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**EMPLOYEE RETIREMENT INCOME SECURITY ACT (ERISA):  
An Evaluation after 25 Years**

**An Educational White Paper**

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October 14, 1999

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**INTRODUCTION**

On September 2, 1974, President Gerald Ford signed the Employment Retirement Income Security Act (ERISA). Since that time, the retirement planning environment has seen tremendous change. These changes include a shift from defined benefit to defined contribution plans. This has placed the burden of making investment decisions on the individual investor. As we enter the Twenty-first century, one may conclude ours is a complex financial world with great consequences pending on our investment and other decisions. At the North American Securities Administrators Association's Annual Conference in September 1999, Leo Canseco, CFP®, stated, "historically, consumers have never had so many choices from which to choose and as a result of technology, such an overwhelming amount of information to absorb and comprehend."

The purpose of this Certified Financial Planner Board of Standards Inc. (CFP Board) white paper is to discuss ERISA and examine whether after twenty-five years since enactment, it still meets its intended purpose of providing "retirement income security." This study consists of two parts. Part One addresses the latest research analyzing the impact of employee education on individuals in participant-directed defined contribution plans governed by ERISA §404(c) of ERISA. Part Two examines ERISA reorganization issues.

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## **PART ONE**

### **EMPLOYEE EDUCATION AND ITS IMPACT ON ERISA**

In November 1998, a discussion began between Dr. E. Thomas Garman and Jinhee Kim, both with Virginia Institute of Technology's National Institute for Personal Finance Employee Education (NIPFEE) (Blacksburg, VA) and David Bixler of Capital Strategies, Inc. (Indianapolis, IN). The topic was the impact of employee education on individuals in participant-directed defined contribution plans.

By January 1999, they jointly outlined a research project known as the Wisconsin Study and identified a suitable 500-subject database. A pre-assessment questionnaire was prepared and distributed in February, education sessions were held in March, and a post-assessment was conducted in May 1999.

The preliminary findings showed the changes in behavior were both insignificant and almost immeasurable. This was consistent with the experience of the education presenter. In short, the attitudes of the participants were, "This was a fine education session, but it is the third time in five years we've seen this stuff, and we still don't know what to do!"

Consequently, a third phase of research was designed consisting of individual sessions lasting thirty minutes each. Participants were able to ask specific questions in private and receive direct advice about not only their 401(k) plan investment options but any other area of their personal finances as well. These individual sessions were held during July with a post-assessment conducted in August 1999.

The preliminary findings from the advice were dramatic, with positive changes in the manner in which the participants handled their 401(k) plan investment responsibility as well as their private investments.

#### **Research Findings Within the 401(k) Plan**

After the individual sessions, the study found of all participants:

- 58% have a better understanding of the relationship between risks and returns in investing
- 56% tried to calculate their retirement income needs
- 17% increased contributions to the plan, but not to the maximum
- 7% increased their plan contributions to the maximum
- 26% changed the way their plan accounts were invested
- 54% did not change their plan investments because they learned it was unnecessary

Notice the last two numbers: 80% of the advice session attendees now know that their money is invested the way they want. They found either a change was necessary and made it, or they learned that a change was not necessary. In addition, 68% had calculated their income needs during retirement using the American Savings Education Council's BALLPARK ESTIMATE worksheet. This statistic varies significantly from the findings set out in the Retirement Confidence Survey (RCS), cosponsored by the Employee Benefit Research Institute (EBRI), Mathew Greenwald and Associates, and the ASEC. (The RCS stated that only half (50%) had bothered to determine how much they would need at retirement.) In this case, the BALLPARK ESTIMATE worksheet was the primary, if not exclusive, means by which they calculated their future income needs.

## Research Findings Beyond the 401(k) Plan

After the individual sessions, the study found of all participants:

- 87% found the individual advice sessions to be beneficial
- 81% have a more adequate knowledge of personal finances
- 71% feel in more control of their personal finances
- 51% are more confident in making investment decisions
- 44% developed a plan for their financial futures
- 37% reduced some personal debts
- 37% increased savings outside the 401(k) plan
- 35% paid their credit card bills on time
- 33% developed a budget or spending plan
- 16% sought financial advice from another outside financial advisor

Not only did advice recipients increase their savings inside the 401(k) plan, 37% increased their savings outside the plan. By whatever measure used, the general financial wellness of the advice attendees was significantly improved.

## Participant's Self-ratings on Investment Knowledge

Reflecting on the attitudes of the participants, the study indicates even though enrollment meetings and education sessions had been conducted several times before the research sessions, participants commented that they still did not "know what to do!"

- 56% rated themselves as "beginners" or below the midpoint of the scale
- 15% rated themselves at the midpoint
- 29% rated themselves above the midpoint
- No one considered himself an "expert"

People who rated themselves below average were more likely to report the individual sessions increased their control and knowledge of personal finances, confidence in managing money, and understanding of the relationship between risks and returns in investing than people who marked above average.

## **IMPACT ON ERISA**

Bearing in mind that the education sessions these participants received over the years and during the first phase of the research project each were designed and conducted in accordance with the guidelines provided in Interpretive Bulletin 96-1 (29 CFR 2509.96-1), issued by the Department of Labor (IB 96-1) June 11, 1996. Practical experience indicates that plan sponsors cling to the safe harbors of ERISA §404c and IB 96-1 as their life jacket in the unfathomable tempest known as ERISA. Since 71% of the participants rated themselves as beginner to average and 80% sought advice or a second opinion on their 401(k) plan investments AFTER numerous education efforts from differing providers covering several years, this indicates IB 96-1 employee education efforts are not sufficient.

## **SUFFICIENT INFORMATION**

ERISA currently requires that a plan sponsor make certain "the participant or beneficiary is provided or has the opportunity to obtain sufficient information to make informed decisions with regard to investment alternatives available under the plan?" (29 CFR §2550.404c-1(b)(2)(i)(B)) Before there were participant-directed plans, investment decisions were made by investment committees. These committees consisted of corporate financial officers, portfolio managers, professional analysts, and investment management

consultants--all of whom typically had formal education and experience in finance and investments. It was not at all uncommon to find CFOs, CPAs, MBAs, CFAs, and others with similar backgrounds holding positions on the investment committee. With the advent of participant direction, everyone from the receptionist to the research chemist now is expected to be his or her own investment committee. Many of these (71%) are the people who have self-rated their investment knowledge as "Beginner" to "Average." This certainly is no reflection on their intelligence or education; for example, a superbly qualified architect still may know little or nothing about investing his or her money.

Practical delivery of IB 96-1 education gives participants little guidance beyond the "Start now," "Max out," "Diversify," and "Dollar Cost Averaging" education presentations now being delivered. Fact sheets and prospectuses are distributed but seldom read and rarely understood. Newsletters are circulated with repetitive, general themes and hypothetical examples of individuals and their portfolio allocations. But probably the most revealing clue also is the most common complaint voiced by participants: "The information is just "too general.""

Education and seminar providers are accustomed to being besieged during and after group presentations by participants wanting to ask specific questions. A quick glance at the plan sponsor paints a portrait of nervous concern and the provider begins doing the "Fiduciary Dance":

"Well, now, that's a good question, but, uh, I mean, I'm not allowed to actually answer that, you see, we are only allowed to provide education and to answer your question, well, that would be giving investment advice and, uh, I'm not allowed to do that."

There is not an education provider of any tenure who has not said something frighteningly close to that, just ask them.

It does not take the making of a great intuitive leap to understand that when a participant, who has received years of IB 96-1 communication and education, says, "This was a fine show, just like the others, but it's too general. Can you just tell me what to do?" it translates directly and completely into "I do not have sufficient information to make informed decisions with regard to investment alternatives available under the plan."

## **RECOMMENDATION**

Experience has shown plan sponsors are fearful of providing investment advice, preferring instead to stay well within the established safe harbors defined for communication and education. Research has now shown what was already widely believed, mainly that participants want, need, and greatly benefit from specific advice. Research also has shown that participants are willing to contribute to the cost of receiving that advice. It should be clear as well that there are three limitations on providing individual advice, namely: time; money; and qualified personnel.

What is needed at this point is a clear delineation of the boundaries of a new safe harbor, this time created to shelter the provision of specific investment and financial planning advice. Without a safe harbor, the plan sponsors will avoid providing any needed investment advice or counsel. The participants will not receive the direction they need. It will be necessary to include in these new regulations provisions for limiting fiduciary liability for the plan sponsor, establishing minimum qualifications for the providers of this advice, and providing tax deductibility for the expense of obtaining or providing investment education and advice.

A plan sponsor currently is able to reduce, if not eliminate, his liability for investment decisions involving plan assets by appointing a qualified investment manager under ERISA. A similar arrangement could be constructed to protect the plan sponsor when appointing a participant investment advisor. Established rules also contain restrictions on advisors who have an "affiliation" with the plan investment options; prudence dictates that these rules extend to the participant investment advisor.

Ideally, this participant investment advisor would be an arms-length, third party provider with no vested interest in the plan investment options and no conflicts of interest. In addition, the advisor must be a person or group of persons with sufficient education and experience in investment management and personal financial planning and counseling. Certainly, a Certified Financial Planner licensee or other qualified financial planning professional of a minimum tenure with experience in investment management would be a logical first choice and would satisfy the need for qualified personnel.

Finally, the time and money involved can be rolled together and simply stated in terms of money. Advice attendees showed a clear desire to have the sessions at work, during business hours or just after, and including their spouse or partner. Half of the respondents also said the sessions were "too short." To provide adequate time for these advice sessions the employer must be willing to give up employee productivity time, which, in the end, is money.

Currently, the federal tax laws do not allow an employer a deduction for offering individual investment advice and financial planning for employees. To make advice a reality, it must be affordable. Individual counseling is labor and time-intensive, making it relatively expensive. For advice to be affordable it must be tax-deductible and the methods of funding the costs of the advice must permit employees to pay for financial planning services on a pre-tax salary reduction basis (if the expenses are not directly paid by the employer).

Others have made the case for a coming crisis in retirement unless individuals provide for themselves. The research project has shown how dramatically individuals will act to provide for themselves once given the specific advice that they need to act. Employers and plan sponsors need an incentive to be willing to provide advice to employees and participants. No other incentive is as strong as tax deductibility.

## **PART TWO**

### **ERISA REORGANIZATION ISSUES**

Change in ERISA's purpose: When President Ford signed ERISA the legislation was intended to provide benefit security, including "retirement income security" to three groups of individuals:

- employees covered by or otherwise actively participating in an employer-sponsored plan;
- retirees receiving or otherwise entitled to receive benefits under an employer-sponsored pension, retirement, or other employee benefit plan; and
- former employees who were not yet eligible for retirement benefits but were entitled to future retirement benefits.

Under pre-ERISA law, the third group of protected individuals was an almost nonexistent group. Employees generally did not become entitled to retirement benefits unless they were credited with a

lengthy period of service and retired from that employer. In many ways, ERISA actually created this third group of individuals; it also implemented protections for all three groups by establishing minimum vesting, minimum service, minimum funding, and similar rules. Today, these rules are well established and the abuses to which ERISA was directed no longer exist. The likelihood of employees losing expected benefits because of the lack of vesting provisions, the lack of sufficient funding of pension benefit plans, or the termination of plans no longer is a significant concern. The Pension Benefit Guaranty Corporation (PBGC) is healthy; the pension funding protections enacted in 1994 implemented additional protections for participants against losing benefits because of insufficient funding; and the qualified plan rules effectively prevent employers from forfeiting employees' benefits except within narrow guidelines. Consequently, amendments to ERISA--particularly in recent years have modified ERISA to be more aptly called an Employee Benefit Protection Act rather than the Employee Retirement Income Security Act.

**See the following excerpt from ERISA §2(a):**

The Congress finds that the growth in size, scope, and numbers of employee benefit plans in recent years has been rapid and substantial; that the operational scope and economic impact of such plans is increasingly interstate; that the continued well-being and security of millions of employees and their dependents are directly affected by these plans; that they are affected with a national public interest; that they have become an important factor affecting the stability of employment and the successful development of industrial relations; that they have become an important factor in commerce because of the interstate character of their activities, and of the activities of their participants, and the employers, employee organizations, and other entities by which they are established or maintained; that a large volume of the activities of such plans is carried on by means of the mails and instrumentalities of interstate commerce; that owing to the lack of employee information and adequate safeguards concerning their operation, it is desirable in the interests of employees and their beneficiaries, and to provide for the general welfare and the free flow of commerce, that disclosure be made and safeguards be provided with respect to the establishment, operation, and administration of such plans; that they substantially affect the revenues of the United States because they are afforded preferential Federal tax treatment; that despite the enormous growth in such plans many employees with long years of employment are losing anticipated retirement benefits owing to the lack of vesting provisions in such plans; that owing to the inadequacy of current minimum standards, the soundness and stability of plans with respect to adequate funds to pay promised benefits may be endangered; that owing to the termination of plans before requisite funds have been accumulated, employees and their beneficiaries have been deprived of anticipated benefits; and that it is therefore desirable in the interests of employees and their beneficiaries, for the protection of the revenue of the United States, and to provide for the free flow of commerce, that minimum standards be provided assuring the equitable character of such plans and their financial soundness.

**TODAYS BENEFIT ISSUES**

These changes are well and good, but perhaps new, alternative legislation is needed to focus on the benefit issues of today:

- access to health care coverage;
- portability of health, retirement, and other coverage (although ERISA §4009 requires that the PBGC "provide advice and assistance to individuals with respect to evaluating the economic desirability of establishing individual retirement accounts or other forms of individual retirement savings for which a deduction is allowable under section 219 of the Internal Revenue Code of 1986 [26 USC

§219] and with respect to evaluating the desirability, in particular cases, of transferring amounts representing an employee's interest in a qualified plan to such an account upon the employee's separation from service with an employer.");

- and retirement and financial planning education.

According to ERISA's initial purpose and its subsequent legislative history, ERISA is not intended to serve the primary benefits issues of today. Congress needs to draft and pass alternative legislation that allocates responsibility for addressing these issues to one or more existing or new agencies.

### **Portability**

ERISA §4009 requires the PBGC to provide advice and assistance on establishing IRAs and similar forms of individual retirement savings vehicles. It also is required to evaluate the desirability of transferring amounts from employer plans to individual savings vehicles on separation from service. This statutory directive is not an appropriate objective of the PBGC. According to ERISA §4002, the purposes of ERISA title IV, "which are to be carried out by the [PBGC] are:

- to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants,
- to provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans to which this title applies [most qualified defined benefit pension plans], and
- to maintain premiums established by the corporation under section 4006 [29 USC §1306] at the lowest level consistent with carrying out its obligations under this title."

Amendments to ERISA are needed to correct this discrepancy, either by deleting the section or amending the section to provide for objectives consistent with the operation and purposes of ERISA and the PBGC.

## **SAVER ACT**

### **Preparation for 2001 National Summit on Retirement Savings**

The Department of Labor should begin efforts to plan for the 2001 summit (as required by ERISA §517) and assure the attainment of the objectives of the 1998 summit. With the gradual shift in responsibility for retirement planning and savings to employees from employers since 1974, additional efforts to educate the public and provide them with the appropriate resources are needed.

See the following excerpts from ERISA §517:

#### **(a) Authority to call Summit.**

Not later than July 15, 1998, the President shall convene a National Summit on Retirement Income Savings at the White House, to be co-hosted by the President and the Speaker and the Minority Leader of the House of Representatives and the Majority Leader and Minority Leader of the Senate. Such a National Summit shall be convened thereafter in 2001 and 2005 on or after September 1 of each year involved. Such a National Summit shall-

- (1) advance the public's knowledge and understanding of retirement savings and its critical importance to the future well-being of American workers and their families;
- (2) facilitate the development of a broad-based, public education program to encourage and enhance individual commitment to a personal retirement savings strategy;
- (3) develop recommendations for additional research, reforms, and actions in the field of private pensions and individual retirement savings; and
- (4) disseminate the report of, and information obtained by, the National Summit and exhibit materials and works of the National Summit.

(b) Purpose of National Summit

The purpose of the National Summit shall be-

- (1) to increase the public awareness of the value of personal savings for retirement;
- (2) to advance the public's knowledge and understanding of retirement savings and its critical importance to the future well-being of American workers and their families;
- (3) to facilitate the development of a broad-based, public education program to encourage and enhance individual commitment to a personal retirement savings strategy;
- (4) to identify the problems workers have in setting aside adequate savings for retirement;
- (5) to identify the barriers which employers, especially small employers, face in assisting their workers in accumulating retirement savings;
- (6) to examine the impact and effectiveness of individual employers to promote personal savings for retirement among their workers and to promote participation in company savings options;
- (7) to examine the impact and effectiveness of government programs at the Federal, State, and local levels to educate the public about, and to encourage, retirement income savings;
- (8) to develop such specific and comprehensive recommendations for the legislative and executive branches of the Government and for private sector action as may be appropriate for promoting private pensions and individual retirement savings; and to develop recommendations for the coordination of Federal, State, and local retirement income savings initiatives among the Federal, State, and local levels of government and for the coordination of such initiatives".

## **OTHER RECOMMENDATIONS**

### **ERISA Title III, Subtitle A--Jurisdiction, Administration, and Enforcement**

Title III, Subtitle A, provides for the allocation of jurisdiction, administration, and enforcement of ERISA. This includes the requirement that IRS notify DOL of any decision to disqualify an otherwise qualified pension or retirement plan (ERISA §3002). It also provides a mechanism by which DOL and PBGC may comment on an application for a determination on a pension or annuity plan's compliance with the qualification requirements (ERISA §3001). Because the IRS does not consider compliance with ERISA's nontax provisions in issuing a letter and an applicant cannot rely on the determination for purposes of the plan's compliance with ERISA's provisions not also found in the IRC, the purpose of this requirement is unclear. For that reason, Congress should request a report on the actual implementation of these requirements, whether they have served a useful purpose, and why they should remain in ERISA. The results of this analysis also may serve to highlight problems of which only IRS and DOL are aware or indicate where any modifications to these requirements are needed.

**Minimum Funding Rules**

The minimum funding rules are another area of concern. All three agencies--IRS, DOL, and PBGC-- have a vested interest in the proper administration of the minimum funding rules. Guidance and clarification of the overlapping and separate jurisdictions over these rules are needed. The minimum funding provisions in the IRC and ERISA differ significantly in language and structure. Therefore, a reorganization of the rules to provide mirror language and enhance the provisions' readability and understanding is needed.

**COBRA Rules**

A similar reorganization of the overlapping COBRA rules is needed as well. This reorganization also should focus on clarifying jurisdictional issues and the implementation of penalties.

**Vesting and Accrual Rules**

The minimum vesting rules and the service crediting rules for purposes of vesting and benefit accruals also create confusion under ERISA, the IRC, and the related regulations. Although the rules are essentially the same under both statutes, IRS and DOL have divided jurisdiction over the rules. Consequently, practitioners, administrators, and sponsors must study both sets of regulations to assure that they are satisfying the applicable rules. The regulations are confusing and intersect in a way that is beyond simple explanation. This confusion adversely affects compliance and the objective of pension simplification.

**Clarification of Duties and Responsibilities of Agencies Under ERISA**

Most people do not understand that, although the Internal Revenue Code and ERISA overlap in many ways, the two statutes and the relevant agencies have entirely different objectives. The Internal Revenue Service and the IRC are concerned about discrimination and the tax consequences of certain benefit arrangements--providing tax advantages to employees and their employers in exchange for complying with certain nondiscrimination rules. The Department of Labor and ERISA are concerned about fiduciary duty, reporting, disclosure, and benefit protection.

In addition to the myriad of overlapping rules and responsibilities is the interaction of ERISA with a variety of other statutes: the Family and Medical Leave Act, the Age Discrimination in Employment Act, the Americans with Disabilities Act, etc. This results in different arms of the DOL, as well as totally different agencies, handling overlapping and sometimes conflicting responsibilities. Clarification of these duties and cooperation by the agencies is needed. This is particularly needed where portions of ERISA's enforcement are under the jurisdiction of IRS or another agency. (The ERISA Reorganization Plan allocated responsibility for administering certain portions of ERISA to the IRS. (43 Fed. Reg. 47713, 8/10/1978).) For example, consider the length of time after the enactment of ERISA §204(h) (on notices about the significant reduction to benefit accruals) before IRS issued guidance on the requirement. (The section was added April 7, 1996, as part of COBRA. The IRS issued temporary regulations interpreting the 204(h) notice requirement on December 12, 1995, and final regulations on December 14, 1998.) In the interim, employers and practitioners were interpreting the requirement in a wide variety of manners--many of them incorrectly.

## **CONCLUSION**

Part One of this white paper study indicates something alarming--the financial education guidelines set forth in IB-96 are not enough. New safe harbor rules need to be implemented to shelter those who are providing specific investment and financial planning advice. It may be necessary to include in these new regulations, provisions for limiting fiduciary liability for the plan sponsor, minimum qualifications for those providing advice, and tax deductibility for financial planning services.

Part Two demonstrates a close examination of reorganization issues involving ERISA is needed as well. Today's work place benefit issues are not adequately addressed by ERISA. Other areas of importance that need to be examined are minimum funding rules, COBRA rules, and vesting and accrual rules.