PENSIONS & RETIREMENT PLANS

USA

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Pensions & Retirement Plans

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Quick reference guide enabling side-by-side comparison of local insights, including into the statutory and regulatory framework; state pension provision; occupational pension schemes; compliance and enforcement; plan changes and termination; fiduciary responsibilities; legal challenges; future prospects; and current hot topics.

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Table of contents

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USA

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STATUTORY AND REGULATORY FRAMEWORK

Primary laws and regulations

What are the main statutes and regulations relating to pensions and retirement plans?

Pension and retirement plans are generally governed by the Internal Revenue Code of 1986, Title 26 of the United States Code , and the Employee Retirement Income Security Act of 1974, Title 29, Chapter 18 of the United States Code (ERISA). Associated regulations appear in Title 26 and 29 (Subtitle B) of the Code of Federal Regulations, respectively. ERISA generally pre-empts the laws of the 50 states on matters that relate to benefits, but ERISA does not pre-empt other potentially applicable US and state laws.

Law stated - 23 January 2023

Regulatory authorities

What are the primary regulatory authorities and how do they enforce the governing laws?

The Department of Treasury and its bureau, the Internal Revenue Service , are responsible for administering the Internal Revenue Code through regulations, generally applicable guidance (such as revenue rulings and procedures, notices and announcements), taxpayer specific guidance (such as private letter rulings), informal guidance and audits. The Department of Labor and its bureau, the Employee Benefits Security Administration , are responsible for administering ERISA through regulations and interpretive bulletins, generally applicable guidance (such as prohibited transaction class exemptions), situation-specific guidance (such as advisory opinions and field assistance bulletins), guidance applicable to a particular plan or transaction (such as individual prohibited transaction exemptions), informal guidance and audits. The Pension Benefit Guaranty Corporation , another bureau within the Department of Labor, is a quasi-governmental entity created under ERISA that provides insurance and oversight with respect to defined benefit qualified plans.

Law stated - 23 January 2023

Pension taxation

What is the framework for taxation of pensions?

Pensions and retirement plans are either ‘qualified’ or ‘non-qualified'. Qualified plans are broad-based arrangements, established by employers and subject to favourable tax rules that provide an employer with an immediate deduction for contributions, permit assets to grow on a tax-deferred basis and defer recipient taxation of benefits until distributed. Non-qualified deferred compensation plans (non-qualified plans) are available for more highly compensated employees but without most of the tax advantages.

Law stated - 23 January 2023

STATE PENSION PROVISIONS

Framework

What is the state pension system?

With limited exceptions, employers, employees and the self-employed are required to contribute to a broad-based social security system. Employers and employees each pay tax of 6.2 per cent of compensation up to an annual taxable wage base (US$160,200 in 2023; indexed for inflation). The self-employed (including sole proprietors and partners) pay both the employer and employee share of the tax – 12.4 per cent on earned income up to the annual taxable wage base – although the self-employed, like employers generally, are entitled to an income tax deduction for a portion of the tax.

Law stated - 23 January 2023

Pension calculation

How is the state pension calculated and what factors may cause the pension to be enhanced or reduced?

Social security benefits are based on a worker's lifetime compensation and work history. To qualify for full benefits, a worker must accumulate 40 quarters of covered employment with minimum compensation of US$1,640 (for 2023; indexed for inflation) per quarter. Benefits generally begin between ages 65 and 67, depending on the worker's birth date, but a reduced amount can be paid beginning at age 62 or an increased amount can be paid by deferring to as late as age 70.

Law stated - 23 January 2023

Aims

Is the state pension designed to provide a certain level of replacement income to workers who have worked continuously until retirement age?

Generally yes, although the maximum available benefit may be limited, and the more compensation a worker earns, the more likely it is that the worker will need private retirement arrangements and personal savings to supplement social security benefits.

Law stated - 23 January 2023

Current fiscal climate

Is the state pension system under pressure to reduce benefits or otherwise change its current structure in any way on account of current fiscal realities?

Social security is currently expected to be insolvent in the next 10 to 15 years. Postponing insolvency will likely include one or more of the following strategies: increasing social security taxes (either by increasing the rate, raising the annual taxable wage base or expanding compensation subject to the tax); reducing benefits; or increasing the retirement age.

Law stated - 23 January 2023

OCCUPATIONAL PENSION SCHEMES

Types

What are the main types of private pensions and retirement plans that are provided to a broad base of employees?

Broad-based qualified plans are either defined benefit plans, including traditional arrangements and cash balance plans, or defined contribution plans, including profit-sharing, stock bonus and money-purchase pension plans. Other forms of broad-based, employer-sponsored, tax-favoured retirement arrangements include 403(b) plans and 457(b) arrangements for non-profit employers and, for smaller employers, simplified employee pensions (SEPs) and savings incentive match plan for employees (SIMPLE) 401(k) plans or individual retirement accounts or annuities (IRAs). Individuals may also maintain their own IRAs, but it is uncommon for an employer to have any involvement with an IRA that is not part of a SEP or SIMPLE IRA.

Law stated - 23 January 2023

Restrictions

Are employers required to arrange or contribute to supplementary pension schemes for employees? What restrictions or prohibitions limit an employer's ability to exclude certain employees from participation in broad-based retirement plans?

Employers are not required to adopt a private pension or retirement arrangement, although doing so is a useful recruiting tool and in some industries is expected. Qualified plans are subject to a myriad of eligibility, vesting, non-discrimination and other requirements that are generally designed to ensure that they are broad-based and do not disproportionately favour highly paid workers. Applicable law can treat related entities with sufficient common ownership to create a parent-subsidiary, brother-sister or affiliated service group (a controlled group) as a single employer to ensure that these requirements are not avoided.

Employers have substantially more flexibility with respect to non-qualified plans, but these may only be offered to a select group of management or highly compensated employees (generally representing no more than 10 per cent to 15 per cent of the workforce) and lack some of the tax benefits available with qualified plans.

Law stated - 23 January 2023

Can plans require employees to work for a specified period to participate in the plan or become vested in benefits they have accrued?

Once employees have reached the age of 21 and have completed one year of service, they must generally be offered the opportunity to participate in a qualified plan within six months. If a qualified plan provides that an employee is 100 per cent vested upon entry, a two-year-of-service requirement can replace the one-year-of-service requirement.

Qualified plans that offer a tax-favoured employee deferral feature (known as a 401(k) deferral) must, beginning in 2024 for calendar year plans, offer employees who have attained age 21 and completed at least 500 hours of service in three consecutive years the opportunity to make employee deferrals. Beginning in 2025 (for calendar year plans), the service requirement is reduced to two consecutive years.

The rate at which an employee must fully vest in a qualified plan has been accelerating over the last several decades. Currently, the minimum vesting requirements are:

	Defined benefit	Defined benefit	Defined contribution	Defined contribution
Years of service	Cliff vesting	Graded vesting	Cliff vesting	Graded vesting
Less than 1	0%	0%	0%	0%
1	0%	0%	0%	0%
2	0%	0%	0%	20%
3	0%	20%	100%	40%

4	0%	40%	100%	60%
5	100%	60%	100%	80%
6	100%	80%	100%	100%
7 or more	100%	100%	100%	100%

Unvested benefits must immediately vest with respect to affected employees if the plan undergoes a 'partial termination', which can result from certain employer actions (such as a layoff) and certain types of amendments, or in the event of a complete discontinuance of contributions or a plan termination.

Law stated - 23 January 2023

Overseas employees

What are the considerations regarding employees working permanently and temporarily overseas? Are they eligible to join or remain in a plan regulated in your jurisdiction?

It is possible for US taxpayers to continue to participate in a qualified plan while working abroad if the plan document so permits and if various non-discrimination and operational requirements are satisfied. For example, a qualified plan's definition of compensation will need to explicitly include certain foreign income. If the US taxpayer is employed by a foreign affiliate, a US tax deduction may not be available for contributions made by the foreign affiliate. If the benefits are taxed locally (immediately or later), any advantages may be undermined.

Law stated - 23 January 2023

Funding

Do employers and employees share in the financing of the benefits and are the benefits funded in a trust or other secure vehicle?

Defined benefit qualified plans are typically funded solely by the employer. Defined contribution qualified plans often have a tax-favoured employee deferral feature. Employee deferrals can be made on a pre-tax (traditional) or after-tax (Roth) basis, with different income tax rules applying to each type at distribution. Qualified plan assets are required to be held in trust, the assets of the trust are protected from the employer's creditors and grow on a tax-deferred basis.

Non-qualified plans are funded by employers, although they may also permit an employee to defer the receipt of otherwise taxable compensation. Assets need not be held in trust, but if a trust is used, the assets must remain available to the employer's creditors and any earnings are taxable to the employer. As a result, participants are considered general, unsecured creditors of the employer. If assets are held in a trust that protects the assets from an employer's creditors, the benefit of deferred tax for the employee is lost.

Law stated - 23 January 2023

What rules apply to the level at which benefits are funded and what is the process for an employer to determine how much to fund a defined benefit pension plan annually?

The maximum permitted participant benefit under a defined benefit qualified plan is an annual life annuity, beginning at normal retirement age, of 100 per cent of average compensation for the highest three years of service or, if less, US

$265,000 (for 2023; indexed for inflation). The employer bears the actuarial risk of ensuring that assets sufficient to pay benefits are contributed to the plan's related trust, and it typically funds within a minimum and maximum deductible contribution corridor, as determined with the assistance of an actuary and in compliance with tax rules. Mortality and interest rates are prescribed by applicable tax law and asset shortfalls are amortised over seven years.

The maximum contributions, by employers and employees, and allocations under a defined contribution qualified plan for a year is the lesser of 100 per cent of the employee's compensation or US$66,000 (for 2023; indexed for inflation). Tax-favoured employee deferrals are capped at US$22,500 (for 2023; indexed for inflation). Employees who have attained or will attain age 50 by the end of a year may make additional employee deferrals of up to US$7,500 (for 2023; indexed for inflation).

Minimum employer contributions may be required for plans with benefits that are skewed too much in favour of owners and officers. Moreover, any of the limits described above may be reduced as necessary to satisfy non-discrimination testing requirements and may be limited by other provisions of the Internal Revenue Code .

Law stated - 23 January 2023

Level of benefits

What are customary levels of benefits provided to employees participating in private plans?

Plan types and levels of benefits vary widely, largely by industry. Historically, defined benefit qualified plans were the most common form of private plan in the US, generally basing benefits on a percentage of average compensation or a dollar amount for each year of service. While this is still somewhat true for industrial employers, particularly with unionised workforces, service businesses and employers in the technology and life sciences spaces tend to offer only defined contribution qualified plans. The latter will typically permit employees to make employee deferrals and may also include matching or other forms of employer contributions (such as a profit-sharing allocation).

Law stated - 23 January 2023

Pension escalation

Are there statutory provisions for the increase of pensions in payment and the revaluation of deferred pensions?

Except for increases in accrued benefits in the case of late retirement, there are generally no statutory requirements for pension escalation or revaluation. Employers may, by design, provide such features if in compliance with applicable tax rules.

Law stated - 23 January 2023

Death benefits

What pre-retirement death benefits are customarily provided to employees' beneficiaries and are there any mandatory rules with respect to death benefits?

Defined benefit and money-purchase pension defined contribution qualified plans must provide benefits in the form of a qualified joint and survivor annuity (QJSA) or a qualified preretirement survivor annuity (QPSA). A QJSA is an annuity for the life of the participant, and if the participant is married, a survivor annuity for the life of the spouse of not less than 50 per cent of the amount payable while the participant was alive. These plans may also be required to offer a qualified optional survivor annuity (QOSA) of either 50 per cent (if the survivor portion of the QJSA is at least 75 per cent) or 75 per cent (if the survivor portion of the QJSA is less than 75 per cent). A QPSA is an annuity for the life of a deceased participant's surviving spouse where the participant dies before retirement but after reaching the plan's earliest retirement age. In that situation, the QPSA cannot be less than the survivor portion of the QJSA. For a participant who dies on or before the plan's earliest retirement age, payments to the surviving spouse may not be less than the survivor portion of the QJSA, determined as if the participant terminated at death, survived until the earliest retirement age, commenced a QJSA and then died the following day.

Those plans, and other types of defined contribution qualified plans, can offer other distribution forms, including other forms of annuities, instalment distributions and lump sums, but a properly witnessed spousal consent to waive the QJSA or QOSA form will be required.

The QJSA, QOSA and QPSA requirements do not apply to other types of defined contribution qualified plans as long as the default beneficiary of the participant's entire vested benefit is the surviving spouse and the participant does not elect a life annuity form. The participant can designate an alternative beneficiary, but the spouse must provide a properly witnessed spousal consent.

It is common but not required to accelerate vesting if an employee dies while employed.

Law stated - 23 January 2023

Retirement

When can employees retire and receive their full plan benefits? How does early retirement affect benefit calculations?

A qualified plan must allow participants to take distributions by the sixtieth day following the close of the plan year in which occurs the later of: (1) the participant attaining age 65 or, if earlier, the plan's normal retirement age; (2) the tenth anniversary of the participant's commencement of participation; or (3) the participant's termination of service. A plan's normal retirement age is typically either age 62 or 65. Participants are required to begin taking distributions shortly after attaining age 72 (age 73 effective 1 January 2023) except with respect to active employees who own not more than 5 per cent of the employer.

Defined contribution qualified plans generally allow a terminated employee to receive a distribution immediately following termination. With a defined benefit qualified plan, distributions are typically deferred until normal retirement age, although a plan may permit commencement of benefits at early retirement, often age 55. Such a benefit may be actuarially adjusted to take a longer distribution period into account.

Distributions received prior to age 59 and one-half may be subject to a 10 per cent excise tax in addition to ordinary income tax, unless 'rolled' over into another tax-favoured vehicle (another employer plan or individual retirement account, for example) or unless a special exception applies.

Law stated - 23 January 2023

Early distribution and loans

Are plans permitted to allow distributions or loans of all or some of the plan benefits to members that are still employed?

Yes, depending on how the plan is designed. Defined benefit and money-purchase pension defined contribution qualified plans can, but are not required to, permit in-service distributions as early as age 59 and one-half. Other types of defined contribution qualified plans can permit in-service distributions after a fixed number of years, on the attainment of a stated age (generally age 59 and one-half) or upon the occurrence of a stated event (such as termination of employment, disability or hardship). In-service distributions received prior to age 59 and one-half are generally subject to a 10 per cent excise tax, in addition to ordinary income tax, unless another exception applies.

Qualified plans may also, but again are not required to, allow participants to borrow up to the lesser of US$50,000 (reduced by the highest outstanding principal balance in the past 12 months) or the larger of one-half of the present value of the participant’s vested benefit or US$10,000. Requirements under the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA) are designed to ensure that a loan is neither a taxable distribution nor a prohibited transaction. A defaulted loan may result in ordinary income tax and, possibly, a 10 per cent excise tax.

Law stated - 23 January 2023

Change of employer or pension scheme

Is the sufficiency of retirement benefits affected greatly if employees change employer while they are accruing benefits?

The impact of changing employers generally depends on the type of qualified plan. Traditional defined benefit qualified plans generally base benefits on a combination of compensation and years of service. As a result, the maximum benefit is generally earned over an employee’s career with the employer maintaining the plan, and termination prior to normal retirement age can significantly reduce the available benefit (even when the employee is fully vested). Defined contribution and certain other defined benefit qualified plans provide a benefit equal to an actual or hypothetical account balance that, once partially or fully vested, can generally be received in the form of a lump-sum distribution without any reduction.

Law stated - 23 January 2023

In what circumstances may members transfer their benefits to another pension scheme?

Most, but not all, distributions from a qualified plan may be deposited or ‘rolled over’ into another tax-favoured employer plan or individual retirement account, thus allowing the employee to continue to defer taxes. Exceptions include annuities, instalments over at least 10 years and hardship distributions. The Internal Revenue Service has a helpful chart on its website .

Law stated - 23 January 2023

Investment management

Who is responsible for the investment of plan funds and the sufficiency of investment returns?

ERISA requires every qualified plan to have a ‘plan administrator’ and both ERISA and the Internal Revenue Code require that qualified plan assets be held in trust. Those responsible for managing the trust’s assets may be the plan administrator, the trustee, an investment manager appointed under ERISA or another fiduciary (such as an investment committee).

In the case of a defined benefit qualified plan, the employer will be responsible for any shortfall in investment returns through minimum required contributions. In a defined contribution qualified plan, participants may manage their own investments. This transfers responsibility for investment risk (but not fund selection) to the participant. The plan administrator, trustee, investment manager or other fiduciary remains responsible for adding, monitoring the performance of and removing the funds offered to participants.

Law stated - 23 January 2023

Reduction in force

Can plan benefits be enhanced for certain groups of employees in connection with a voluntary or involuntary reduction in workforce programme?

Yes. Defined benefit qualified plans will sometimes offer early retirement window incentives, treating participants as older (closer to normal retirement age), crediting additional years of service for vesting or benefit accrual purposes or adjusting compensation. Special allocations or additional years of service for vesting purposes may also be provided under a defined contribution qualified plan, within certain limits.

In modifying any qualified plan for this purpose, care must be taken to ensure that non-discrimination requirements are met and that any changes are compliant with other applicable laws, such as age discrimination laws.

Law stated - 23 January 2023

Executive-only plans

Are non-broad-based (eg, executive-only) plans permitted and what types of benefits do they typically provide?

Non-broad-based plans are permitted but such arrangements do not have the same tax-favoured status as qualified plans. These non-qualified plans can be structured as defined benefit or defined contribution arrangements and with or without employee contributions. No immediate deduction is available to employers, and benefits are generally subject to social security tax at vesting and ordinary income tax at distribution. For non-profit employers, benefits are generally subject to tax at vesting rather than at distribution.

Non-qualified plans are generally exempt from most provisions of ERISA as long as they are maintained primarily for a select group of management or highly compensated employees.

Law stated - 23 January 2023

How do the legal requirements for non-broad-based plans differ from the requirements that apply to broad-based plans?

To avoid current income tax on the benefits, non-qualified plans must be unfunded and unsecured, meaning that the promised benefit is paid from the employer's general assets, which are subject to claims of the employer's creditors. No immediate deduction is available for the employer with respect to non-qualified plans and they must be designed to be exempt from or compliant with section 409A of the Internal Revenue Code . This means that payments must generally be made on certain pre-specified dates and any employee deferral elections generally must be made prior to the year amounts are earned. Amounts paid pursuant to a non-qualified plan are not eligible to be rolled over to a broad-based plan or other tax-favoured account.

To avoid most of the requirements of ERISA , the non-qualified plan must also be limited to a select group of management or highly compensated employees.

Law stated - 23 January 2023

Unionised employees

How do retirement benefits provided to employees in a trade union differ from those provided to non-unionised employees?

Employers with union employees may be required to collectively bargain with respect to retirement benefits. This may result in participation in a multi-employer plan in which several unrelated employers (but typically in the same industry) make contributions on behalf of their union employees. This allows the employees to more easily change jobs within the same industry (trucking or airlines, for example) without losing benefits. Multi-employer plans are more often than not defined benefit qualified plans, and they are jointly administered by a board of employer and union representatives.

There has been a trend more recently to limit the potential liability of contributing employers to liabilities attributable to their own workforce, as well as to allow employers to participate in a multi-employer defined contribution arrangement, typically with an employee deferral feature.

Law stated - 23 January 2023

How do the legal requirements for trade-union-sponsored arrangements differ from the requirements that apply to other broad-based arrangements?

A multi-employer plan must satisfy the qualified plan requirements of ERISA and the Internal Revenue Code and are subject to the Multiemployer Pension Plan Amendments Act (MPPAA), a part of ERISA. MPPAA provides that if a multi-employer plan is underfunded, all contributing employers can be required to make additional contributions, even if the liability did not arise with respect to the employer's own union employees. As a result, employers can face significant liability to a multi-employer plan if the plan is not sufficiently funded by all employers. Minimum required contributions are determined by an actuary based on best estimate assumptions, and asset shortfalls are amortized over 15 years. Severely underfunded plans are required to implement formal procedures to avoid insolvency.

Law stated - 23 January 2023

ENFORCEMENT

Examination for compliance

What is the process for plan regulators to examine a plan for periodic legal compliance?

The Internal Revenue Service , the Department of Labor and the Pension Benefit Guaranty Corporation (PBGC) have authority to audit qualified plans. Broadly speaking, the Department of Labor focuses on fiduciary compliance under the Employee Retirement Income Security Act (ERISA), the Internal Revenue Service focuses on tax compliance under the Internal Revenue Code and the PBGC focuses on benefits and sufficiency of assets solely with respect to defined benefit qualified plans.

Law stated - 23 January 2023

Penalties

What sanctions will employers face if plans are not legally compliant?

The Internal Revenue Service can revoke a qualified plan's tax-favoured status if the arrangement fails to satisfy the requirements of the Internal Revenue Code in form or operation. Revocation of tax-favoured status means that employer deductions are lost, earnings on trust assets are subject to income tax and benefits are taxed as they vest. Employers may also be subject to various excise taxes if certain requirements are not satisfied (for example, failure to timely file annual reports, making non-deductible contributions, failing to satisfy minimum contribution requirements or failing to timely correct certain non-discrimination testing failures).

The Department of Labor has the authority to remove fiduciaries and impose sanctions in the form of monetary penalties for which fiduciaries can be personally liable. Various other penalties can be imposed on plan administrators who fail to timely provide certain information or fail to timely file annual reports. Plan administrators and fiduciaries can also be sued in civil court, and the Internal Revenue Code and ERISA both include criminal penalties.

For non-qualified plans, failures largely adversely affect participants, although an employer can be penalised for failing to withhold income or social security taxes or for failing to satisfy certain reporting requirements.

Law stated - 23 January 2023

Rectification

How can employers correct errors in plan documentation or administration in advance of a review by governing agencies?

The Internal Revenue Service maintains a robust programme, known as the Employee Plans Compliance Resolution System (EPCRS), that allows employers to correct a range of qualified plan issues. EPCRS allows for self-correction, correction with Internal Revenue Service approval and a closing agreement program for issues discovered by the Internal Revenue Service on audit. The latter two arrangements involve a sanction payment to the Internal Revenue Service. In general, EPCRS requires restoration of the plan to the position it would have been in had the error not occurred. Correction programmes are far more limited for non-qualified plans.

The Department of Labor permits fiduciaries to correct certain fiduciary violations and prohibited transactions. This programme is known as the Voluntary Fiduciary Correction Program (VFCP).

For plans that fail to timely file annual reports, an employer and plan administrator can voluntarily file through the Department of Labor's Delinquent Filer Voluntary Correction Program (DFVC). Penalties for filing under DFVC can be substantially smaller than the penalties the Department of Labor could impose under ERISA and filings under DFVC can also result in a waiver of Internal Revenue Service penalties.

Law stated - 23 January 2023

Disclosure obligations

What disclosures must be provided to the authorities in connection with plan administration?

Employers and plan administrators jointly file an annual report using a Form 5500 series filing. The annual report is generally due by the end of the seventh month following the end of the plan year, absent an extension.

The annual report includes information used by the Internal Revenue Service and Department of Labor and, in the case of defined benefit qualified plans, the Pension Benefit Guaranty Corporation (PBGC). Depending on the number of participants in a qualified plan at the beginning of the plan year, and, in certain other situations, audited financial statements must also accompany the annual filing. Since 2009, previously filed Forms 5500 are available on the Department of Labor website . Additional Internal Revenue Service filings may be required, such as a request for a determination letter as to the tax-favoured status of the form of qualified plan or a notification when plans are merged or assets are transferred.

Defined benefit qualified plans are required to pay annual premiums to the PBGC and certain plans must file annual

PBGC forms. Filings are also required if there has been a ‘reportable event’, which includes reductions in active participants, failures to make a required minimum funding and certain ownership changes, among others.

Non-qualified plans must make a one-time filing with the Department of Labor.

Law stated - 23 January 2023

What disclosures must be provided to plan participants?

All qualified plan participants must receive a plain English summary in the form of a summary plan description (SPD), as updated from time to time. Plans are also required to provide summary annual reports and provide participants with benefit statements. At the time of distribution, participants must receive notices explaining various tax issues, rights and elections.

A notice may be required (depending on the change and type of plan) when a qualified plan is amended to reduce future benefit accruals, certain changes are made to the vesting schedule or, for certain plans, if there is a failure to satisfy minimum funding requirements. Defined benefit qualified plan participants may also receive funding notices, notices if there are benefit restrictions and beneficiary designation forms. Defined contribution qualified plan participants may also receive employee deferral election forms, beneficiary designation forms, safe harbour notices, information concerning plan investments and other specialised notices.

Qualified plan participants also have a legal right to request and receive plan documents and other materials from the plan administrator.

Law stated - 23 January 2023

Enforcement mechanisms

What means are available to plan participants to enforce their rights under pension and retirement plans?

ERISA provides several tools for participants to use in enforcing their rights. Each plan must establish and publish claims procedures that are used in making, and appealing adverse, benefits decisions. Dissatisfied participants may, usually after satisfying the requirements of the claims procedures, bring a civil action in federal or state court to challenge a claim decision.

Participants may also bring complaints directly to the Department of Labor , which may follow-up informally, launch an audit or bring a civil or criminal action with respect to plan violations, fiduciary breaches and prohibited transactions.

Law stated - 23 January 2023

PLAN CHANGES AND TERMINATION

Rules and restrictions

What restrictions and requirements exist with respect to an employer changing the terms of a plan?

Plan amendments may be required as a result of changes in the Internal Revenue Code , the Employee Retirement Income Security Act (ERISA) or Internal Revenue Service or Department of Labor guidance. In these situations, the law or agency will specify a date by which an amendment must be adopted and become effective. In the case of tax-related changes, it is not uncommon for a change to become effective in operation earlier than the required date by which an amendment must be adopted.

With respect to discretionary changes, the required timing of an amendment and any participant notice may depend on the type of plan and the significance of the amendment. For reductions in future benefit accruals under defined benefit or money-purchase pension defined contribution qualified plans, advance notice to participants under Internal Revenue Code section 4980F and ERISA section 204(h) may be required, and the amendment generally must be adopted before it becomes effective. For many other changes, amendments can often be effective as of the beginning of the plan year in which the amendment is adopted. Generally, however, an employer cannot take away benefits that have already accrued. As an example, if a plan provides for matching contributions with respect to employee deferrals on a pay period basis, the plan can be amended to eliminate matching contributions, but the employer cannot take away any matching contributions that are already funded.

Special rules, including advanced notice requirements, may apply to amendments that slow down the rate at which benefits vest.

Law stated - 23 January 2023

What restrictions and requirements exist with respect to an employer terminating a plan?

Although a qualified plan may be terminated, it must initially be established as a permanent benefit arrangement. Termination within a few years of creation may cause the Internal Revenue Service to challenge the tax-favoured status of the arrangement.

On termination, all unvested benefits become immediately vested. Employees in terminated defined contribution qualified plans are eligible to receive distributions that can be rolled over on a tax-deferred basis to other employer qualified plans or individual retirement accounts.

Terminating a defined benefit qualified plan involves compliance with additional Pension Benefit Guaranty Corporation (PBGC) procedures, including filings with that agency, notices to participants and participant elections to annuitise benefits. Additional funding may be required to fully fund the benefits earned. Plans may be terminated in distress situations if the cost of maintaining the plan would result in the employer's failure to continue to operate. The PBGC has the authority to terminate a defined benefit qualified plan involuntarily, and the employer's controlled group (including foreign entities) may be jointly and severally liable for unfunded benefits.

A terminated qualified plan's trust assets generally must be distributed as soon as administratively feasible (typically within one year of the date of termination) or the Internal Revenue Service will require ongoing amendments to comply with law changes. Annual reports must continue to be filed until all assets have been distributed, at which point a final annual report must be filed by the end of the seventh month following the month in which all assets have been distributed.

Law stated - 23 January 2023

Insolvency protection

What protections are in place for plan benefits in the event of employer insolvency?

Qualified plan assets are held in trust and are protected from the claims of an employer's creditors in the event of insolvency. In contrast, non-qualified plan assets, even if set aside in a trust, must remain subject to the claims of the employer's creditors.

While the PBGC provides insurance with respect to a portion of the benefit under a defined benefit qualified plan, in the event of employer insolvency the PBGC's guaranty will freeze as of the date the employer enters bankruptcy, and employers are required to provide notice of this limitation to participants. While an employer is in bankruptcy, a defined benefit qualified plan generally may not be amended to increase benefit accruals, and distributions other than in the form of a life annuity generally may not be paid unless certain requirements are met.

Law stated - 23 January 2023

Business transfer

How are retirement benefits affected if the employer is acquired?

In the case of a stock acquisition, a qualified plan will transfer to the buyer's controlled group, which post-closing includes the target employer. If the qualified plan remains separate, that plan, and any other qualified plans maintained by the buyer's controlled group, must satisfy eligibility requirements known as minimum coverage and, in the case of a defined benefit qualified plan, minimum participation. These requirements are designed to ensure that benefits under each qualified plan remain broad-based. Transition relief may be available through the end of the plan year following the plan year in which the target joins the buyer's controlled group, provided no significant change in the qualified plan or to coverage are made. Alternatively, the target's qualified plan can be terminated, which results in all unvested benefits becoming fully vested, and the assets distributed. If employee deferrals are part of the plan, the timing of the termination (generally at least one day prior to closing) becomes critical for distribution purposes. Finally, the buyer can merge the target's plan into a qualified plan of the buyer at or following closing, although careful attention must be paid to ensure that accrued benefits are not diminished for target employees.

In the case of an asset sale, the target's qualified plan will remain with the target and the target's controlled group, unless the buyer agrees to assume the arrangement. Employees of the target's qualified plan will generally be eligible to take distributions since they will have ceased employment with the target.

Where larger employers with multiple business lines are involved and a particular business and its associated employees are moved to the buyer, the parties may agree to a 'spin-off' in which a portion of the assets and liabilities of the target's qualified plan are transferred directly into a qualified plan of the buyer. In a defined contribution qualified plan, the spin-off is generally accomplished by transferring the vested and unvested account balances of affected employees. In the case of a defined benefit qualified plan, the accrued benefits of the transferred employees are assumed by the buyer's plan and the value of assets (determined as if the target's plan had been terminated) must be proportionately allocated among the two plans. Prior to a spin-off or merger of qualified plans, a filing with the Internal Revenue Service may be required.

Law stated - 23 January 2023

Surplus

Upon plan termination, how can any surplus amounts be utilised?

Defined contribution qualified plans generally have no surplus amounts at termination. For defined benefit qualified plans, an employer may, if permitted under the plan document, recover any surplus assets remaining after all benefits have been properly calculated and distributed. If the document does not include this provision, an amendment to add it cannot take effect until the end of the fifth calendar year following the adoption of the amendment. Otherwise, any surplus assets must be used to increase benefits. Even if a surplus could be paid to the employer, the employer may opt to increase benefits since an employer (other than a non-profit) receiving a surplus (a reversion) is subject to income tax plus a 50 per cent excise tax on the amount received. The excise tax can be reduced to 20 per cent if at least 25 per cent of the reversion is transferred to a qualified replacement plan, which can be an existing or a new defined contribution qualified plan.

Law stated - 23 January 2023

FIDUCIARY RESPONSIBILITIES

Applicable fiduciaries

Which persons and entities are 'fiduciaries'?

The Employee Retirement Income Security Act (ERISA) provides that a fiduciary is any person or entity: (1) exercising any discretionary authority or control respecting the management of the plan or its assets; (2) rendering investment advice with respect to plan assets for a fee or other compensation, or who has the authority or responsibility to do so; or (3) having any discretionary authority or responsibility in the administration of the plan. ERISA fiduciaries include the plan administrator (the employer by default). By virtue of the preceding definition, those responsible for adding, monitoring and removing investments are fiduciaries.

Fiduciary responsibility can be delegated, but relieving oneself of fiduciary responsibility is not always simple. The employer that maintains the plan (or its board of directors or trustees) is considered a fiduciary at least with respect to its authority to appoint and remove other fiduciaries. The trustee of a qualified plan's related trust will also be a fiduciary, although its liability may be limited if it is a 'directed' trustee.

Law stated - 23 January 2023

Fiduciary duties

What duties apply to fiduciaries?

ERISA provides that a fiduciary must: (1) act for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying the reasonable expenses of administering the plan (the exclusive benefit rule); (2) discharge duties with respect to a plan with the care, skill, prudence and diligence that a prudent man acting in like capacity and familiar with such matters would use (the prudent expert rule); (3) unless clearly prudent not to do so, diversify the plan's investments as to minimise the risk of large losses; and (4) discharge its duties in accordance with the plan documents.

Fiduciaries must also avoid engaging in prohibited transactions, a category of transactions that lawmakers determined are so rife with conflict that they should not be allowed to occur, unless strict exemption requirements are satisfied. The prohibited transaction rules exist under both the Internal Revenue Code and ERISA, and the Department of Labor is responsible for promulgating guidance and issuing class and individual exemptions. (ERISA and the Internal Revenue Code also set forth statutory exemptions.)

Law stated - 23 January 2023

Breach of duties

What are the consequences of fiduciaries failing to discharge their duties?

A fiduciary can be held personally liable for any losses resulting from a breach of fiduciary duty, and for restoring any profits made through improper use of plan assets resulting from the fiduciary's breach. A fiduciary may also be liable for a breach by another fiduciary by knowingly participating in, or knowingly undertaking to conceal, an act or omission of the other fiduciary, knowing that the act or omission is a fiduciary breach, or by failing to comply with specific fiduciary duties, thereby enabling another fiduciary to commit a breach. A breaching fiduciary is also subject to removal, civil actions to recover benefits and appropriate relief sought by the Department of Labor . A fiduciary who causes or allows a prohibited transaction to occur is liable for reversing the transaction and restoring any loss a plan may have experienced in the transaction, and for a 20 per cent civil penalty, on top of the amount actually involved in the transaction.

Law stated - 23 January 2023

LEGAL DEVELOPMENTS AND TRENDS

Legal challenges

Have there been legal challenges when certain types of plans are converted to different types of plan?

Generally, legal challenges on conversions are rare, in part because conversions themselves are rare. A significant exception involved cash balance plans, a type of defined benefit qualified plan in which a participant's benefit at any time is defined by reference to the value of a hypothetical account that can be translated into a life annuity at normal retirement age. The benefit is derived from employer contributions and interest credits, the latter of which may generally be more valuable to younger participants. When traditional defined benefit qualified plans began to be converted to cash balance arrangements, challenges asserted that the conversions violated Internal Revenue Code and Employee Retirement Income Security Act (ERISA) rules against reductions in benefits, as well as US age discrimination laws. Ultimately, these issues were resolved when laws changed to permit such arrangements if a participant's benefit would be at least that of any similarly situated (in every way except age) younger employee who is or could be a participant. The changes also addressed the reduction in benefits issues.

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Have there been legal challenges to other aspects of plan design and administration?

The most significant litigation trend involving private plans involves class action lawsuits with fiduciary breach claims relating to oversight and management of defined contribution qualified plan investments and the investment and other fees borne by participants. The litigation, as well as newer fee disclosure regulations issued by the Department of Labor , have resulted in plans utilising or including lower-cost investment alternatives (in particular, passively managed funds), paying lower recordkeeping fees and having greater overall fee transparency.

A more recent trend has involved challenges to the use of outdated mortality and interest assumptions used in calculating benefits under defined benefit qualified plans.

Law stated - 23 January 2023

Future prospects

How will funding shortfalls, changing worker demographics and future legislation be likely to affect private pensions in the future?

Because of the voluntary nature of the US system, this is difficult to predict. Defined benefit qualified plans, particularly multi-employer plans, face significant funding shortfalls that have yet to be fully addressed. Changing worker demographics have already moved qualified plans generally from defined benefit to defined contribution type arrangements. Tax increases generally result in greater interest in qualified plans, but if there are related changes (such as lower benefits limits or changes to the existing social security exemption with respect to qualified plan benefits) that interest may be limited and interest in non-qualified plans may increase.

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UPDATE AND TRENDS

Hot topics

Are there any current developments or trends that should be noted?

Increases in US tax rates (some of which will occur automatically in 2026) will likely trigger renewed interest in both qualified plans and non-qualified plans. Under current law, virtually all contributions and benefits under a qualified plan escape social security tax. Congress could reduce or eliminate that exemption.

Recent legislation (known as the SECURE 2.0 Act) makes a variety of changes to qualified plans, although the effective dates of these changes are spread out over many years.

We anticipate that privacy and data security concerns will continue to garner increased attention, as will the appropriateness of environmental, social and governance factors in selecting investment alternatives under qualified plans. We have also seen renewed efforts to broaden the scope of persons considered fiduciaries to qualified plans and individual retirement accounts or annuities (including those providing rollover advice).

In the non-qualified plan realm, audits and tax litigation involving section 409A of the Internal Revenue Code are likely to increase and there have from time to time been legislative proposals to require accelerated tax on such arrangements, which would reduce the attraction of such vehicles.

Law stated - 23 January 2023

Jurisdictions

Germany	CMS Germany
Netherlands	Eversheds Sutherland (International) LLP
United Kingdom	Irwin Mitchell LLP
USA	Sullivan & Worcester LLP