

Revising ERISA for the Next 25 Years

by **James O. Wood, CEBS**

Two years ago, I felt honored when asked to serve as guest editor for this special edition commemorating the 25th anniversary of ERISA. On September 2, 1999, we observed the 25th anniversary of the signing of ERISA (September 2, 1974) by President Gerald Ford. This date is especially important to employee benefit practitioners, because we have so few other important dates to celebrate. This silver anniversary milestone is an appropriate occasion to evaluate the future effectiveness of this cornerstone of pension and health/welfare law.

The employee benefits environment has changed radically since ERISA's passage in 1974. What is becoming clear is that ERISA, even after extensive modifications, may be becoming outdated and is being rapidly outdistanced by social changes and business practices.

Entire careers spent with a single employer are becoming a practice of the past. Corporate management is now under extreme pressure to reduce overhead expenses (including employee benefit costs) and increase short-term profits. Corporate paternalism has long since expired, and employees now are commodities easily hired and terminated with each business cycle.

None of these situations was anticipated when ERISA was enacted in 1974. Due to these changing circumstances, there appears to be a growing consensus that the private pension system needs to be reexamined. Not unexpectedly, there does not appear

to be agreement as to how this reform should be accomplished. An obvious place to start is with ERISA itself. Although ERISA applies to private plans, many state and municipal public plans voluntarily elect to align themselves with ERISA's guidelines. Therefore, any revisions to ERISA should concern both private and public plan sponsors, trustees, fiduciaries and service providers.

To give our readers a broad-based perspective on the future of ERISA, I asked our distinguished authors to share their thoughts on potential revisions to make ERISA more applicable in our current and future employee benefit environment. Each potential revision is shown in bold type for the benefit of our readership.

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Given my focus on ERISA's fiduciary responsibility provisions, it is no surprise the sections I would amend fall in that category. Specifically, I would **amend operation of the prohibited transaction (PT) provisions of Section 406(a)(1)**—the party-in-interest rules.¹

The overall structure of these provisions prohibits certain types of transactions between a plan and defined "parties in interest." The prohibited transaction provisions of §406(a)(1) preclude a fiduciary from knowingly causing a plan to engage in a direct or indirect:

a. Sale or exchange, or leasing, of any property between the plan and a party in interest

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- b. Lending of money or other extension of credit between the plan and a party in interest
- c. Furnishing of goods, services or facilities between the plan and a party in interest
- d. Transfer to, or use by or for the benefit of, a party in interest of plan assets or
- e. Acquisition, on behalf of the plan, of any employer security or employer real property in violation of §407(a).²

As currently structured, the "PT" rules provide two types of exemptions—the first statutory, the second, administrative. Statutory exemptions are written into ERISA, particularly Section 408.³ For example, under Section 408(b)(2)⁴ an otherwise prohibited provision of services between a plan and a party in interest is exempted if it constitutes "contracting or making reasonable arrangements" "necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor." Similarly, under Section 408(b)(6)⁵ a bank or similar financial institution that is a fiduciary to a plan (and thus a party in interest) may provide "ancillary service" to the plan (in addition to the primary services giving rise to fiduciary status) if it has "adopted adequate internal safeguards which assure providing of such ancillary service is consistent with sound banking and financial practice," and

the extent to which such ancillary service is provided is subject to specific guidelines issued

by such bank or similar financial institution . . . and adherence to such guidelines would reasonably preclude . . . providing such ancillary service (i) in an excessive or unreasonable manner, and (ii) in a manner inconsistent with the best interests of participants and beneficiaries of employee benefit plans.

If a prohibited transaction is not statutorily exempted, it may nonetheless be permissible pursuant to an administrative exemption, under Section 408(a).⁶ An administrative exemption may be in the form of a class exemption issued by the U.S. Department of Labor or an individual exemption. A class exemption applies to a category of transactions and—if the parties involved satisfy conditions set forth in the class exemption—they may proceed with the transaction without further “blessing” from the Department. For example, the so-called QPAM class exemption⁷ permits a certain otherwise prohibited manager, which is independent of the parties in interest and meets specified financial standards, to proceed with the transaction. By contrast, an individual exemption

requires an individual application to the Department and, typically, an extended, costly, complex process.

Over the years, the Department has made various attempts to streamline the process for individual exemptions, including promulgation of an “expedited” exemption process and issuance of many class exemptions to bypass the individual process altogether. But class exemptions are carefully circumscribed, and obtaining an individual exemption is often still necessary. The process is uncommonly frustrating, protracted and costly. The process also may delay or preclude transactions of genuine benefit to plans. I would amend the statute to mitigate those problems.

A very common provision in individual exemptions is the Department’s requiring that the parties install an “independent fiduciary” to act on behalf of the plan. As with the QPAM class exemption, the basic concept is straightforward: If a qualified, impartial person, with fiduciary responsibility (and liability), advises or acts on behalf of the plan, the risk of an “insider” transaction harming the plan is sharply curtailed. Extending

this principle, the statutory exemptions under §408(b) could be expanded to exempt more types of prohibited transactions (without need for an individual exemption) if the parties install a qualified, independent fiduciary to approve the transaction and issue a supporting written report.

As an added safeguard, the statute might also require that parties file a notice with the Department, highlighting the transaction, and require the plan’s named fiduciaries to maintain the independent fiduciary’s report for a period of years. This would enable the Department to verify the reasonableness of any individual transaction, either because of its magnitude, parties or issues involved, or otherwise. Such random audits would help deter and detect abuse.

Endnotes

1. 29 U.S.C. §1106(a)(1).
2. 29 U.S.C. §1107(a).
3. 29 U.S.C. §1108.
4. 29 U.S.C. §1108(b)(2).
5. 29 U.S.C. §1108(b)(6).
6. 29 U.S.C. §1108(a).
7. PTE 84-14, 49 *Fed. Reg.* 9494 (March 13, 1984).

