employer any of whose employees are covered by the plan, and any director or indirect owner of 50% or more of such employer;
      d. A relative (i.e. spouse, ancestor, lineal descendant, or spouse of a lineal descendant) of any person described in a), b) or c) above;
      e. An employee organization, any of whose members are covered by the plan;
      f. A corporation, partnership, estate or trust of which at least 50% is owned by any person or organization described in a), b), c), d) or e) above;
      g. Officers, directors, 10% or more shareholders, and employees or any person or organization described in b), c), e) or f) above; or
      h. A 10% or more partner or joint venturer with any person or organization described in b), c), e) or f) above.
   3. A fiduciary must not cause the plan to engage in any transaction if the fiduciary knows or should know constitutes a direct or indirect:
      a. Sale, exchange or lease of any property between the plan and party in interest;
      b. Loan or other extension of credit between the plan and a party interest;
      c. Furnishing of goods, services, or facilities between the plan and a party in interest;
      d. Transfer of plan assets to a party in interest or the use of plan assets by or for the benefit of a party in interest; or
      e. Acquisition of employer securities or employer real property in excess of the limits set by law.

D. Penalties (Fiduciaries may be individually liable)
   1. IRS penalties for qualified plans:
      a. 15% excise tax on the amount involved for each year the transaction remains uncorrected (for PTs after August 5, 1997); and
      b. an additional 100% tax if the transaction is not corrected between the date of the prohibited transaction and 90 days after a final agency order has been made in the particular case; and
      c. other penalties.
   2. DOL penalties for nonqualified and welfare plans subject to ERISA
      a. A civil penalty not to exceed 5% of the amount involved; and
      b. Up to 100% of amount involved if the transaction is not corrected within 90 days after receiving a penalty notification from

b. Up to 100% of amount involved if the transaction is not corrected within 90 days after receiving a penalty notification from DOL.

E. Statutory Exceptions to Prohibited Transaction Rules

1. Loans by a plan to a party in interest who is a plan participant or beneficiary if the loan meets certain specified criteria.
2. Services performed by a party in interest to a plan that are necessary for the establishment or operation of the plan if no more than reasonable compensation is paid.
3. Loan to an employee stock ownership plan (ESOP) if the loan is primarily for the benefit of plan participants and beneficiaries and the interest rate is not in excess of a reasonable interest rate.
4. Ancillary services provided by a bank or other financial institution that is a fiduciary so long as the bank has adopted internal safeguards and reasonable compensation is paid.
5. Acquisition or sale by a plan of qualifying employer securities or the acquisition, sale or lease by the plan of qualifying employer real property is the transaction involves adequate consideration, no commission is charged and certain other ERISA limitations (in Section 407) are satisfied.

G. Department of Labor Prohibited Transaction Exemption ("PTE")

1. Administrative Exemption: DOL may grant an exemption to the prohibited transaction rules if the exemption is administratively feasible, in the interests of the plan and its participants and beneficiaries and protects the rights of the plan's participants and beneficiaries.
2. Class Exemptions: DOL has issued a number of class exemptions copies of which are available from the DOL website. These class exemptions contain detailed requirements which, if followed, provide relief from the prohibited transaction rules.

H. Fiduciary Liability Insurance.

1. Recourse by insurer required. A plan may purchase insurance for its fiduciaries or for itself to cover liability or losses due to the act or omission of a fiduciary if the insurance permits recourse by the insurer against the fiduciary in the case of the fiduciary's breach of a fiduciary obligation.
2. No recourse by insurer required. A fiduciary or a plan sponsor can purchase fiduciary liability insurance without a provision for recourse against the fiduciary by the insurer.

VI. Some Other Important Provisions.

A. Claims and Claim Appeal Procedures

B. QDRO Rules

C. Enforcement Actions

D. Plan Termination Rules

VII. Additional ERISA Resources and Website Links.

A. Governmental Documents from DOL, IRS and PBGC

1. U.S. Department of Labor, PWBA. http://www.dol.gov/dol/pwba/
2. Internal Revenue Service, TEGE Division www.irs.gov/bus_info/ep/index.html
3. Pension Benefit Guarantee Corporation (PBGC) — www.pbgc.gov/programs.htp

B. Subscription Services

1. BNA Pension and Benefits Reporter. www.bna.com/resources/PEN
2. Commerce Clearing House (CCH) Pension and Federal Taxation Services
3. Research Institute of America (RIA) Payroll, Federal Taxation and Benefits and Pension Services (CD ROM or Online) Subscription includes newsletter

C. Free E-Mail Updates

1. BenefitsLink Newsletter. Daily e-mail updates on welfare and pension plan developments with URLs to articles. www.benefitslink.com/newsletter/
2. CCH NetNews: Pension and Benefits. CCH e-mail newsletter with links to articles available in the CCH subscription service. http://hr.cch.com.

D. ACCA ERISA Subcommittee. www.acca.com

Image

Image

* "Act" refers to the sections of the Employee Retirement Income Security Act of 1974

** Portability (HIPAA), Mothers and Newborns Act, Mental Health Parity Act, Mastectomy, Preemption