XI. SUPERVISION OF PRIVATE PENSION PLANS IN THE UNITED STATES

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Introduction

The United States system of pension supervision is best understood in the context of the role of private pensions in providing retirement income for retirees and the historical development of the employment based system in the United States.

The United States' system of government is federal, with much of the governmental services provided by the fifty state governments and the innumerable local governments, all of whom have local taxing authority. Many government functions which are the responsibility of centralized governments in other countries, such as education and criminal law, are primarily the responsibility of the various state governments. Also, the dominant ethos of the country's citizens is one of individualism, something which was noted by DeToqueville in the 1830's.

Given this background, it is not surprising that until the Great Depression of the 1930's there was no provision for pensions provided by the national government. In the 1930's a national pension program (called "Social Security") was created for workers, financed by a payroll tax on wages. The concept of providing retirement security for the elderly envisages a "three legged stool" of income support – Social Security to provide for subsistence income to keep the elderly out of poverty, with private pensions and personal savings providing the additional income to enable a comfortable retirement.

Reflecting the individualistic nature of American society, there are no mandates that private employers provide pensions or that individuals save for retirement. Indeed, until World War II, there were relatively few private pension plans. During World War II, the United States government severely limited wage increases so as to prevent inflation, but allowed unions to bargain with employers to provide pension plans and health plans. Given the scarcity of labor, employers whose workers were represented by unions adopted pension plans and many non-union companies did the same, for competitive reasons. The government encourages employers to create pension plans by giving favorable tax treatment to the employers who establish the plans and to the plans themselves.

Reflecting the size and diversity of the country and the voluntary nature of the private pension system, there are a variety of private pension plan arrangements. Those established by a single employer are known as single employer plans, while plans which cover workers at a number of businesses in a common industry, pursuant to a collective bargaining agreement with a union representing workers in the industry, are known as multiemployer plans. Of the approximately 6 million private firms in the United States, about 1.8 million provide some pension coverage to their employees. A large proportion of these are small and medium size employers, many of whom provide pension coverage through slightly more than 3,100 multiemployer plans, which provide about 15% of private sector workers with pension coverage. Single employer plans are the most common type of pension plan, accounting for the remainder of the 730,000 private pension plans.

There are a wide variety of private pension plans, which are crafted to meet the particular needs of the employer adopting the plan, taking into account the nature and needs of its workforce. However, while there is great variety in the particulars of each individual pension plan, private pension plans fall into two different general categories — defined benefit (DB) plans, in which a benefit is computed from a formula specified in the plan and is typically paid as a lifetime annuity payable on retirement, and defined contribution (DC) plans, in which an individual account is created for each participant and the benefit at retirement is a lump sum resulting from the value of the assets contributed to the account plus any investment gains less any investment loss and any administrative expenses charged to the account. There are two essential differences between DB and DC plans. In a DB plan, investment and mortality risk is underwritten by the employer sponsoring the plan, who is responsible for any funding shortfall and for payment of the annuity as long as the retiree lives. If the employer goes bankrupt and there aren't sufficient assets in the plan to pay benefits, a government agency, the Pension Benefit Guaranty Corporation (PBGC), assumes control of the plan and will pay annual pension benefits up to a maximum amount, which was USD 43 997.24 per year in 2003 for workers who retire at age 65. This amount suffices to cover the entire annual pension annuity for the average worker. In contrast, in a DC plan, the individual worker bears the investment risk of his account and risks outliving his accumulated funds.

When the national law governing private pension plans (the Employee Retirement Income Security Act, known as ERISA) was passed in 1974, the bulk of the pension covered workforce was in DB plans. In 1975, 87% of the pension covered workforce was in DB plans, compared to only 50% in 1996. The major reason for the shift was the desire of employers to reduce and make more certain their pension costs and the fact that workers found DC plans easier to understand and valued them more. Currently, there are about 60 000 DB plans and 670 000 DC plans, with combined assets of USD 4.4 trillion in 1998, compared to USD 260 billion in 1975. Pension plans play a major role in capital markets, holding about 20% of all outstanding equities and 17% of all corporate bonds.

ERISA was passed in 1974 as a result of rising complaints of workers that the private pension plans that covered them often had unreasonable requirements for their right to a pension to become nonforfeitable (vesting rights), that the plans were not required to be funded in a separate entity, so that if the employer went bankrupt, employees would receive no pension, and that the plans often required a lengthy period of employment before an employee was eligible to participate in the plan, while containing provisions stating that a relatively short break in service (for instance, a period of unemployment) would wipe out all service credited prior to the break in service. These factors combined to make the pension promise illusory for a large portion of workers covered under private pension plans. ERISA provided for minimum standards for vesting, funding, participation and breaks in service to protect workers, and gave the Department of the Treasury the primary responsibility for enforcing those rules. Prior to the passage of ERISA, with the exception of some weak reporting requirements that were within the purview of the Department of Labor, jurisdiction over pension plans was totally within the purview of the Department of the Treasury, within the Internal Revenue Service (IRS), through the tax qualification process.

At the same time, there was evidence that many employers did not clearly reveal to their workers the many conditions they had to meet to receive a pension, thus deceiving them as to their eligibility for a pension. There was also evidence of cases in which pension plan fiduciaries mismanaged pension plans, making imprudent investments or engaging in self-dealing. To rectify these problems, ERISA contained provisions governing fiduciary conduct and contained provisions for reporting of certain information to the government and disclosure of information to plan participants, along with provisions for enforcement of the fiduciary responsibility and reporting and disclosure requirements by the government (primarily by the Department of Labor) and by plan participants. A major concern of employers was also addressed. In reaction to worker complaints, several states had passed laws regulating private pension plans, and more were considering enacting such laws. Because many plans covered participants in more than one state and some covered participants in every state, it would be quite expensive to comply with different and sometimes conflicting laws. The drafters of ERISA provided a broad provision stating that ERISA preempted all state laws with certain relatively minor exceptions.

Because of the division of responsibility for the administration of ERISA between the Department of Labor and the IRS, and the provision of insurance of DB plans by the PBGC, this paper will separately discuss structures of the IRS and the PBGC and the Department of Labor. It should be noted that there is regular coordination between the Department of Labor and the IRS and coordination between the agencies and the PBGC as the need arises.

Department of labour supervisory, compliance and enforcement structure

The unit within the Department of Labor charged with administering ERISA is the Employee Benefits Security Administration (EBSA). Another unit within the Department of Labor, the Plan Benefits Security Division of the Office of the Solicitor, provides legal advice to EBSA and brings lawsuits, along with regional offices of the Office of the Solicitor, based on EBSA's investigations.

The fiduciary responsibility, reporting and disclosure and enforcement provisions of ERISA were adopted against the backdrop of the voluntary nature of our private pension system, the large number of plans, their diversity in terms of size and type of plan, and the limited resources of the government to police such a large number of plans (730 000 private pension plans in 1998, as well as 6 000 000 health and welfare plans covered by ERISA.)

Recognizing the voluntary nature of private pension plans and their great diversity, ERISA's fiduciary responsibility provisions, in establishing requirements for the administration of pension funds and the investment and disposition of fund assets, sets forth general principles and generally focuses on process rather than on specifying particular directives for fiduciaries to follow. For example, unlike the pension laws in many countries, there are no maximum or minimum percentage requirements for investment of assets and no prohibition of any category of investments.

ERISA requires plan assets to be held in trust (unless it is held by an insurance company) so as to assure that plan assets are safe in the event of an employer's bankruptcy. The trustees are responsible for the administration of the plan and the investment of its assets, unless such responsibility is allocated or delegated to others. Whoever has responsibility for the management of the plan or for exercising discretion in the investment or disposition of its assets or who provides investment advice for a fee is considered a fiduciary of the plan under ERISA and is subject to ERISA’s fiduciary responsibility requirements. These requirements, in brief, are that the administration of the plan and the investment of its assets be done in a prudent manner. This requires that the fiduciaries have expertise appropriate for the matters for which they are responsible, and exercise skill and diligence in undertaking their actions. The fiduciaries’ actions must be for the exclusive benefit of the plan’s participants and defraying the reasonable expenses of the plan. This duty of loyalty prevents fiduciaries from making investments whose primary purpose is to further an interest external to the plan, such as regional development or even enhancing the job security of the plan sponsor’s employees. Pension plan investments are required to be diversified to minimize the risk of large losses. DC plans, if they so provide, can override this provision. If they do so, they are still subject to the underlying requirement that their investments be prudent.

ERISA also contains provisions which prohibit certain transactions that have a high potential for conflicts of interest and self-dealing. These are generally transactions between the plan and its fiduciaries, plan sponsors, employees of the employer, service providers to plans, their relatives, and unions representing the employees, and certain related entities. Because these prohibitions cover many potentially advantageous transactions for plans, ERISA provides statutory exemptions for certain categories of transactions and has a process for securing administrative exemptions from the Department of Labor.

The reporting and disclosure provisions are meant to enable plan participants to know the details of their pension plan and to enforce their rights and for plan participants and the government to detect fiduciary violations. Plans are required to furnish their participants summary plan descriptions shortly after they become participants in the plan and updates whenever there is a material modification to the plan, along with a summary annual report, which provides an abbreviated description of the plan’s financial status. Plans are required to file an annual report with the government, which contains extensive financial information, and to make that report available to participants on request. If the plan has 100 or more participants, the plan must obtain a financial audit by an independent auditor and submit the opinion of the auditor on the completeness and accuracy of the financial statement contained in the annual report. If the plan is a DB plan, an actuary has to certify as to the reasonableness of the actuarial assumptions used in funding the plan. The reporting and disclosure provisions provide regulators and participants with essential information to assess compliance with the law and also serve as a substantial deterrent to irresponsible or illegal behavior. Willfully violating the reporting and disclosure provisions of ERISA is a criminal offense.

ERISA provides for enforcement of its fiduciary provisions both by plan participants and the Department of Labor. Given that there are 730 000 pension plans and 6 000 000 health and welfare plans, and 900 employees in EBSA, a major emphasis of EBSA is on securing voluntary compliance with ERISA. This is done in the first instance by issuing regulations, advisory opinions and field assistance bulletins to clarify areas of the law which are ambiguous or which apply settled areas of the law to new financial products which were not contemplated when ERISA was passed. EBSA also has a vigorous outreach program to plan sponsors and plan participants, publishing many booklets and maintaining a website explaining aspects of ERISA, as well as participating in many conferences. When violations are found during the course of an investigation, the first course of action is to secure voluntary compliance, which is generally successful.

ERISA provides a strong incentive for persons in violation of the law to voluntarily comply with the law when the government finds a violation, by providing for a 20% civil penalty measured by the amount of loss to the plan payable to the government if a court finds a fiduciary breach. This is over and above the requirement that the fiduciary restore the plan's losses. There are general criminal law penalties for fraud or embezzlement, and provisions in ERISA requiring bonds in certain maximum amounts to protect plans from losses due to criminal activity. In addition, though not required by ERISA, many plan fiduciaries secure insurance to cover losses resulting from fiduciary misconduct.

Private pension plan participants play a key role in policing possible fiduciary misconduct in making pension plan investments, particularly in DC plans, where any plan losses show up in their investment accounts. Where a fiduciary breach does not cause a loss to the plan, but rather a loss to a particular plan participant, usually an improper denial of a benefit, ERISA only provides for a lawsuit to secure the denied benefit. ERISA does not provide for consequential or punitive damages in any cases. Because claims for improper denial of benefits typically are for relatively small amounts and the award of attorney's fees are discretionary to the court, it is difficult for participants to find attorneys to pursue these cases. As a result, EBSA has allocated 105 of its 900 positions to the Office of Participant Assistance and to employee benefits advisors in its field offices to help participants voluntarily resolve their claims against their plans. EBSA benefits advisors handled 82 792 inquiries from plan participants in the first half of fiscal year 2003, of which 26 147 related to pension plan issues. This activity brought USD 33.58 million in benefits to pension participants in the first six months of fiscal year 2003. During the first half of fiscal year 2003, EBSA also participated in 1004 outreach efforts.

Organization of Department of Labor Compliance Components

EBSA is headed by the Assistant Secretary of Labor for Employee Benefits Security who is appointed by, and serves at the discretion of, the President. This agency head is therefore a political appointee who provides overall policy leadership for the agency and generally serves only for the administration of a single President. The day to day operations of the agency are the responsibility of a senior civil servant, the Deputy Assistant Secretary (DAS) for Program Operations, who provides advice to the agency head on policy matters and is responsible for managing the operations of the agency.

Within EBSA, there are four components which carry out the pension compliance program:

- The Office of Enforcement (OE) (15 employees) located in the National Office (headquarters) which sets policy, priorities and procedures, provides support (such as training), and conducts evaluation for enforcement activities.
- The Office of Participant Assistance (OPA) (40 employees) located in the National Office which sets policy, priorities and procedures, provides support (such as training), and conducts evaluation for participant assistance activities.
- The Office of Chief Accountant (39 employees) located in the National Office charged with enforcing ERISA's reporting and disclosure requirements. In a typical year it rejects approximately 2500 annual report filings for material deficiencies and requires the filings to be corrected.
- Ten regional offices with assigned geographic jurisdictions that divide up the United States, which carry out the enforcement and participant assistance activities.

OE, OPA, OCA and each of the ten regional offices report directly to the DAS for Program Operations, which means that OE and OPA are staff offices without direct line authority over the field offices. The direction from OE and OPA to regional offices ensures that the regional offices carry out overall agency priorities and apply uniform policies and procedures, and that there is a sufficient centralized review to assure quality control across the regions. Within this overall direction, regional offices have considerable latitude to carry out their activities in a manner that best suits the universe of plans and the types of problems encountered in their geographic jurisdiction. Thus, the field offices exercise broad discretion in determining the focus and nature of their supervisory and compliance activities to suit the requirements of their specific area of jurisdiction, but function within the overall national policy framework and guidance.

Strategic planning, operational planning, and evaluation

EBSA's compliance program is primarily carried out through civil examinations (which are called investigations), which seek to identify and correct violations. The agency also conducts criminal examinations where theft or fraud is suspected. About 85% of the agency's resources are directed toward civil issues and 15% toward criminal. In addition, EBSA carries out a public information program to advise participants of their rights and to advise employers, service providers and plan officials of their obligations. In summary, EBSA's current strategy for enforcing ERISA's pension plan provisions is a multi-faceted approach of investigations supplemented with a strategically focused outreach/public education effort. Outreach efforts use the internet, brochures on specific topics and appearances at events. They are aimed both at plan participants and plan sponsors, as well as a new voluntary correction program that is carried out by the field offices.

To direct these activities, EBSA sets out an overall strategic plan, develops annual operational plans at the National and regional levels, and establishes evaluation criteria.

Strategic planning

The size and diversity of the pension plan universe coupled with scarce enforcement resources dictate EBSA's compliance strategy. The agency has limited resources, about 400 investigators, to supervise a vast plan universe, which consists of 730 000 pension plans with about USD 4.4 trillion in assets, and about 6 million health and other employer-based benefit plans. As a result, EBSA must carefully decide how it will use its scarce resources to gain the greatest levels of compliance.

For the first ten years of its existence, EBSA did not formally set out an overall compliance strategy. Regional offices had almost unfettered latitude to determine their priorities and direct their enforcement efforts to the areas within their geographic jurisdiction where they perceived the greatest needs. However, EBSA was criticized for trying to do a little bit of everything and for not having an organized and coherent enforcement strategy that set overall priorities and direction.

In response, in 1986 EBSA issued its first strategic plan for compliance activities. This plan identified two "significant issues" and required that regional offices spend 50% of their resources on activities related to these issues. For pension plans, the "significant issue" concerned abuses by financial institutions which provide services to these plans.

EBSA's current strategic plan for enforcement activities is set out in a document, issued in 2000, and entitled the "ERISA Strategic Enforcement Plan (StEP)," which describes the current goals, priorities and methods. The primary purpose of the StEP is to establish a general framework through which enforcement resources may be efficiently and effectively focused to achieve the agency's policy and operational objectives. To most effectively use scarce resources to safeguard the interests of plan participants and beneficiaries, the StEP establishes the following broad policy priorities.

- *Effective targeting.* The term "targeting" refers to the process whereby specific individuals or entities are identified for examination because of some indication that an ERISA violation may have or may be about to occur. The goal in targeting is to identify factors that can be used to identify specific plans, individuals, and other entities that are violating the pension law, so that examinations will be most likely to find and correct violations. Thus, EBSA does not conduct random audits, but instead seeks to effectively target investigations to where they will have the greatest positive impact in safeguarding pension plan assets and benefits.
- *Protecting at-risk populations.* At-risk populations are those plan participants and beneficiaries whose retirement security is in the greatest danger of being harmed as a result of ERISA violations. An example of this group would be participants in defined contribution plans, such as 401(k) plans (these are plans funded by employee contributions, often matched in whole or part by their employer, where participants direct their investments among several options provided by the employer). By contrast, the risk to participant's retirement security from fiduciary misconduct in defined benefit plans is substantially lower, as the employer is responsible for making up plan losses to fund promised benefits, and if the employer fails to do so, benefits are guaranteed up to a certain level by a governmental corporation, the PBGC.
- *Deterring violations.* EBSA seeks to deter illegal conduct through the continuing effectiveness and impact of its examination efforts, and by publicizing violations and corrections. While EBSA seeks to recover losses, it also seeks to maintain the financial and operational integrity of the private pension system, by conducting examinations that address potentially abusive practices, where losses may not have yet occurred. Examinations of firms providing services to plans, such as administration, accounting or legal firms offer the opportunity to address abusive practices that affect many plans.

Operational planning

National Plans. For each fiscal year (FY), EBSA's National Office issues guidance on the specific compliance priorities for that year (which reflect the overall policy priorities set out in the StEP), and on the level of activity to be carried out. The specific compliance priorities are called National Projects, and are intended to ensure that enforcement activities focus on the areas which are most critical to the well being of pension plans. For FY 2003, the National Projects include plans with employee contributions (mainly 401(k) plans) to ensure that employee contributions are forwarded to the plans; plans that are abandoned by the individuals responsible for them to assure that plan assets are properly distributed to plan participants; and plans whose sponsors have filed for bankruptcy, to assure that the plan's interests are protected in the bankruptcy proceedings.

Regional Plans. Based on the National Office Guidance, each of the ten regional offices submit plans for approval by the National Office, which set out the regional office's participation in National Projects, their conduct of Regional Projects and the number of examinations and public information activities to be carried out in the fiscal year. Regional Projects are compliance initiatives developed by a regional office to address areas that are unique or particularly problematic in their geographic jurisdiction. Each region has a lot of flexibility in selecting projects. This is because different regions have different characteristics. For example, the New York region has many large plans, multiemployer plans, and large service providers to plans, while the Kansas City region has many small plans. Because of the diversity between regions, each region has the unique opportunity to observe industry practices within the region first hand and select issues for development as regional projects, which may ultimately be appropriate for adoption as national projects. Because some national projects may originate as an expansion of a successful regional project or arise in connection with field office investigations, communication between the national office and field offices is key to a successful enforcement program.

Evaluation

As required for all Federal agencies, EBSA has selected measurable goals against which performance can be evaluated. These goals highlight the most important activities of the enforcement program and challenge the agency to improve its efficiency and effectiveness. For FY 2002, the goals include increasing by 5% per year (to 1993 in FY 2002) the number of examinations with violations corrected and to increase by 1% per year (to 35% in FY 2002) the ratio of examinations with violations corrected to all the examinations conducted. From these National goals, detailed goals are set for each regional office, whose performance is measured by the number of civil and criminal examinations conducted and the results from these examinations, including the number with violations corrected, the amount of funds secured and the number of criminal convictions. These evaluation criteria reflect the policy priorities described earlier: effective targeting, protecting at-risk populations and deterring violations.

Conduct of Department of Labor investigations

Targeting cases

Targeting is an effective method for case selection in the ten regional offices. A good source of targeting is the information received from participant complaints. Our participant assistance activities provide field offices with many sources for opening investigations, including participant complaints and congressional inquiries stemming from complaints from constituents. The best source for cases has come from customer service leads. In order to increase the number of leads received by EBSA's employee benefits advisors, EBSA continues to work on informing the general public of their rights with regards to their pension and welfare employee benefit plans. Since this targeting method is key to our enforcement program, we continue to expand our outreach programs in order to advise the general public of our existence and mandate.

Another fertile targeting method involves opening cases based on a review of the Annual Report Form 5500 filed by employee benefit plans subject to ERISA. These forms are filed by the plan administrators or plan sponsors and include basic plan information, plan type, sponsor's name, benefits provided, funding arrangements, covered participants, asset information, service provider information, and accountant's opinion when required. This form is extremely useful for targeting purposes due to the amount of financial information being provided about the employee benefit plan.

In addition to the above-mentioned methods, regional offices target cases through the following arenas: the news media, trade journals, bankruptcy court records, real estate records, and information received from other regulatory agencies such as the IRS, federal banking regulatory agencies, State Insurance Commissions, the Securities and Exchange Commission, U.S. Attorney's Offices, the Federal Bureau of Investigation, U.S. Postal Inspection Service, and other federal and state agencies. EBSA has memorandums of understanding governing the exchange of information with respect to ERISA covered plans with the IRS, federal banking regulatory agencies, and the Securities and Exchange Commission.

Many regional offices coordinate on a regular basis with other federal and state agencies who are conducting investigations of employers who may have employee benefit plans and who may receive complaints regarding ERISA covered plans. Regional offices are known to utilize the Internet to target potential cases and to develop and research leads. Monitoring the media in outlying areas of regional jurisdictions can be a valuable source for targeting potential cases. By reading newspapers published on the Internet, investigators are able to develop potential leads from articles. In addition, by monitoring enforcement actions by other agencies and regulatory groups on the Internet can lead to cases.

Targeting of criminal investigations happens in various ways, including computer data analysis, information obtained through a civil investigation, leads from individuals such as plan participants, plan officials, service providers to plans, informants, news media sources, or information obtained from other federal and state agencies. Once such leads have been identified and unlawful conduct is indicated or suspected, the field office managers are responsible for determining whether an investigation should be opened and then whether the investigation should proceed criminally, civilly or both simultaneously.

Case opening

After the targeting methods are applied, the field office then needs to make a determination whether to formally open an investigation on the subjects found from the particular targeting method. Investigations may be opened on plans, plan sponsors, service providers, or for criminal investigations, on individuals.

Regional offices are generally responsible for opening investigations and each office needs to analyze the factors such as the possible conduct in question, the amount of money or property potentially at risk, the number of participants potentially effected and the resources available to conduct such investigations. The field offices, at the direction of each regional director, must apply its investigative resources in a manner that will result in prompt and effective enforcement actions, and timely results.

Once cases are selected either through a national office project, regional office project or through some targeting method, the particular entity selected for review needs to be identified and entered into the computer system for tracking purposes. Entering the information into the computer system allows the investigator to review the regional office's indices in order to ensure that a case is not already opened on the subject. In addition, every case opened must have a narrative detailing the reason for selecting a particular subject (employee benefit plan, service provider, or financial institution) for investigation. Therefore, the pre-investigative steps include selecting or assigning a case, reviewing the regional office's indices, obtaining and reviewing the Annual Report 5500 for prior years through a national ERISA data system, identifying potential issues, and then officially opening the case.

Case conduct

Once the case is opened the investigator can proceed with obtaining information on the employee benefit plan and addressing any possible issues that have been identified. ERISA assigns to EBSA and its regional offices the power to conduct investigations, and in connection therewith to require the submission of reports, books, and records and to enter such places, inspect such books and records and question such persons as they may deem necessary to determine the facts relative to the investigation. Normally, the investigator will send an opening letter detailing our investigative authority and advising the subject that an official investigation is being conducted. This letter initiates contact with the subject under investigation in order to begin the process of obtaining evidence through both written documentation and oral testimony. If EBSA encounters resistance and the subject refuses to voluntarily provide documents, EBSA has subpoena authority to compel testimony and/or the production of documents. There are procedures to follow in serving a subpoena and limitations on the extent of the amount and type of information being required under that subpoena.

Once documents are received (either voluntarily or through the subpoena process), the investigative process begins with drafting an investigative plan on how to proceed with the review and to address the predicate issue on why the case was opened. An investigative plan for a subject case includes an analysis and scope of the investigation by setting forth the issue and/or issues being investigated and which sections of ERISA, if known, which may have been violated. After laying out each allegation within the context of the applicable sections of the statute, interpretations and regulations, the investigator can move onto the planned investigative activities. Normally, an investigative plan will include what records will be reviewed and/or what interviews will be conducted in order to fully investigate each issue.

Interviews of employee benefit plan fiduciaries may be conducted in order to understand the plan and how the plan is administered. The objective of an interview of a fiduciary or of a service provider to an employee benefit plan is to develop credible information that is relevant and material to the investigation and to ascertain the interviewee's version of the facts. Once an interview is completed, the investigator will timely record the interview in a formal written report. This report of interview will become part of the exhibit file. Regional

Directors have the authority to permit investigators the right to discuss their findings (depending on the situation) with plan officials during an investigation, provided that the officials are advised that the matters discussed represent only the views of the investigator and the findings are always subject to review by higher authority. It is understood that it may be useful in certain circumstances during an investigation to discuss with the plan officials their position and intentions regarding any possible action they may take voluntarily to correct a violation.

Once the investigation is complete, the investigator will draft a report of investigation with the facts of the case and organize all of the exhibits. The report of investigation contains facts of the investigation only and will not contain opinions of the investigator. Subsequent to this draft, the investigator will prepare the final report of investigation and submit this report with the exhibit file to their supervisor. The investigator will also make recommendations on the disposition of the matter.

Case disposition

After the completion of the investigation, the field office makes a determination on the disposition of the case. A case is closed with no action taken when no violations are identified. In addition, while violations may be identified, a decision may be reached that the matter will not be pursued because it is not worth the governmental resources that would be required or the parties responsible for the violation are unable to make the correction.

Where violations are found and are pursued, remedies and sanctions are imposed, as appropriate. In fiscal year 2002, 3 762 pension cases were opened, 3 370 civil cases were closed, with 1 985 cases finding a violation. USD 691 million was restored to pension plans. Also, 203 criminal cases were opened, 154 criminal cases were closed, with 134 indictments and USD 4.6 restored to pension and health and welfare plans.

Remedies and sanctions under the labor provisions of ERISA

There are a variety of remedies and sanctions designed to address the many types of violations and financial transactions encountered in EBSA’s investigations. EBSA’s priorities are to protect plan assets, to recover losses, to assure future compliance, and in some cases, to punish the parties responsible for violations.

Civil remedies

ERISA provides for "make whole relief" to the plan, which means placing the pension plan back in the position it would have been in if the violation(s) had not occurred, and holds the parties responsible for the violations to be personally liable to the plan for the losses. In addition, any illegal gains must be "disgorged," which means returned to the plan. The law allows for the removal from positions affecting plans of parties responsible for violations and for barring them in the future from serving in such positions. ERISA also provides for civil penalties in certain situations, which are monetary fines.

- Voluntary compliance. Most violations are corrected by a process called "voluntary compliance," through which EBSA sends a letter to the responsible parties citing the violations and requesting correction, generally in the form of make whole relief and disgorgement. The letter states that if the parties cited do not make the correction voluntarily, the matter will be referred to the legal department to bring suit in Federal court. Only the Federal courts have the authority to compel the correction. Nevertheless, most violations are corrected voluntarily, based on the expectation that, if correction were not made, the Department of Labor would bring suit and prevail, and a civil penalty would have to be paid to the government in addition to making good any losses to the plan. Regional offices have the authority to settle cases through voluntary compliance. EBSA also has two self-correction programs, one for certain straight-forward civil violations and the second for reporting violations. For the former, where parties that have engaged in certain types of civil violations, such as failing to forward employee contributions to 401(k) plans, the program allows the violators to correct the violations, notify EBSA, and in return, receive a letter from EBSA accepting the correction. For reporting violations, the parties file the correct report and pay a reduced fine from the amount that would otherwise have been due.

- *Litigation.* Where parties do not voluntarily correct violations cited by EBSA, or where the violations are especially egregious, EBSA refers the examination to the Office of the Solicitor of the Department of Labor to bring suit in Federal court. These suits seek make whole relief for the plan, the disgorgement of ill-gotten gains and, in egregious cases, the barring of responsible parties from serving as fiduciaries to ERISA plans. In addition to legal action by the Department of Labor, ERISA provides participants and beneficiaries with the standing to sue in Federal court to correct violations of ERISA and to obtain benefits illegally denied to them.

- Penalties. ERISA provides civil penalties for failing to report required information to EBSA when due (up to USD 1 000 per day, payable to the government) and for failing to disclose information to participants when requested (up to USD 100 per day payable to the participant, if approved by a Federal court). In addition, ERISA provides for a 20% penalty payable to the government of the amounts recoverable from a responsible party as a result of a settlement agreement or a court order to correct violations of this law. This penalty is rarely assessed for violations corrected by voluntary compliance.

Criminal sanctions

Criminal sanctions include imprisonment, fines and the restitution of illegal gains. EBSA refers its criminal violations which it finds to the federal Department of Justice or to the appropriate state prosecutor, depending on the severity of the criminal violation. If the criminal defendants are found guilty after trial or enter a plea of guilty, they may be fined or imprisoned or both and are required to reimburse the pension plan for any losses suffered as a result of their criminal acts.

IRS supervisory, compliance and enforcement structure

Determination letters

An employee retirement plan that meets certain requirements under the Internal Revenue Code (the "Code") is referred to as a "qualified plan" and is entitled to favorable tax treatment. For example, contributions made in accordance with the plan document are generally currently deductible expenses for the employer. Earnings on plan assets are not taxable and participants will not include the employer contributions to the plan in income until the time they receive a distribution from the plan. In some cases, taxation may be further deferred by rollover to another qualified plan or individual retirement arrangement. Finally, plan earnings may accumulate free of tax. Employee retirement plans that fail to satisfy the requirements under the Code are not entitled to favorable tax treatment.

There are no legal requirements to initially register a pension plan with the Department of Labor, the IRS, or the PBGC. Given the significant adverse tax consequences of failing to satisfy the qualification requirements of the Code, however, most employers desire advance assurance that the terms of their plans satisfy the qualification requirements.

The IRS provides such advance assurance by means of the determination letter program. A favorable determination letter indicates that, in the opinion of the IRS, the terms of the plan conform to the applicable requirements of the Code. To be a qualified plan, however, a plan must satisfy, in both form and operation, the applicable requirements of the Code, including requirements that the plan not discriminate against low wage workers and cover a certain percentage of the workforce.

The application process for determination letters differs based on the type of plan that has been adopted. Sometimes prototype plans are sponsored by financial institutions, accounting firms, or other plan service providers. These prototype plans are submitted to the IRS for an opinion letter that the plan's design satisfies the requirements of the Code. The adopting employer completes an adoption agreement under which various design options available under the plan are selected. In the simplest case, the adopting employer relies on the opinion letter and does not file for an individual determination letter. In the more complex cases, the employer files the adoption agreement with the IRS for an individual determination letter. Individually designed plans are submitted for individual determination letters.

A determination letter application is accomplished by filing with the IRS an application form (Form 5300 for individually designed plans or Form 5307 for certain adopters of prototype plans), the plan document, and a fee (as much as $1,250 for individually designed plans and as little as USD 125 for prototype plans). The level of the user fee is generally dependent on whether the plan is seeking comfort on the methodology of certain non-discrimination testing under the plan.

The plan document and documents are reviewed by the IRS to determine if all of the elements of a properly executed plan document are present as dictated by the Code.

An investment policy for the plan is not required by the IRS, but is strongly encouraged by the Department of Labor, and many plan fiduciaries adopt a policy for the plan. Such investment policies are not subject to initial review or evaluation by any government agency. There is a lively debate as to the prudence of using an investment policy. Many plan sponsors believe that they offer protection in the event of the loss of value of plan assets. If the investment policy was prudent and was followed, then a loss of asset value could be defended. Other plan sponsors argue that a formal investment policy only provides more opportunities to fail to follow the terms of the plan.

Determination letters apply only to the plan as submitted. If the plan is subsequently amended, often due to a change in the qualification rules, the plan will need to be re-submitted for a determination letter. Because of the regular changes in recent years to the qualification rules, plan sponsors have been submitting their plans for a favorable determination letters every 10 years or so.

During 2003 (to date) and for the four prior years, the numbers of determination letter applications filed with the IRS were as follows:

1999	37 177
2000	27 005
2001	30 492
2002	71 368
2003	44 134

If a determination letter application is timely filed, the applicant is permitted to make retroactive amendments to the plan to remedy any issues discovered as part of the determination letter application. Because of the dire consequences of failing to satisfy the qualification requirements, virtually all plans take advantage of that opportunity. Because of this ability to make amendments and the desire to do so, virtually no plans are denied a favorable determination letter. During 2003 and the four prior years, only nine plans were denied favorable determination letters.

Generally, changes in the plan's structure are not required to be approved or reported. However, a favorable determination letter applies only to the document as submitted. Thus, when a plan is amended, the plan's sponsor generally files for a new IRS determination that the plan's terms do not violate the qualification rules of the Code.

Examinations

The office of Employee Plans (EP) under the Tax Exempt and Government Entities (TE/GE) operating division of the IRS helps retirement plan sponsors, plan participants, and practitioners working in the retirement benefits arena understand and comply with the pension law. The goal of EP Examinations is to promote voluntary compliance by analyzing operational features of retirement plans. Activities include developing processes to identify areas of noncompliance, developing corrective strategies, and assisting other functions, such as EP's Customer Education and Outreach and ruling and Agreements in implementing those strategies. EP uses a centralized examination case selection and review process to enhance consistency of enforcement activities and to focus resources on the areas of highest noncompliance. During fiscal year 2002, 7 558 examination cases were closed by EP Examinations.

In inventorying and classifying returns for examination, EP has used an informal doctrine called "LUQ" — that is, returns are scrutinized to determine if an item is Large, Unusual or Questionable. The IRS is now moving towards using more sampling and analyzing sampling variants to identify the items that may lead to a mix of issues that lead to compliance problems. The IRS uses this analysis not only to pick the returns with the highest potential for noncompliance but also to identify the issues that are relevant to a particular market or customer segment.

In some market segments, because of the low number of trained agents, statistical sampling is not appropriate at this point. One area for a high potential for statistical sampling is 401(k) plans. The IRS will be identifying a significant number of these cases and will have a good opportunity for statistical sampling. The IRS will be developing the appropriate baseline criteria for its customer segments. The IRS is moving to special audits and away from general audits and developing audit technique guidelines.

The IRS is developing limited scope audits that will be limited to those issues that are relevant to a particular market segment. The IRS has received significant feedback that its current audit strategy is too burdensome and that irrelevant and extraneous items where there is no history of noncompliance are being audited. With a limited scope audit approach, more plans can be covered.

Four initiatives are underway related to examinations in EP's current work plan in various stages of development and evolution:

- multiemployer plans — cases are being selected based on number of participants and amount of assets; program findings will be used to create baseline data, which, in turn, will be used to develop long-term compliance strategies;
- 403(b) and 457 plans — new selections are being made taking into consideration the changes made in recent legislation; audit guidelines are being developed; the pilot project for ineligible employers is continuing;
- 401(k) plans — the IRS recently increased its examination units to 600 because of increased Congressional interest; and
- a more in-depth look at plans of larger corporations with a team audit approach including subject matter experts, computer audit specialists, etc

There are three other projects that EP is contemplating seriously for next year:

- Non-Filers. These are either people who filed for a while and stopped, or never filed, or filed incomplete returns to minimize their exposure to an EP examination thinking that they have satisfied their filing requirements;
- Simplified Employee Plan adopters, and
- Service Providers.

Compliance assistance programs

The Employee Plans Compliance Resolution System (EPCRS) is a comprehensive system of correction programs for sponsors of retirement plans that are intended to satisfy the requirements of sections 401(a), 403(a) or 403(b) of the Code, but which have not met these requirements for a period of time. EPCRS is based on the following general principles:

- Sponsors and other administrators of eligible plans should be encouraged to establish administrative practices and procedures that ensure that plans are operated properly in accordance with the applicable requirements of the Code.
- Sponsors and other administrators of eligible plans should satisfy the applicable plan document requirements of the Code.
- Plan sponsors and other administrators should make voluntary and timely correction of any plan failures, whether involving discrimination in favor of highly compensated employees, plan operations, the terms of the plan document, or adoption of a plan by an ineligible employer. Timely and efficient correction protects participating employees by providing them with their expected retirement benefits, including favorable tax treatment.
- Voluntary compliance is promoted by providing for limited fees for voluntary corrections approved by the Service, thereby reducing employers' uncertainty regarding their potential tax liability and participants' potential tax liability.
- Fees and sanctions should be graduated in a series of steps so that there is always an incentive to correct promptly.
- Sanctions for plan failures identified on audit should be reasonable in light of the nature, extent, and severity of the violation.

- Administration of EPCRS should be consistent and uniform.
- Plan Sponsors should be able to rely on the availability of EPCRS in taking corrective actions to maintain the tax-favored status of their plans.

EPCRS includes the following basic elements:

- *Self-correction (SCP).* A plan sponsor that has established compliance practices and procedures may, at any time, correct insignificant Operational Failures without paying any fee or sanction. In addition, in the case of a Qualified Plan that is the subject of a favorable determination letter from the Service or in the case of a 403(b) Plan, the plan sponsor generally may correct even significant Operational Failures without payment of any fee or sanction.
- *Voluntary correction with Service approval (VCP).* A plan sponsor, at any time before audit, may pay a limited fee and receive the Service's approval for correction. Under VCP, there are special procedures for certain submissions involving only Operational Failures (Voluntary Correction of Operational Failures ("VCO")), and for certain submissions in which limited Operational Failures are being corrected using standardized corrections (Voluntary Correction of Operational Failures Standardized ("VCS")). VCP also includes a special procedure that applies to 403(b) Plans (Voluntary Correction of Tax-sheltered Annuity Failures ("VCT")), a special procedure for anonymous submissions ("Anonymous Submission Procedure"), a special procedure for group submissions (Voluntary Correction of Group Failures ("VCGroup")), and a special procedure that applies to SEPs (Voluntary Correction of SEP Failures ("VCSEPs")). During fiscal year 2002, 780 voluntary compliance cases were closed.
- *Correction on audit (Audit CAP).* If a failure (other than a failure corrected through SCP or VCP) is identified on audit, the plan sponsor may correct the failure and pay a sanction. The sanction imposed will bear a reasonable relationship to the nature, extent and severity of the failure, taking into account the extent to which correction occurred before audit.

Taxpayer communication and education

EP's Customer Education and Outreach (CE&O) helps plan practitioners, plan sponsors, plan participants and plan vendors understand their tax responsibilities. Activities relating to CE&O include both direct contacts (through IRS delivery at EP Benefit Conferences, speeches, workshops, panels and exhibits) and indirect contacts (through newsletters, publications, educational videos and interactive CDs, and websites). During fiscal year 2002, the IRS participated in 265 outreach efforts reaching 51 778 customers directly and 432 customers indirectly.

Technical guidance

EP provides guidance that explains how the tax law may apply to individuals or plans. In addition to guidance items of general applicability that are published weekly in the Internal Revenue Bulletin and accessible on the IRS website, individuals may request a letter ruling that applies to their specific situation.

The supervisory role of the Pension Benefit Guaranty Corporation (PBGC)

The Pension Benefit Guaranty Corporation (PBGC) was created by the Employee Retirement Income Security Act of 1974 to encourage the continuation and maintenance of defined benefit pension plans, provide timely and uninterrupted payment of pension benefits, and keep pension insurance premiums at a minimum. The PBGC is not funded by general tax revenues. The PBGC collects insurance premiums from employers that sponsor insured pension plans, earns money from investments and receives funds from pension plans it takes over. The PBGC pays monthly retirement benefits, up to a guaranteed maximum, to about 345 000 retirees in 3 132 pension plans that ended. Including those who have not yet retired, the PBGC is responsible for the current and future pensions of about 783 000 people.

Under its Early Warning Program, the PBGC monitors certain companies with underfunded pension plans. Through this effort, PBGC identifies corporate transactions that could jeopardize pensions and works with companies sponsoring underfunded pension plans to arrange suitable protections for those pensions and the pension insurance program. One important source of information about underfunded plans is the report that must be filed annually with the PBGC under ERISA by companies that sponsor plans with significant amounts of underfunding, although the PBGC does not confine its analyses simply to the information submitted under this provision.

While the PBGC focuses on companies in bankruptcy proceedings, it also negotiates non-bankruptcy-related agreements. During 2002, such agreements were valued at about USD 454 million and provided contributions, security, and other protections for the pensions of about 57 000 workers and retirees.

Conclusion

Due to the large number of pension plans in the United States, the voluntary nature of the pension plan system, the great variety of plans, and the limited amount of resources allocated to the governmental agencies charged with supervising pension plans, a significant emphasis on the part of government has been on voluntary compliance, through educational outreach programs and voluntary compliance programs for plan sponsors and plan fiduciaries who have discovered violations and want to correct them. Both the Department of Labor and the IRS have sophisticated programs for identifying likely areas of non-compliance with the law and targeting examinations at those areas. Through these programs, the agencies have made significant recoveries of money for plans and have imposed plans to correct deficiencies in their operations.

TABLE OF CONTENTS

I. **SUPERVISING PRIVATE PENSIONS: AN INTRODUCTION**
by Ambrogio Rinaldi 9

Supervisory structures 10
Supervisory methods 13
Further work 17

II. **SUPERVISORY STRUCTURES FOR PRIVATE PENSION FUNDS IN OECD COUNTRIES**
by Vinicius Carvalho Pinheiro 21

Background 21
Institutional framework of private pension fund supervision 21
Organization of the Supervisory Agency 41
Conclusion 62

Annex II.1. Primary supervisor for pension funds 67
Annex II.2. Questionnaire on supervisory structure for private pension funds 70
Annex II.3. Distribution of supervisory responsibilities 75

III. **SUPERVISION OF PENSION FUNDS: THEORY AND PRACTICE**
by Richard Hinz 77

What is pension supervision? 77
Rationale for the supervision of private pensions 78
Distinctive features of funded pension systems 81
Primary elements of pension fund supervision 83
Characteristics of supervisory systems 90
Factors associated with different styles of pension supervision 92

IV. **INTEGRATED FINANCIAL SUPERVISION AND PRIVATE PENSION FUNDS**
by Edgardo Demaestri and Gustavo Ferro 97

Introduction..97
The regulation of financial intermediaries and pension funds............99
Integrated or specialized supervision? 105
Analysis of the advantages and disadvantages of consolidating
pensions under an integrated regulator 110
Specific aspects of pension regulation...117
Extending the analysis of advantages and disadvantages
of integrated supervision, taking into account
the peculiarities of pension funds 128
Conclusion 132

V. **THE EXPERIENCE OF CENTRAL AND EAST EUROPEAN COUNTRIES ON FINANCIAL SUPERVISION**
by Tibor A. Párniczky 139

Changes of supervisory agencies 140
Functions and responsibilities..141
Legal mandates of the supervisor...142
Political and institutional independence 143
Financing 144
Transparency..146
Human resources..147
Organisation...148
Conclusions..149

VI. **SUPERVISORY AGENCIES IN LATIN AMERICA**
by Ana Patricia Morera Martinelli..153

Introduction..153
General comments on the pension systems......................................154
Efficacy and efficiency of the superintendencies of pensions 162
Main functions of the Superintendencies...174
Conclusions..176
Annex 1. Mission and vision of the superintendencies
of pensions...180

VII. **PRIVATE PENSIONS SUPERVISORY METHODS IN AUSTRALIA**
by Greg Burner 183

Introduction 183
Types of superannuation entities 184
Supervisory framework 185
Organisation and management of APRA 187
Supervisory methods: entry requirements 191
Supervisory methods: on-going supervision 197
Supervisory examination 203
Compliance enforcement and sanctioning 207
Conclusion 211
Annex VIII.1. Explanation of some terms used to describe various arrangements and structures 212
Annex VIII.2. Divisional structure of APRA 215
Annex VIII.3. APRA key result areas and key performance indicators 217
Annex VIII.4. Disclosure requirements 219
Annex VIII.5. Annual reporting requirements to commence from 1 July 2003 222
Annex VIII.6. PAIRS/SOARS 225

VIII. **PRIVATE PENSIONS SUPERVISORY METHODS IN HUNGARY**
by Erdos Mihály 227

Institutional framework, market structure and general approach to supervision 227
Entry requirements 231
On going supervision 237
Compliance, enforcement and sanctioning 243
Conclusions 245

IX. **PENSION FUND SUPERVISORY METHODS IN IRELAND**
by Mary Hutch 247

Introduction 247
Supervisory framework 248
The Pensions Board 249
Entry requirements 251
On going supervision 254
Compliance enforcement and sanctioning 262
Conclusions 264

X. **PENSION FUNDS SUPERVISORY METHODS IN MEXICO**
by Isaac Voulin....269

Introduction....269
Summary of the supervision scheme 271
Supervision scheme 272
Conclusions....278

XI. **SUPERVISION OF PRIVATE PENSION PLANS IN THE UNITED STATES**
by Morton Klevan, Carol Hamilton and David Ganz....279

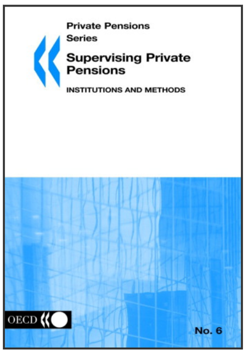
Introduction....279
Department of labour supervisory, compliance and enforcement structure....282
IRS supervisory, compliance and enforcement structure....294
The supervisory role of the Pension Benefit Guaranty Corporation 300
Conclusion 301

XII. **THE STRUCTURE AND FUNCTIONS OF THE SUPERVISORY REGIME OF RETIREMENT INCOME PROVISION IN THE REPUBLIC OF BULGARIA**
by Bozhidar Parvanov 303

Overview of the Bulgarian pension system: Institutional framework and market structure....303
The organization and scope of authority of the Supervisory Agency 310
Entry requirements....314
On-going Supervision 316
Compliance enforcement and sanctions....318
Conclusions....320

XIII **SUPERVISION OF PRIVATELY MANAGED, DEFINED CONTRIBUTION PENSION SCHEMES IN HONG KONG**
by Hong Kong Mandatory Provident Fund Authority (MPFA) 323

Overview of the private pension system....323
General information about the financial system and culture 325
Summary of supervisory practices in Hong Kong....330
Organization and scope of authority of the Supervisory Agency: 331
Entry requirements and administration:....334
On-going supervision:....336



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