ERISA Fiduciary Duties: Health & Welfare Plan Implications

Lauren B. Dunn
Attorney
Foster Swift Collins & Smith PC
Phone: 517.371.8324
Email: ldunn@fosterswift.com
Health & Welfare Benefit Plan: Agenda

• Introduction & ERISA Implications
• ERISA
• Health & Welfare Benefit Plan
• Terminology
• Fiduciary Duties
• Application
• Risk Mitigation
• Other Considerations
• Conclusion
• Questions
Introduction: Service Contract Act

• McNamara-O’Hara Service Contract Act of 1965 Health and Welfare Benefit Requirements
  – Generally applies to federal contracts
  – Specifies certain dollar amount that must be used for purposes of providing health and welfare benefits to employees performing contract work
  – Bona fide in-kind fringe benefits, such as group health benefits and other welfare benefit programs (e.g., life insurance)
  – Can provide cash in lieu of fringe benefits – tax implications?
ERISA Implications

Why does ERISA matter?

- Federal law that applies to health and welfare plans (and retirement programs)
- Imposes disclosure and reporting obligations
- Imposes fiduciary duties
- Penalties for failing to comply
- Potential personal liability if fiduciary breach
ERISA
ERISA

• The Employee Retirement Income Security Act of 1974 (ERISA) is a federal law that sets minimum standards for most voluntarily established pension and health plans in private industry to provide protection for plan participants and beneficiaries.

• ERISA Exempt Employers
  – Governmental
  – Churches

• Non-Exempt
  – Private sector employers
  – Tax-exempt non-governmental employers
ERISA

• ERISA requires plans to provide participants with plan information including important information about plan features and funding.

• ERISA also:
  – provides fiduciary responsibilities for those who manage and control plan assets;
  – requires plans to establish a grievance and appeals process for participants to challenge adverse benefit determinations; and
  – gives participants the right to sue for benefits and breaches of fiduciary duty.

• Monetary and civil penalties for noncompliance
ERISA

ERISA generally applies to the following health and welfare benefit plans, regardless of whether they are fully insured or self-insured:

• Medical, Surgical, Hospital, or HMO Plans
• Health Reimbursement Accounts (HRAs)
• Health FSAs (Flexible Spending Accounts)
• Dental Plans
• Vision Plans
• Prescription Drug Plans
• Sickness, Accident, and Disability (Disability Insurance)
• Death (Life and AD&D Insurance)
• Employee Assistance Plans (EAPs) (if providing counseling, not just referrals)
ERISA generally does not apply to:

- Cafeteria Plans
- Premium Only Plans
- Premium Conversion Plans
- Dependent Care Assistance Plans
- Paid Time Off Plans

- Adoption Assistance Plans
- Educational Assistance or Tuition Reimbursement Plans
- On-site Medical Clinics (exceptions apply)
Health & Welfare Benefit Plan
What is a Health & Welfare Benefit Plan?

• Welfare benefit plans—commonly referred to as health and welfare plans—are described in Title I of ERISA.

• ERISA's definition of employee welfare benefit plans has 4 basic elements:
  1. there must be a plan, fund, or program
  2. that is established or maintained by an employer
  3. for the purpose of providing specifically listed benefits, through the purchase of insurance or otherwise
  4. to participants and beneficiaries
Health & Welfare Benefit Plan Examples

- Medical, surgical, or hospital care or benefits
  - Major medical, dental and vision
  - Medical reimbursement plans

- Benefits in the event of sickness, accident, disability, death, or unemployment
  - Life insurance
  - Disability insurance
Health & Welfare Benefit Plan Funding: Self-Funded

• Many health and welfare plans are self-funded, meaning that the employer bears the risk of paying plan benefits.

• A plan sponsor may choose to pay health benefits on a pay-as-you-go basis directly from the general assets of the corporation (which may include participant contributions collected by the plan sponsor).

• Alternatively, a trust may be established to hold assets from employer and/or employee contributions to pay all or a part of the covered benefits.
  – Plan is considered “funded”
  – Additional reporting requirements apply
Health & Welfare Benefit Plan Funding: Fully-Insured

- Plans also may be fully insured, whereby a premium is paid by the plan sponsor to an insurance company and the insurance company assumes the risk for the payment of benefits.

- The plan may be insured under a pooled arrangement (insurance premiums are based on the experience of a pool of other similar plans) or an experience-rated arrangement (insurance premiums are based on the experience of the specific plan).

- Sometimes the insurance company and the plan sponsor share the risk of paying benefits.
Health & Welfare Benefit Plan: Contributions

- Contributions to a health and welfare plan can come from the employer, participants (active or inactive employees, retirees, or COBRA participants), or a combination of both.

- Employer contributions may be voluntary or required under the terms of the plan.

- Contributory plans require contributions from participants and/or employers, while noncontributory plans do not require contributions from participants.

- Contributions by active participants typically are made through payroll withholdings.
Health & Welfare Benefit Plan: Contributions

- Contributions by participants covered under COBRA and retirees are paid directly to the plan sponsor or to a third-party administrator.

- For retirees, the contribution amounts also may be withheld from pension retirement checks.

- Payments made directly to the plan sponsor are either deposited into the trust or used directly to pay benefits.

- In many cases, the collection of COBRA and retiree contributions is performed by outside administrators.
Health & Welfare Benefit Plan: Contributions

• Participant contributions deposited into a trust of a health and welfare plan must be used to pay benefits or be deposited on the earliest date they can reasonably be segregated from the employer’s general assets, but in no event later than 90 days from the date on which such amounts are withheld or received by the employer.

• Defined-benefit health and welfare plans specify a determinable benefit, which may be in the form of reimbursement to the covered plan participant or a direct payment to providers or third party insurers for the cost of specified services.
  – Such plans may also include benefits that are payable as a lump sum, such as death benefits.
TERMINOLOGY
Terminology

• Plan Sponsor—the name of the sponsoring employer.

• Plan Year – the twelve month period on which the plan operates.
  – Different from policy or contract year

• Plan Administrator—the Plan Administrator is directly responsible for Plan compliance and is liable for compliance penalties even if it has delegated the performance of its duties to another party.
  – The Plan Administrator may amend, modify, or terminate the Plan, if this right is reserved in writing properly.

• Named Fiduciary—has the authority to control and manage the operation of the Plan, and generally decides benefit appeals. A fiduciary can be a person or an entity. An individual acting as a Named Fiduciary who breaches his duty can be personally liable under ERISA.
Terminology

• Claim Fiduciary—in the event of a member appeal for review of a denied claim, the Claim Fiduciary makes the final determination as to whether the claim is covered.

• Other Fiduciaries—anyone who performs fiduciary functions or control over Plan management decisions, disposition of Plan assets, or rendering investment advice.
Terminology

• Participant—any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit.

• Beneficiary—a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder.
FIDUCIARY DUTIES
Fiduciary Duties

• Code of conduct for fiduciaries
• Determine who has responsibility and liability for each aspect of plan administration and management.
• Under ERISA § 3(21), a fiduciary includes any person who:
  – Exercises discretionary authority or control with respect to the management of a plan,
  – Exercises any authority or control respecting management or disposition of plan assets,
  – Has discretionary authority or responsibility in the administration of the plan, or
  – Provides investment advice for a direct or indirect fee with respect to money or property of the plan.
Fiduciary Duties

• Fiduciary status flows from plan functions performed, regardless of person’s formal title or designation.

• Anyone can be a fiduciary when performing ERISA fiduciary functions; even individual employees can become fiduciaries based on the functions they perform for their company’s ERISA plans.

• Functional test – individual may be a fiduciary without intending to be.
Fiduciary Duties

• Personal liability if a breach
  – Restore any losses to the plan
  – Restore any profits made through improper use of plan assets
  – Appropriate court action including removal of fiduciary

• An ERISA fiduciary is held to a very high standard of behavior, which requires more careful decision-making and more disclosure to plan participants and beneficiaries than would be required in a normal business relationship.
Fiduciary Duties

• Individual Fiduciaries
  – What person or persons has authority to make decisions regarding the plan?
  – Board of Directors, CEO, HR, etc.
  – Delegation

• Institutional Fiduciaries
  – Generally, bank or other financial institution
  – Contract – delegation (directed vs. discretionary)
  – Named fiduciary has duty of oversight
  – One method to reduce personal liability risk
Fiduciary Duties

• Undivided Loyalty—Act solely in the interests of participants and beneficiaries;

• Exclusivity—Act for the exclusive purpose of providing plan benefits or for defraying reasonable expenses of plan administration (“Exclusive Benefit Rule”);

• Prudence—Exercise the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
Fiduciary Duties

• Diversification—Diversify the plan’s investments to minimize the risk of large losses; and

• Adherence to Plan Documents—Act in accordance with the documents and the instruments governing the plan insofar as those documents and instruments are consistent with ERISA.
Fiduciary Duties: Duty of Loyalty

• ERISA requires that a fiduciary discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of:
  – Providing benefits to participants and their beneficiaries; and
  – Defraying reasonable expenses of administering the Plan.
Fiduciary Duties: Exclusive Benefit Rule

- The fiduciary must act solely in the interest of the participants and beneficiaries and for the sole purpose of providing benefits to the individual participants and their beneficiaries.
- The fiduciary must ensure that expenses charged for administering the plan are reasonable.
- A fiduciary is prohibited from receiving a benefit as a result of its relationship with an ERISA client/plan.
- Cannot use the assets of the plan for personal interest, or favor the interests of a third party over the interest of plan participants.
- ERISA §406(b): self-dealing and conflicts of interest; prohibited transactions
Fiduciary Duties: Duty of Prudence

- ERISA states that a fiduciary must act “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”

- The standard is an objective one requiring the fiduciary to:
  - Employ proper methods to investigate, evaluate, and structure the investment;
  - Act in a manner as would others who have a capacity and familiarity with such matters; and
  - Exercise independent judgment when making investment decisions.

- Process!
Fiduciary Duties

• In judging whether a fiduciary breach has occurred, “[t]he court’s task is to inquire whether the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment.”

• In Tibble v. Edison International the U.S. Supreme held that a ERISA fiduciary has a continuing duty to monitor that is separate from the duty to exercise prudence in the initial selection of the investments.
Fiduciary Duties: Diversification

• A fiduciary must diversify plan investment so as to minimize the risk of large losses unless, under the circumstances, it is clearly prudent no to do so.

• Diversification must be considered in the context of the entire portfolio and as a part of the overall strategy considering the appropriate risk and return.

• Applicable to health and welfare plans funded through a trust (and retirement plans)
Fiduciary Duties: Adherence to Plan Documents

- A fiduciary must act in accordance with the documents governing the plan to the extent the documents are consistent with ERISA.

- A fiduciary must decline to follow the plan document if the direction contained in the document is inconsistent with ERISA.

- The plan sponsor must ensure that plan and trust documents accurately reflect current administrative practices.
Application

- Plan operation and administration
- Implementing plan design
- Hiring of service providers
- Monitoring of service providers
- Providing administrative services to the plan (depending on services)
- Discretionary authority or control over plan administration
- Control over plan assets
- Plan documents
- Claim procedures
Application

- Payment plan benefits
- Methodology for paying plan benefits
- Selection of health care providers
- Investment and financial decisions regarding plan assets
- Plan disclosures
- Fees and expenses
- Participant communications
Application:
Plan Documents & Employee Disclosures

• Written Plan Document
  – Technical
  – Kept on file by employer
  – Must be provided upon request (participant, beneficiary, DOL)

• Summary Plan Description
  – Describes terms of plan
  – ERISA specific information must be included (e.g., individual of service for legal process on behalf of plan; plan sponsor’s EIN)
  – Distributed to employees
  – Must be updated every 5 years if plan has been amended; every 10 years regardless
  – Insurance booklets often do not meet requirements

• Prospective and accuracy
Application: Reporting

• Form 5500
  – Annual filing – due last day of 7th month after end of plan year
  – Required for all health and welfare benefit plans that are subject to ERISA
    • Exemption: small, unfunded plans (i.e., generally plans with fewer than 100 participants on the first day of the plan year which are provided through insurance contracts)
  – Delinquent filings – DOL’s Delinquent Filer Voluntary Fiduciary Compliance Program (“DFVCP”)
  – Statue of limitations and audit exposure
Application: Hiring/Monitoring Service Providers

• Selection of a service provider to a plan is a fiduciary decision
  – Claims administration, COBRA administration, etc.

• Continuous duty of oversight

• No bright line test for when fiduciary duty has been satisfied
Application: Plan Assets

• Participant contributions
  – Held in trust?
  – Cafeteria plan non-enforcement policy if forwarding premium payments to an insurance company

• Investment
  – No bright line test

• Plan expenses
  – Certain expenses can be paid with plan assets
  – Appropriate?

• Criminal liability possible for egregious mishandling of plan assets (e.g., embezzlement)
RISK MITIGATION & OTHER CONSIDERATIONS
Risk Mitigation

- D & O Insurance
- Fiduciary Liability Insurance
- Indemnification by employer-sponsor
  - Plan cannot indemnify fiduciary
- Use of institutional trustee
- Use of outside independent advisers
  - Remember, selection and monitoring are fiduciary actions!
Other Considerations

• Cafeteria Plan Implications
  – Relevant if employees will choose between taxable and tax free benefits
  – Code Section 125

• PPACA
  – Employer mandate rules
  – Small group market member-level rating
SUMMARY
Summary

• ERISA
  – Imposes certain disclosure, reporting and fiduciary duties
  – Does not apply to governmental and church plans

• Health & Welfare Benefit Plan
  – a plan, fund, or program that is established or maintained by an employer for the purpose of providing specifically listed benefits, through the purchase of insurance or otherwise to participants and beneficiaries
  – Group health benefits, life insurance, disability insurance, etc.
Summary

• ERISA Fiduciary
  – An ERISA fiduciary is held to a very high standard, which requires more careful decision making and disclosure than would otherwise be required in a business relationship.
  – Fiduciaries who do not follow these principles of conduct may be personally liable to restore any losses to the plan, or to restore any profits made through improper use of plan assets.
  – undivided loyalty, prudence, exclusivity, diversification, and adherence to plan documents

• Application
  – discretionary, authority, control, responsibility, or advice with regard to plan management, disposition, administration, or assets
  – Plan document, summary plan description, Form 5500, plan asset management
Summary

• Mitigate Risk
  – Options available
  – Retain duty of oversight if delegation of fiduciary duty

• Other Considerations
  – Tax
  – PPACA
Questions?
Lauren Dunn

- Lauren provides leading edge counsel to clients regarding the tax considerations and compliance requirements relating to employee benefits programs. She works with both private and public employers to structure retirement and welfare benefit plans and programs that work for their unique needs and business philosophies.

- Lauren received her juris doctorate from Wayne State University Law School, where she spent two years as a member of the Wayne Law Review; and her Bachelor of Arts degree, magna cum laude, from Western Michigan University.
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