ERISA Erosion?

Practices in the Employee Retirement Income Security Act (ERISA) world constantly are evolving to reflect economic realities and market opportunities. This evolution can occur beneath the surface—until emerging as a seemingly "new" development. The late Yogi Berra noted, "You can observe a lot just by watching." This article will discuss two emerging trends—the growth of voluntary benefits and the increased use of system-generated generic summary plan descriptions (SPDs)—that raise questions about existing policies and practices. With these trends, some more watching is merited.

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The Rise of Voluntary Welfare Plans

Laws and regulations change (somewhat) infrequently, while ERISA market practices change constantly. As a result, there are instances where the statutory and regulatory framework simply does not keep up with changing market practices.

This disconnect can create an opportunity for markets to innovate. For example, market practices supporting automatic plan features (such as automatic enrollment, automatic contribution escalation and automatic asset reallocation) gained traction long before the legal and regulatory framework reflected these practices.[1] On the other hand, the disconnect between market trends and the regulatory framework creates gaps that may undermine the objectives behind ERISA. The decline in 401(k) fees since the introduction of new fee disclosure requirements makes one wonder how much more money would be in 401(k) accounts if these regulatory changes had occurred sooner.[2]

The growth of voluntary benefit programs seems to be another area where the disconnect between market practices and the regulatory framework is expanding.

The entire regulatory framework of ERISA is premised on the idea that ERISA protections apply to employee benefit plans—plans "established or maintained" by an employer.[3] In the case of health and welfare plans, the regulatory criteria for identifying employer-sponsored plans (subject to ERISA) have been in place since 1975. Under these longstanding regulations:[4]

> For purposes of title I of the Act and this chapter, the terms "employee welfare benefit plan" and "welfare plan" shall not include a group or group-type insurance program offered by an insurer to employees or members of an employee organization, under which
>
> (1) No contributions are made by an employer or employee organization;
>
> (2) Participation in the program is completely voluntary for employees or members;
>
> (3) The sole functions of the employer or employee organization with respect to the program are, without endorsing the program, to permit the insurer to publicize the program to employees or members, to collect premiums through payroll deductions or dues checkoffs and to remit them to the insurer;

> (4) The employer or employee organization receives no consideration in the form of cash or otherwise in connection with the program, other than reasonable compensation, excluding any profit, for administrative services actually rendered in connection with payroll deductions or dues checkoffs.

The delineation under these regulations between employer sponsorship (and ERISA coverage) and voluntary programs (with no ERISA involvement) seemed to strike an appropriate balance: Voluntary benefits were a relatively small corner of the employee benefits world; the employer role was more tenuous than the "sponsorship" of plans that would justify ERISA coverage; and employers that followed these criteria defining voluntary benefits should not be burdened with the obligations that accompany ERISA sponsorship.

However, several things are changing. First, voluntary benefits now represent a significant—and growing—component of the employee benefits world. Sales of voluntary/worksite benefits approached $7 billion in 2014, an increase of almost 20% over 2012.[5] And health care policies (such as critical illness coverage or accident and injury coverages) now represent a significant portion of the voluntary coverage market.[6]

At the same time, employers view voluntary benefit plans as a "no-cost" way to beef up benefits packages. More specifically, voluntary (health) coverage increasingly is viewed as a way to fill "gaps" in health coverage created by increases in deductibles and out-of-pocket maximums. This perspective has both a "pull" and a "push" component—Employees are concerned about the economic consequences of high-deductible plans and, at the same time, both employers and employees are being sold on the ability of these ancillary plans to address this concern. Employees see frequent ads with a ubiquitous duck, and employers are receiving plenty of attention from brokers. This attention from brokers is not surprising; this ancillary coverage provides revenue potential for brokers. Articles telling brokers "How to Sell Critical Illness (and Why You Should)"[7] and "Creating Your Marketing Machine with Voluntary Benefits" reflect the marketing opportunity for brokers posed by employee concerns over high-deductible health plans.

Finally, we have learned from behavioral economics that employer actions intended to be neutral may be viewed by employees as an endorsement. Without any actual employer endorsement or recommendation, there is a real possibility that employees will assume that their employer has vetted carriers and products and negotiated favorable rates. This *endorsement effect* can be seen in a study published by the Employee Benefit Research Institute, which notes that over 80% of surveyed employees believe that voluntary plans selected by their employer cost less than coverages purchased individually and that over 20% of surveyed employees thought there was an advantage to their employer choosing providers.[8]

Yet, under ERISA, employers have no responsibility or role in reviewing carriers or assessing voluntary offerings. Indeed, employer review of voluntary offerings triggers the very kind of ERISA obligations that employers sought to avoid by offering voluntary benefits. See 29 C.F.R. Section 2510.3-1(j)(3), allowing an employer to avoid designation as a plan sponsor only if the sole functions of the employer are to permit the insurer to publicize the program, to collect premiums through payroll deductions and to remit the premiums to the insurer.

As a result, we have momentum building for significant growth in employees' use of voluntary health and welfare products that are not subject to ERISA. By being outside of ERISA, employees lose a number of important protections: access to the information required in summary plan descriptions (SPDs), fiduciary oversight in the selection and management of providers, and recourse to an appeals process that reflects ERISA's fiduciary responsibilities.

Interestingly, some of the factors described above—that prior guidance was last issued in 1975, the segment of the market left "unregulated" by 1975 rules has grown and current employee protections may be inadequate—are listed as reasons for the Department of Labor's (DOL's) proposed expansion of the definition of *fiduciary*.[9]

My point in raising this issue is not to advocate for a massive expansion of ERISA's regulatory scope. After all, employees purchasing voluntary benefits do have some protections—These are

insured products and are subject to state insurance regulation. And these are still (primarily) ancillary products, so the absence of ERISA jurisdiction is not likely to lead to Studebaker redux.[10] Accordingly, continuing the current regulatory framework may be an acceptable course of action. But the employee protections afforded by ERISA are too important to be set aside simply because of historical practices and regulatory inertia. Rather, this is an issue that should be purposefully assessed and considered.

The March of the System-Generated Generic SPD

Another market-driven phenomenon does require action—by plan sponsors. This phenomenon is the rise of system-generated generic (and potentially noncompliant) SPDs. This phenomenon affects both retirement and health and welfare plans, although it has developed under different circumstances for these different types of plans.

Retirement Plans: The Impact of IRS Preapproved Plan Documents

In the years following ERISA, retirement plan documents were drafted specifically for employers by counsel, reflecting the nuances (some might say idiosyncrasies) of the plan sponsor. The plan document would then be submitted to the Internal Revenue Service (IRS) for a determination letter ruling that the plan's provisions were consistent with relevant provisions of the Internal Revenue Code. Following preparation of the plan document, an SPD would be prepared—also representing a customized document reflecting the employer's specific plan provisions. This process would be repeated for design-driven or legislatively required plan amendments.

Over the course of time, there has been increased growth of IRS preapproved master, prototype and volume submitter plans prepared by service providers (such as recordkeepers). In this preapproved environment, the document sponsor prepares a document for use by a large number of clients and obtains an IRS determination letter for this preapproved plan. The IRS process limits the modifications that can be made by individual employers as a component of IRS preapproval of the plan document. Adopting employers could, by and large, rely on the IRS letter regarding the plan provisions. In the first years following the emergence of preapproved plans, small employers were attracted to the reduced burden associated with these plans while larger employers retained a preference for individually designed plans because these employers valued the ability to customize the plan document.

In reality, there is a real risk to employers that these system-generated SPDs will fail to actually provide the information required by DOL regulations. The author has observed too many system-generated SPDs (created by major service providers) that contain specific provisions that bear little relationship to the provisions of the plan and, more importantly, fail to actually provide the information required under DOL regulations.

However, in recent years, it seems that preapproved plans have moved upmarket, and a greater number of large employers have been willing to forgo customized plan documents. This shift was underscored by IRS Announcement 2015-19,[11] in which IRS announced it was significantly reducing the determination letter process for individually designed plans—a change likely to increase both the costs and the risks of maintaining individually designed plans and induce more employers to move into the world of prototype plan documents.

In light of the cost and administrative burden of maintaining individually drafted plans, the move toward preapproved plans makes sense. However, preapproved plans often come with system-generated SPDs, and it is this trend that raises concerns.

DOL regulations specify the information that must be in-

cluded in an SPD.[12] The required contents include a mix of administrative requirements (such as the Employer Identification Number (EIN) of the plan sponsor and the plan number) and substantive information about the plan provisions, including "the plan's requirements respecting eligibility for participation and for benefits"[13] and a "statement clearly identifying circumstances which may result in disqualification, ineligibility, or denial, loss, forfeiture, suspension, offset, [or] reduction . . . of any benefits that a participant or beneficiary might otherwise reasonably expect the plan to provide."[14]

SPDs that accompany preapproved IRS plans contain system-generated generic text. The system-generated SPD is intended to reflect the plan provisions selected by the employer in the preapproved plan's adoption agreement. At least, that is the idea. In reality, there is a real risk to employers that these system-generated SPDs will fail to actually provide the information required by DOL regulations. The author has observed too many system-generated SPDs (created by major service providers) that contain specific provisions that bear little relationship to the provisions of the plan and, more importantly, fail to actually provide the information required under DOL regulations.

For example, the author has observed system-generated SPD provisions that:

- Describe how vesting works—but fail to include the plan's actual vesting schedule
- Fail to describe the plan's specific eligibility provisions
- Describe the ability to make rollover contributions to a plan before the employee meets the plan's eligibility requirements . . . in a plan with immediate eligibility
- Describe how partial vesting works . . . in a plan with a cliff-vesting schedule.

These system-generated SPDs also contain information that is not required—and that creates additional risk for employers. Specifically, system-generated SPDs often contain a significant amount of information about tax rules governing plan distributions. DOL regulations do not require SPDs to provide tax information. Inclusion of this tax information creates additional risk for employers—if the information is not accurate or is not updated to keep up with changes in the Tax Code—and (based on DOL SPD requirements) this risk is completely unnecessary. Indeed, the author recently reviewed one system-generated SPD (for a new plan) that included detailed descriptions about treating distributions as capital gains and about ten-year averaging (provisions phased out by the Tax Reform Act of 1986). Moreover, service providers can be unwilling to revise these provisions, instead offering SPD documents on a "take-it-or-leave-it" basis, and employers may not have the resources to review or correct these SPDs.

IRS reviews preapproved plan documents—This is the essence of the plans' "preapproved" status. Preapproved plans are structured to restrict employers' ability to modify plan provisions—and this helps preserve IRS approval of the plan document. So preapproved plans can represent a cost-effective way for employers to stay on top of increasingly complex plan documentation requirements. But the same system that efficiently generates Code-compliant plan documents may also be generating ERISA-deficient SPDs.

Employers need to recognize this issue and, possibly, allocate sufficient resources to ensure that SPDs meet DOL requirements and do not create gratuitous exposure for employers.

Health and Welfare Plans: (Over)Reliance on Carriers?

In the health and welfare space, employers historically have relied on carriers (and third-party administrators (TPAs) in self-funded situations) to provide benefit summaries. After all, carriers and TPAs are in the best position to describe detailed administrative practices and complex medical plan provisions. However, carriers and TPAs are not well-positioned to describe key employer-specific features of these plans—such as the definition of the covered class of employees and the service requirements for plan eligibility.

With Affordable Care Act (ACA)-driven changes and the related turmoil in the health insurance arena, a wave of updated documentation is washing over employers. This updated documentation includes plan summaries that reflect the carrier's efforts to meet SPD requirements. At the same time, employers' limited resources are straining to meet the administrative challenges posed by ACA.

Herein lies the risk. Carrier-gen-

erated documents are (tantalizingly) close to meeting SPD requirements. However, carriers and TPAs typically do not have all of the employer specifics needed to provide a complete SPD—or the carrier-generated documents may not have the flexibility necessary to reflect these specifics.

The solution to this issue parallels the comment made regarding retirement SPDs. Employers are responsible for providing accurate—and complete—SPDs to participants. Carriers and TPAs can make a significant contribution toward meeting this obligation—but, at the end of the day, employers need to recognize the inherent limitations in vendor-generated summaries and review these summaries to ensure that all of the SPD requirements are met (either directly in the carrier-generated document or in an employer-prepared supplement).

The system-generated SPD does not represent an issue the regulatory framework has overlooked. DOL regulations already specify what must be included in an SPD. Rather, the issue is that employers need to recognize the fact that service providers' (efficient) processes for generating SPDs may not necessarily reflect employers' compliance obligations.

Conclusion

Trends in the structure and delivery of employee benefit programs take years to play out—and often occur below the radar screens of the benefits community. Perhaps it is time to put some of the issues related to voluntary benefits and system-generated generic SPDs on the radar. BQ

Endnotes

1. The author worked with a number of employers to implement automatic enrollment provisions several years before the statutory framework governing these plans was adopted under the Pension Protection Act of 2006.
2. See *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2014,* Investment Company Institute, August 2015, available at www.ici.org/pdf/per21-03.pdf. Although the ICI report does not identify a causal link between fee disclosure and lower fees, the correlation between the two is striking.
3. See ERISA Section 3(1) and 3(2).
4. 29 C.F.R. Section 2510.3-1(j).
5. Cyril Tuohy, "Growth In Voluntary/Worksite Benefits Sales Slow In 2014," *InsuranceNewsNet,* April 13, 2015, available at insurancenewsnet.com/innarticle/2015/04/13/Growth-In-Voluntary-Worksite-Benefits-Sales-Slow-In-2014-a-612530.html.
6. "LIMRA Survey: Voluntary Benefits Sales Grow 9 Percent as Employers Navigate Impact of Affordable Care Act," LIMRA blog post, March 25, 2014, available at www.limra.com/Posts/PR/Industry_Trends_Blog/LIMRA_Survey__Voluntary_Benefits_Sales_Grow_9_Percent_as__Employers_Navigate_Impact_of_Affordable_Care_Act.aspx.
7. Alan Goforth, "How to sell critical illness (and why you should)," BenefitsPro, October 1, 2015, available at www.benefitspro.com/2015/10/01/how-to-sell-critical-illness-and-why-you-should?t=voluntary.
8. Paul Fronstin, Ph.D., and Ruth Helman, "Views on the Value of Voluntary Workplace Benefits: Findings from the 2014 Health and Voluntary Workplace Benefits Survey," *EBRI Notes,* November 2014, available at www.ebri.org/pdf/notespdf/EBRI_Notes_11_Nov-14_WBS-RetGap.pdf.
9. See the preamble to the proposed regulations, starting at 80 C.F.R. 21932.
10. The closing of the Studebaker-Packard plant in South Bend, Indiana is considered a pivotal moment in the enactment of ERISA. See www.dol.gov/ERISA40/historical.htm for the DOL's perspective. For a lengthier description of the Studebaker bankruptcy and its role in the history of ERISA, see James A. Wooten, " 'The Most Glorious Story of Failure in the Business': The Studebaker-Packard Corporation and the Origins of ERISA," *Buffalo Law Review,* Vol. 49, p. 683, 2001.
11. "Revisions to the Employee Plans Determination Letter Program," Announcement 2015-19, available at www.irs.gov/pub/irs-drop/a-15-19.pdf.
12. 29 C.F.R. 2520.102-3.xiv, 29 C.F.R. 2520.102-3(j).
13. 29 C.F.R. 2520.102-3(l).

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