

REGULATION AND SUPERVISION OF PRIVATE PENSIONS IN THE UNITED STATES

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Introduction

The following sketches a very broad-brush outline of the system and methods of regulation and supervision of the private pension system in the United States. In the interest of brevity, this paper does not describe regulatory arrangements or procedures in detail, and it is not intended to address the “first pillar” of the United States retirement system, the mandatory, defined benefit, government-provided Social Security program.

The material that follows deals with the voluntary retirement plans, defined benefit and defined contribution, that cover private-sector workers, as well as the plans, generally established pursuant to statute, that benefit the employees of federal, state and local governments in the United States. Altogether, occupational or employment-based pensions in the US cover about 65 million employees (representing, in recent years, somewhat less than half the total US workforce and about half the full-time US workforce). These plans, together with the nonemployment-based individual retirement accounts that have developed in the US, have accumulated a pool of investment capital currently totaling about ten trillion US dollars (see box, page 2, below).

Legal and Regulatory Framework

¹ Any views expressed in this paper represent solely the views of the author, and not the views or positions of the U.S. Department of the Treasury. The author served as Benefits Tax Counsel in the Department of the Treasury from 1995 until 2001. The Benefits Tax Counsel is the senior official in the Department of the Treasury with specific responsibility for the development and analysis of national retirement savings policy and tax policy relating to pensions and retirement savings, employer-provided health care, and other employee benefits, as well as executive compensation and employment taxes, and for overseeing most of the regulation of tax-qualified retirement plans and other employee benefits in the United States. The Benefits Tax Counsel also represents the Executive Branch in testimony on these issues before committees of the US Congress, and serves as the principal legal adviser to the Secretary of the Treasury with respect to these areas.

The subject matter within the purview of the Office of Benefits Tax Counsel includes traditional pension plans, profit-sharing and 401(k) plans, cash balance pension plans, ESOPs, IRAs, SIMPLE plans, cafeteria plans and flexible spending accounts, health care portability, COBRA health care continuation, long-term care, medical spending accounts, stock options, nonqualified deferred compensation, and other benefits, as well as Social Security and Medicare payroll taxes and worker classification. The Office has also been involved in implementation issues relating to Social Security individual account proposals.

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The regulation of private pensions in the United States is based mainly on the statutory provisions of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). ERISA Titles I, II, III and IV amended the labor laws, amended the tax laws (the Internal Revenue Code), provided for coordination between the two, and added a benefit guarantee program for terminating defined benefit pension plans, respectively. These Federal pension laws, which preempt the application of most State laws to pensions, have been amended by the US Congress on numerous occasions since 1974.

The tax laws relating to pensions are administered and interpreted by the Internal Revenue Service (IRS), under the oversight of the U. S. Department of the Treasury Office of Benefits Tax Counsel (within the Office of Tax Policy). The IRS operating division with responsibility for this area is the Tax-Exempt and Governmental Entities (TEGE) division.

The labor laws relating to pensions are administered and interpreted by the U. S. Department of Labor (Pension and Welfare Benefits Administration)(PWBA) or, in connection with terminations of defined benefit plans, by the Pension Benefit Guaranty Corporation (PBGC), the government corporation established pursuant to Title IV of ERISA.

Under the US private pension system, employer and individual retirement plans are voluntary (except insofar as plans sponsored by governmental entities for their employees are provided for by federal, state or local law). A significant number (but not a majority) of employment-based plans are established and maintained pursuant to collective bargaining agreements entered into between employers and organized labor.

Total assets held by pension funds in the United States (excluding Social Security):

Private defined benefit plans	US \$ 1.8 trillion
Private defined contribution plans	\$ 2.3 trillion (including 401(k)s & Federal govt employee DC plan)
State and local govt employee plans	\$ 2.2 trillion
Federal govt employee DB pension fund reserves	\$ 0.8 trillion
IRAs	\$ 2.7 trillion
Total	US \$ 9.8 trillion

All figures are as of end of 2001, except IRAs are as of end of 2000.

Source: Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States, Statistical release Z.1 (March 7, 2002)

Qualified Retirement Plans

Under the statutory scheme, special favorable Federal income tax treatment accrues to a retirement plan that satisfies certain conditions. These conditions include the form of the plan (the provisions of the plan document) and the operation of the plan (the manner in which the plan applies to the plan sponsor's work force – e.g., which employees or classes of employees the plan covers -- and the manner in which it is actually administered).

A plan that satisfies the conditions necessary to qualify for favorable tax treatment is referred to as a "qualified" plan. ERISA requires that the plan's assets be held in trust for the exclusive benefit of the employees covered by the plan and their death beneficiaries (except to the extent assets consist of insurance contracts). A tax-exempt trust that holds the assets of a "qualified" plan is treated as a "qualified" trust. (For the most part, the remainder of this outline refers to the plan and trust collectively as "the plan".)

Defined benefit pension plans and defined contribution plans in the US take several different forms. These include traditional and hybrid defined benefit pension plans, as well as profit-sharing, 401(k), money purchase, stock bonus, and employee stock ownership ("ESOP") defined contribution plans. As in some other systems, there has been a steady trend in the United States for new employee plans to be defined contribution rather than defined benefit plans. Within the defined benefit universe, many plan sponsors have converted their traditional defined benefit plans to hybrid defined benefit plans in the nature of notional defined contribution or "cash balance" plans.

For years, the fastest-growing type of plan in the US has been the "401(k)" (also known as a "cash or deferred arrangement" because the employee chooses whether to contribute to the plan funds that the employee would otherwise receive as cash wages).

The employer sponsoring a 401(k) nominally shifts to the employee both the cost of making contributions to fund retirement benefits and the investment risk (because employees generally determine how their 401(k) contributions will be invested among options defined by the plan).

Favorable Tax Treatment for Qualified Plans

The special tax treatment accorded to qualified plans includes a favorable mismatch in the timing of the employer's deduction for its retirement contributions to the plan and the employee's recognition of income in respect of those contributions. In general, outside the context of a tax-qualified plan, an employer would not be entitled to claim a tax deduction for compensation provided to an employee until the compensation was includable in the employee's income for tax purposes, and the employee ordinarily would be required to recognize income for tax purposes on vested compensation in a funded plan. However, under a qualified plan, an employer is entitled to deduct a contribution when it is made (within limits), even though the employee is entitled to postpone recognition of income for tax purposes until the corresponding amount is distributed from the plan to the employee, typically years later.

Earnings on contributions to a qualified plan, held in trust, accumulate tax-free; taxation of contributions and earnings is postponed until they are distributed from the plan. In most cases, distributions from a qualified plan are taxed as ordinary income, not as capital gains. Many types of qualified plan distributions can be transferred tax-free (in a tax-free “rollover”) to another qualified plan or to certain other tax-favored retirement vehicles including a tax-sheltered annuity or an individual retirement account (IRA).

If employees contribute to the plan, their contributions may qualify for treatment similar to employer contributions (that is, the amount contributed is not taxed to the employee until it is distributed from the plan). This “pretax” treatment of employee contributions is characteristic of 401(k) plans.

This tax-advantaged treatment of private pension plans constitutes the largest “tax expenditure” of the US Federal government.

Tax Law -- Plan Qualification Requirements

The conditions a plan must satisfy in order to be tax-qualified are set forth in the tax code and related Treasury regulations and rulings, and are administered, enforced and interpreted by Treasury/IRS. These standards are extensive and detailed, and include

- minimum standards for the funding of employer-sponsored defined benefit pension plans (enforced by excise taxes on underfunding) and authority to grant plan sponsors temporary waivers of the funding requirements under certain circumstances;
- minimum standards that limit permissible waiting periods for eligibility to participate and that limit delays in the earning (accrual) and vesting of benefits;
- requirements to offer lifetime annuities for employees and survivor annuities for their spouses (but no legal requirement for annuitization at any age if employees and spouses elect otherwise);
- prohibitions on amendments eliminating or reducing benefits that have been earned;
- dollar and percentage-of-pay limits on the maximum amount of benefits and contributions employees can receive and a US \$200,000 limit (for 2002) on the amount of compensation that can be taken into account in a pension formula;
- restrictions on the amount and timing of employers’ tax deductions for contributions;

- provisions for “portability” of pensions, including transfers and “rollovers” to other plans or IRAs, and requirements governing other benefit distribution options and elections by participants;
- a 10% additional tax on many early distributions (specified types of withdrawals made before a particular age) and prohibition of distributions from defined benefit plans before termination of employment;
- rules that limit the ability to defer tax on distributions until death by requiring certain minimum distributions beginning after attainment of age 70 ½; and
- very extensive rules limiting permissible discrimination in favor of highly compensated employees (generally defined as employees whose pay from the employer is at least US \$90,000 (for 2002) or who own at least a 5% interest in the employer).

The nondiscrimination regime is intended to help effectuate the central purpose of the qualified plan system to encourage provision of benefits to moderate- and lower-income workers that will meaningfully supplement Social Security.² The nondiscrimination rules include provisions governing

- which employees are covered by the plan,
- the amounts and types of benefits provided to employees generally compared to highly paid employees,
- special nondiscrimination rules for employee contributions and for employer contributions that match all or a portion of employees’ contributions,
- an employer’s ability to provide different levels of benefits to employees in separate lines of business,
- the definitions of compensation and of highly compensated employee for these purposes, and
- the minimum benefits or contributions that employers must provide when a plan confers a disproportionate share of its benefits on owners and highly paid employees (so-called “top-heavy” rules).

² Insofar as the qualified plan system is intended also to increase personal saving in the United States, the nondiscrimination regime has also been viewed as a means of maximizing saving by targeting incentives to moderate-income workers. These individuals are thought to be less likely than higher-income people to merely substitute new qualified plan benefits for other savings or for saving behavior that they in any event would have engaged in.

IRS Administration and Requirements

Enforcement of Plan Qualification

A plan that violates any of the qualification requirements can lose its tax-qualified status (potentially triggering immediate taxation of employees and loss of deductions for the employer). However, the IRS actually disqualifies very few plans. This is largely because the sanction of disqualification is so drastic (potentially harming employees as well as the plan sponsor) and because, as a practical matter, most plans are probably out of compliance at least to a very limited extent with one or more of the numerous technical qualification requirements. Disqualification tends to be imposed in the rare situations where the plan sponsor engages in fundamental abuses, inconsistent with the basic character of a qualified retirement plan established for the benefit of employees.

Outright disqualification of a plan is the atomic bomb of pensions. Disqualification is recognized to be so severe a sanction, its deterrent effect is limited. Accordingly, the IRS has developed over time a more credible and flexible arsenal of “tactical nuclear” and “conventional weapons”. These intermediate sanctions, organized within the framework of the Employee Plans Compliance Resolution System (“EPCRS”) (described below), are designed to deter and address violations of the plan qualification rules.

Enforcement tools with respect to tax-qualified retirement plans include IRS examinations (audits) of individual and corporate taxpayers for general tax purposes as well as audits of plan sponsors that focus on compliance with the plan qualification rules. IRS audits are based in part on an analysis of annual reports filed on behalf of plans as well as tax returns filed by sponsors.

While the resources of the IRS include more than 100,000 employees, its central mission is the collection of income taxes from over 100 million individuals and businesses. Although the tax expenditure for retirement plans in the United States – estimated to be on the order of US \$90 billion a year – is the largest tax expenditure in the Federal Government budget, enforcement of the plan qualification rules comprises only a fraction of the IRS mission. Many of the procedures that apply to the collection and administration of the income tax generally – including methods of informing and educating taxpayers, audits, administrative appeals, agreements with taxpayers, and litigation -- are used also for qualified retirement plans.

IRS Qualified Plan Compliance and Corrections System - EPCRS

The IRS enforcement and compliance strategy in the pension area emphasize cooperation with plan sponsors, “up-front” voluntary compliance and prevention of violations, in the context of a voluntary private pension system and an income tax system that also relies heavily upon voluntary compliance by taxpayers and that increasingly focuses on user-friendly “customer service”.

Commonly, qualification violations that do occur are corrected voluntarily by the plan sponsor, with or without IRS involvement, in accordance with an array of IRS administrative compliance and correction programs and practices for qualified retirement plans. Collectively known as the Employee Plans Compliance Resolution System, or EPCRS, these programs encourage plan sponsors to correct their own violations without adverse tax consequences and without government involvement. To assist employers to self-correct, the IRS has published an extensive set of acceptable correction methods and related examples.

The system provides carefully laddered incentives and consequences (including monetary sanctions) that are designed to encourage employers to institute regular compliance checks and procedures by rewarding correction to the extent it occurs earlier in the process. The constituent programs were developed with the aid of extensive dialogue with the private sector.

As noted, the system encourages employers to establish compliance procedures and practices by allowing plans that have done so to “self-correct” many violations without payment of any fee or sanction and without IRS involvement. However, some plan sponsors that take the initiative to correct violations voluntarily, before audit, want the comfort of IRS approval of their corrections. These sponsors can apply for approval for a limited, specified fee, designed to reduce their uncertainty regarding their potential liability, and they have the further alternative of submitting their corrections for IRS approval on an anonymous basis. Alternatively, if the violations are not voluntarily corrected by the sponsor but are discovered by the IRS on audit, higher sanctions are payable, although those sanctions are required to be proportional to the nature and severity of the problem. In general, the earlier the violation is corrected, the lower the fee or sanction.

IRS Determination Letter Program

Many of the basic tax qualification and other legal requirements for qualified plans are required to be set forth in the plan document. ERISA requires the plan document to govern plan officials’ actions, except where doing so would violate their other fiduciary duties.

A plan sponsor can obtain a written determination from the IRS that its plan satisfies the numerous qualification requirements and therefore is entitled to favorable tax treatment for a specified year or years. Such a “determination letter” can protect the sponsor from the risk that an IRS agent will later assert, in the event the plan is examined on audit, that the plan failed to comply with one or more of the requirements and hence was not qualified for favorable tax treatment.

In addition to its function as a “comfort letter”, the IRS determination entails a process whereby an IRS agent reviews the plan and typically identifies imperfections the agent believes to exist in the plan. A plan sponsor that applies timely for the determination

then has an opportunity to amend the document and take other action, if necessary, to cure the defects during a protected period of time before they can be asserted to impair the qualified status of the plan. (See the following section regarding the role in this process of private-sector professional advisers.)

Plan sponsors are not required to obtain determination letters from the IRS, and the application requires payment of a relatively modest fee. However, it has become customary to apply for such a letter whenever a new plan is adopted and in most instances when a plan is amended or terminated.

Plans have been amended relatively frequently since ERISA was enacted in 1974. These changes are attributable in part to plan sponsors' periodic decisions to change the way their plan is designed or operates and in part to frequent amendments of the pension laws by the US Congress. When plan amendments are necessitated by changes in law, employers have typically applied to the IRS for determination letters on several hundred thousand qualified plans at about the same time. To alleviate the spike in IRS personnel requirements and delays associated with processing so many plans at the same time, the IRS is considering the possibility of "staggering" the submission deadlines for plans that wish to obtain determination letters in future years. The IRS is also currently entertaining other proposals for revision of the determination letter process.

Although employees cannot sue to enforce the tax code plan qualification requirements, a plan sponsor is required to inform employees of plan amendments for which it is seeking an IRS determination. This is designed to enable employees to raise concerns about the amendments to the IRS and the Labor Department. (It appears that employees rarely avail themselves of this opportunity, in part because the amendments generally are highly technical and difficult for nonexperts to understand.)

Key Role of Private-Sector Pension Professionals

Perhaps the most important practical function of the IRS determination process is to provide a point of entry for private-sector pension professionals to "enforce" voluntary compliance by plan sponsors. These specialists may include the sponsor's legal counsel, specially qualified ("enrolled") pension actuaries, consultants, accountants, financial providers, recordkeepers or other service providers, and inhouse administrators.

Prior to IRS review, the process of amending the plan and applying for an IRS determination creates an action-forcing deadline for plan sponsors to arrange for a specialized review of the plan and to focus on compliance with the legal requirements. This provides an occasion, every few years, for pension specialists, whether inside or outside the sponsoring organization, to obtain information from the organization that they need to evaluate compliance and to call the attention of management to the actions the organization needs to take to comply or maintain compliance.

The process of responding to questions on the application for determination letter and amending the plan often brings to light documentary and operational problems and issues that were previously submerged. These matters and the associated dialogue are often more extensive and significant than the issues raised by IRS personnel who review the application for determination letter.

In part, this is simply because the internal review and correction process generally precedes the IRS review. In addition, however, it is not uncommon for the internal review process to surface discrepancies between the provisions of the plan documents and the actual operational administration of the plan – discrepancies that generally will not be evident based solely on a review of the application for determination letter. Such divergences between plan administration and plan documents are more likely to be discovered by the IRS on audit than on review of an application for determination letter. However, as a practical matter, it appears that such issues tend to be identified more often by the sponsor's professional advisers or other specialists than by the IRS.

The compliance issues tend to be identified not only when the sponsor brings in its private-sector experts to advise or assist in connection with legally required amendments to the plan and applications for IRS determination letters, but also when experts are asked to advise or assist with questions raised by plan sponsor personnel administering the plan, occasional internal compliance reviews, or changes to the plan design and associated plan amendments that the plan sponsor wishes to make for business reasons. Plan amendments, whether legally required or prompted by the plan sponsor, often require approval of the sponsor's board of directors. This tends to involve relatively senior personnel within the organization, who generally have little or no time for or interest in issues of compliance with pension laws and regulations. The higher levels of the sponsoring organization's management will often be more willing to invest corporate resources in compliance when confronted with a crisis or a deadline which, if disregarded, could give rise to a crisis.

Once identified, compliance problems can be resolved internally by the sponsor, with the help of its inhouse or outside pension specialists. The IRS guidelines regarding "self-correction" and other correction of plan qualification defects before or after discovery on IRS audit are referred to in the section on "EPCRS" above. (The Labor Department has also begun to establish a framework plan sponsors can use to self-correct fiduciary and certain other violations of Title I of ERISA.)

Given the large number of plans and plan sponsors and the limited resources available to the government, it can be argued that private-sector pension professionals and advisers in effect serve as the principal agents of compliance in the US system. As a practical matter, the professional pension community often functions much like an extension of the Treasury/IRS and Labor Department: it enables those agencies to leverage their limited resources by in effect deputizing this community of pension experts to translate and interpret the law for plan sponsors (and, in some instances, the

providers of financial services), apply the rules to specific circumstances arising in connection with particular plans, explain to some degree regulators' concerns, and assist sponsors in implementing systems or methods of compliance and correction.

IRS Model Plan Programs

Qualified plans can be designed in a variety of ways, depending on the preferences of the sponsor. The law gives plan sponsors flexibility to design specific plan provisions within an extensive framework of minimum standards and requirements designed to protect the pension rights of participating employees and to protect the integrity of the Government's tax expenditure from abuse. The combination of detailed rules and numerous individual choices by plan sponsors has given rise to extensive and varied plan provisions, often set forth in documents running to 50 or 100 pages in length.

To minimize the barriers and costs associated with establishing and amending qualified plans, the IRS maintains administrative model plan programs. Banks, insurance companies, mutual funds, brokerage firms, law firms, trade and professional associations, and others can provide and assist their customers or members in adopting standard, model plan documents that the IRS has approved. The customer or member, typically a small business, can purchase these preapproved "master and prototype" or other model plans "off the shelf", typically choosing among a limited array of plan design variations.

Unfortunately, there is anecdotal evidence of basic noncompliance among these types of plans in too many instances. Too often, once an insurance agent, stock broker, or other representative of a financial institution sells an "off-the-shelf" retirement plan to a small business, no one with sufficient knowledge takes responsibility for compliance with the law (such as annual reporting, amendments to keep up with changes in legal requirements, nondiscrimination testing, and minimum "top-heavy" benefits).

Labor Laws -- Department of Labor

As a general matter, the Department of Labor has regulatory jurisdiction to interpret and enforce the requirements of ERISA that do not constitute conditions of plan qualification. Labor enforces these requirements by conducting plan reviews and investigations, bringing lawsuits or taking administrative action. These provisions (in Title I of ERISA) include

- standards of conduct for those responsible for managing the plan and its funds: an exclusive benefit rule imposing on such plan "fiduciaries" a duty of loyalty to plan participants and a prudent person (sometimes referred to as a "prudent expert") standard; provisions intended to allocate investment and other fiduciary responsibilities and accountability clearly among trustees, investment managers and advisers, plan committees, and other specified parties; a requirement that plan assets be held in trust; a few other

investment-related provisions that are also derived from the common law of trusts; a duty, noted earlier, to follow the provisions of the plan document, and restrictions on related party transactions, self-dealing and self-investment;

- reporting to Federal government authorities and disclosure to participating employees (to assist in monitoring plans to help prevent abuse of plan funds and mismanagement and to ensure that plan participants are accorded the rights and benefits to which they are entitled), and
- ERISA's civil enforcement and remedial provisions, including the authority to investigate plans and to initiate or participate in lawsuits against plan sponsors and plan fiduciaries.³

US fiduciary standards include a general nonquantified duty to diversify investments so as to minimize the risk of large losses. However, this diversification standard is subject to two exceedingly broad exceptions: it does not apply when participating employees direct their own investments (the common approach to investment of employee contributions in 401(k) plans) and it does not apply to plan investments in employer stock or employer real estate (which is also an exception to ERISA's restrictions on conflicts of interest). While defined benefit plans may invest only up to 10% of their assets in employer stock, defined contribution plans (including 401(k) plans) are subject to no limit. In fact, one form of defined contribution plan, the employee stock ownership plan, or "ESOP", is designed to invest primarily in employer stock and the plan sponsor receives special, generous tax advantages for doing so.

The Labor Department investigates fiduciary violations of ERISA and other noncompliance, such as

- "The failure of fiduciaries to operate the plan prudently and for the exclusive benefit of participants.
- The use of plan assets to benefit certain related parties in interest to the plan, including the plan administrator, the plan sponsor, and parties related to these individuals.
- The failure to properly value plan assets at their current fair market value, or to hold plan assets in trust.
- The failure to make benefit payments ... due under the terms of the plan.
- Taking any adverse action against an individual for exercising his or her rights under the plan (e.g., being fired, fined, or otherwise being discriminated against)."⁴

³ The Department of Labor's PWBA states that its mission is to "assist workers in getting the information they need to protect their benefit rights; assist plan officials to understand the requirements of the relevant statutes in order to meet their legal requirements; develop policies and laws that encourage the growth of employment-based benefits; and deter and correct violations of the relevant statutes." Department of Labor, Pension and Welfare Benefits Administration web site, mission statement (May 2002).

⁴ Quoted from Office of Enforcement, Pension and Welfare Benefits Administration, US Department of Labor web

The Department may require the production of information relating to the investigation. Upon finding a violation, Labor has authority, as do the courts, to impose civil monetary penalties for violations, to require plan fiduciaries that have breached their duties to restore any ill-gotten gains and to make employees whole for any losses attributable to the breach. Labor also has authority to find violations of the prohibited transaction rules (as noted), which trigger the assessment of excise taxes, and to grant class or individual exemptions from the prohibited transaction provisions.

In addition, the Labor Department investigates violations of criminal laws affecting pensions, but prosecutions are handled by the Department of Justice.

In the case of ERISA's participation, accrual, vesting, funding, and certain other standards that were enacted in both the labor title (Title I) of ERISA and the tax code, Labor generally has enforcement authority, while Treasury/IRS has interpretive authority. Labor's can exercise its enforcement authority over these provisions only if requested to do so by Treasury/IRS or by plan participants to the extent necessary to protect their claims to plan benefits.

As part of its authority over the fiduciary rules, Labor has issued regulations interpreting the statutory provision that limits the liability of the plan's normal fiduciaries where employees choose their own investments (as they commonly do in 401(k) plans). Participating employees, their death beneficiaries, and plan fiduciaries may bring civil lawsuits to recover plan benefits, enforce plan rights, and enjoin or redress certain violations of ERISA. As noted, they also may seek assistance from or file complaints with the Department of Labor regarding their pension rights and possible violations of law.

Reporting and Disclosure by Plans

Retirement plans are required by law to file an annual report with the government and to provide participants with a brief summary. Plan sponsors that fail to file timely are subject to monetary penalties. The report for qualified plans is processed mainly by the Labor Department, pursuant to coordination with the IRS and PBGC, and the resulting information is shared among the three agencies. The Labor Department and the IRS use the information to develop audit priorities and strategies, to select particular plans to investigate or audit, and for other purposes.

The annual report includes financial statements for the plan and associated trust, information about coverage of employees, investments, and other compliance issues, and, in the case of a defined benefit plan, an actuarial certification regarding the funded status of the plan. The report also involves some auditing of the plan. In recent years, there has been an effort to review and simplify the annual reporting form to collect only

information the agencies believe to be truly necessary to their missions, with a view to minimizing paperwork and related costs and burdens on employers.

A very cursory filing in lieu of an annual report is required to inform the Department of Labor of the existence of certain nonqualified retirement plans for executives. This requirement was disregarded by employers in many instances, in part because the scope and application of the requirement may not have been entirely clear, in part because there is a spectrum of nonqualified arrangements and it was not invariably evident to some employers which programs or arrangements were required to file.

Labor responded by instituting a “delinquent filer” program for both qualified and nonqualified plans. The program encourages voluntary compliance with the reporting requirements by providing reduced penalties to plan administrators that report voluntarily after previously having failed to report on time.

Plans’ obligations to disclose information to participants include a summary plan description designed to inform them of the key terms of the plan, a number of specialized notices, and an individual benefit statement if requested by the participant. As a matter of practice, most defined contribution plans give participants statements automatically on some regular basis. Many have moved to daily accounting and valuations, including participant access to daily account information and ability to make investment changes on a daily basis, typically through electronic methods such as an internet or intranet website, email, or telephone access. The Labor Department has regulatory authority over the summary plan description and over disclosure to employees in general, but Treasury/IRS has authority over certain notices required by the tax code, such as the notice describing the tax treatment and rollover possibilities associated with benefit distributions.

Other Department of Labor Programs

Along similar lines, Labor recently established a kind of counterpart to the longstanding IRS voluntary compliance and correction programs, a voluntary fiduciary correction program that encourages plan sponsors and plan officials to correct certain violations of ERISA’s fiduciary provisions by granting relief from applicable excise taxes and enforcement action.

This program, which applies largely to loans, sales, and other self-dealing and related-party transactions with plans, grew in part out of earlier administrative initiatives designed to address the failure of certain 401(k) plan sponsors to deposit employee payroll deduction contributions in the trust in a timely fashion. Where this problem arises, the perpetrator often has been a small business struggling to survive, that “borrows” employees’ payroll deduction amounts in order to make the employer’s withholding tax deposits or to pay creditors. Labor has specified methods of correction for late deposits (including repayment by the employer of earnings or “float” that the

diverted amounts should have earned for employees). In the past, this program has also made use of the amnesty approach, offering reduced penalties to employers that correct past violations.

Labor also has been involved in improving plan sponsors' and investment providers' disclosure to employees of the fees and charges 401(k) plans and participating employees pay in connection with their investments, and has worked with the private sector to develop certain standardized forms for disclosure.

Treasury and Labor Department Interpretive Functions

In addition to enforcement of the rules, considerable resources in the national headquarters of the Treasury/IRS and the Labor Department (including the PBGC) are devoted to the development of regulations and other administrative interpretations of the often complex legislative requirements. In addition to regulations and other interpretive administrative guidance that applies to all regulated entities, Treasury/IRS and Labor offer plan sponsors the opportunity to resolve uncertainties by obtaining individual rulings specific to their circumstances. Such agency rulings (IRS private letter rulings, Labor advisory opinions, information letters) purport not to have precedential value that would enable other parties to invoke them as protection in an audit or litigation. However, they are studied by the professional community of advisers and therefore serve informally as guidance regarding agency positions, albeit guidance that is not binding on the agency with respect to parties other than those that obtained the ruling.

In the interest of preventing the sort of widespread abuses and corruption that affected pensions in the US before ERISA, the law prohibits a very wide range of transactions between plans and related parties, including many that would not prejudice the plan or participating employees. The Labor Department has jurisdiction over ERISA's prohibited transaction provisions, and issues administrative class and individual exemptions for transactions involving related parties or conflicts of interest when it concludes that the terms of a transaction are appropriately protective of the interests of plans and employees.

Both the Treasury/IRS and the Labor Department also engage in less formal quasi-interpretive and educational activities. These include a variety of publications (notices and announcements, plain-language explanations, answers to frequently asked questions, press releases, and the like) aimed at businesses that sponsor plans, employees, taxpayers, and others, as well as public speeches and participation in panels and other forums for professional and occasionally nonprofessional audiences.

As a practical matter, such activities also play an indirect role in compliance. The government's continual publication of regulations, rulings, notices, announcements, and the like, its solicitation of public comment on proposed regulations, and the participation of regulatory personnel in professional conferences and meetings serve to maintain a dialogue with the community of pension sponsors and pension professionals regarding

changes in the rules and their interpretation, practical problems confronted by those seeking to comply with the law, and related matters. Attentive regulators receive feedback on ways to minimize the cost and intrusiveness and maximize the effectiveness of regulation, while pension professionals are provided with opportunities to communicate with clients regarding compliance issues and regarding changes in and interpretations of the law.

Divided Regulatory Responsibilities

The division of jurisdiction over pension regulation between Treasury and Labor reflects jurisdictional competition among the congressional committees that enacted ERISA. Separate committees have jurisdiction over taxes and labor laws, with corresponding responsibility to oversee the Treasury/IRS and the Labor Department, respectively. It is believed that neither the tax-writing nor the labor committees (and neither the Treasury nor the Labor Department) were prepared to cede jurisdiction over pensions in the interest of consolidating pension regulation in a single administrative agency. The regulatory jurisdiction of the two Departments over numerous statutory provisions that are identical or similar in the labor and tax titles of ERISA (Titles I and II) was further allocated between the Departments by a 1978 Reorganization Act.

Defined Benefit Plan Termination Insurance

Most participants in terminating qualified defined benefit pension plans receive benefit protection in the form of a plan termination benefit guarantee administered by a government agency called the Pension Benefit Guaranty Corporation (PBGC).

The PBGC pays vested pension benefits to participants monthly (amounting to more than \$900 million a year) up to specified dollar limits. This PBGC guarantee applies only if a defined benefit plan terminates without adequate funding to pay the benefits and the employer goes out of business or is otherwise financially unable to fund the benefits. In that event, the PBGC generally steps in and takes over trusteeship of the plan and its assets in order to pay the benefits.

The PBGC often pays the guaranteed benefits by purchasing annuities from an insurance carrier in order to cut off PBGC's ongoing responsibility to hold plan assets and administer benefit payments to participants. The process of taking over a plan and its records in order to make the correct payments to hundreds or thousands of employees, including those who were not previously receiving an annuity, can be challenging and labor intensive. The character and quality of pension and human resources data systems vary among corporations. Moreover, companies that are in the process of going out of business are particularly likely to have gaps in data and records and to experience departures of the key corporate pension administrative personnel who are thoroughly familiar with the plan records, data, rules, and procedures.

An employer that is financially capable of fully funding a plan's benefits when the plan

terminates is required to do so. In that case, the employer terminates the plan under the general supervision of the PBGC, making filings that disclose to the PBGC the termination arrangements. This typically involves the dissolution of the trust and the use of plan assets to purchase annuities from an insurance carrier to provide the promised benefits. In general, an employer that is solvent may not terminate the plan without funding it adequately.

The PBGC is funded by insurance premiums paid by employers that sponsor defined benefit pension plans, by funds received from plans it takes over, and by earnings on the investment of its assets. General tax revenues are not used to finance the PBGC.

PBGC insurance covers both plans sponsored by a single employer and plans sponsored by multiple employers in an industry where employees are represented by collective bargaining and where the plans are jointly trustee by representatives of corporate management and of the trade union (known as “multiemployer plans”).

In a sense, the PBGC operates as an insurance company for pension plans. However, it has a special public responsibility to protect the interests of plan participants. The agency often acts as an advocate for participants’ pension interests in negotiating with corporations that are in financial distress regarding pension plan funding and benefits in connection with corporate bankruptcy. The PBGC is directed by an executive director who reports to a board of directors consisting of the Secretaries of Labor (the chair), Treasury and Commerce.

Voluntary Personal Pensions -- Individual Retirement Arrangements (IRAs)

Individual retirement accounts and individual retirement annuities (IRAs) generally allow and in fact require individuals to exercise more control over their investments than 401(k) or other employer-sponsored plans. The tax code governs the tax treatment of IRAs and prescribes various rules with which they must comply. Accordingly, the Treasury/IRS has regulatory jurisdiction, including jurisdiction to interpret the law and to determine which types of financial institutions are qualified to act as trustee or custodian of an individual retirement account or as issuer of an individual retirement annuity contract.

Labor has jurisdiction over prohibited transactions involving IRAs. However, the financial institutions – such as banks, credit unions, insurance companies, brokerage firms, mutual funds – that offer IRAs to customers are also generally subject to extensive financial or securities law regulation at the federal or state level.

The financial institution sponsoring the IRA must report annually to the IRS and to the customer who owns the IRA the IRA account balance and any new contributions. The sponsor also is required to provide information about the IRA in a disclosure statement

to the customer, including an explanation of when and how the IRA can be revoked.

IRAs play a key role in facilitating portability within the US retirement system. An individual who changes employers or who leaves a job without entering into a new employment relationship can make a tax-free transfer or “rollover” of benefits from the former employer’s plan to an IRA for the benefit of the individual. Such rollovers generally also can be made from IRAs to employer-sponsored plans and from one IRA to another.

Types of IRAs include the traditional (tax-deductible) IRA, the Roth IRA (subject to different tax treatment), the SEP (simplified employee pension) and the SIMPLE plan. Both the SEP and the SIMPLE allow employers to contribute to IRAs established for employees.

Other Types of Retirement Plans

Retirement plans for millions of State and local government employees (including teachers, police and firefighters) are often provided for by State or local law. For the most part, these plans are exempt from regulation by the Department of Labor under ERISA, but many are qualified plans that are subject to a somewhat more liberal version of the plan qualification rules. State and local governments and tax-exempt organizations also sponsor other types of retirement savings plans and tax-sheltered annuities that are not qualified plans but that are subject to their own sets of tax rules and to a degree of regulation by the IRS.