ERISA: the Most Common Compliance Errors

(And how to fix them)

ERISA is a sprawling, complicated law. It has decades of caselaw and thousands of pages of regulations to contend with. It changes constantly, and the penalties it imposes for non-compliance can be ruinous. Employers may face expensive lawsuits and fines that run into the thousands of dollars per day for certain compliance errors. Willful violations of fiduciary responsibilities owed by employers to plan participants can include criminal penalties.

Any form of non-compliance might expose you and your company to serious penalties. Even innocent mistakes with no malicious intent behind them can prove disastrous. Here we'll review the five most common compliance errors under ERISA, and how to avoid them.

1. Properly Determining Who Can Participate - and How Much They Get

Calculation errors are the most common type of compliance error across all forms of ERISA litigation. There are two different species of error to consider here: amounts of compensation, and determinations of who gets to participate.

For example, a retirement plan that promises, for example, a full year's compensation upon reaching a certain tenure mark or retirement age might seem simple enough. If you work for a certain number of years, you receive a full years' pay. But what exactly is a "full year's pay?" According to ERISA, it isn't just cash. The value of health insurance payments, retirement contribution matches, other fringe benefits, and even non-cash benefits like gift certificates, allowances for housing or travel, and other forms of compensation may all need to be considered in determining the eligible amounts of compensation.

ERISA also has rules related to non-discrimination that should keep you seriously focused on who is actually allowed to participate in your ERISA-governed plan. An extremely common compliance error arises in the context of another major employment law risk: the misclassification of an employee as an independent contractor. Misclassification alone has serious risks for the company. Someone on a 1099 who should have been on a W2 might be entitled to years' worth of back pay and payroll withholdings. Under ERISA, such a person will generally also be entitled to compensation as if they had been properly enrolled in your company's retirement plan all along.

A misclassified independent contractor who “should” have been a W2 employee for the last five years might cost you five years’ worth of your average retirement benefits. If you’re doing that math in your head, you might be getting a little nervous already.

2. Keeping Plan Documents in Order

ERISA requires that all plans be kept according to a written plan document. The industry generally refers to the master document - the Constitution of the retirement plan - as the Summary Plan Description or SPD. The SPD is supposed to describe every important feature of the plan, using low-legalese language that the actual employees who are supposed to benefit from the SPD can be reasonably expected to read and understand.

This means that any material change that you make to your plan’s terms must be kept reasonably up to date in your SPD. This includes any relevant detail from the length of tenure required to qualify for certain benefits, to the timing and the amounts of the benefits, to the consequences of resigning or being terminated on actually receiving those benefits.

Keeping the SPD up to date is essential. Some employers make regular changes to the actual benefits that employees receive (for example, making adjustments based on inflation or other regular adjustments) without keeping their plan documents in order. If you are in the habit of changing the benefits that you offer, or making extra promises to certain employees, your SPD must be updated to match. Your counsel and your human resources team must be empowered to regularly review and update the SPD, lest you run afoul of a noncompliance penalty that could cost you hundreds of dollars per day in fines per covered employee.

3. Record-Keeping Failures

All information related to your ERISA plan must be kept in writing. Even the most seemingly trivial or incidental information, such as an internal record of turnover of plan-qualifying employees, or change of address records from former employees receiving benefits under COBRA, must be kept for no less than six full calendar years after the date the record is created.

Plans with at least one hundred participants, or plans with at least $250,000 in assets, are also required to file Form 5500 (a short-form Form 5500 is available for smaller-headcount filers who meet the asset threshold). These records are public documents that are freely searchable. An improperly-prepared Form 5500, or failing to file a required Form 5500, can subject you to the same serious set of fines and penalties.

The most common variant of this compliance failure is the failure to file a Form 5500 at all when the plan is supposed to. Note that this requirement applies even if you do not know that you are required to file it - or even if you do not know that you’ve accidentally created an ERISA-governed plan! If you aren’t sure whether or not you’ve accidentally created a plan by making certain promises of future compensation to your employees, check out our other publications on this topic or give us a call.

4. Correcting Mistakes

The failure to file a Form 5500 (either filing it on time, filing it accurately, or filing it at all) can be mitigated by using the Department of Labor’s Delinquent Filer Voluntary Compliance Program (DFVCP). Filing a Form 5500 through the DFVCP might save you some, but not all, of the fees and fines associated with an ERISA compliance failure.

And if you are in the position of not even knowing that you've accidentally created an ERISA-governed plan, the DFVCP won't help you until it's too late - you can't file reports on a plan you don't even know that you have!

A similar voluntary reporting system is available for more serious failures to abide by the fiduciary duty requirements of ERISA. As with the DFVCP, any such filing can merely mitigate - not eliminate - the fees and costs of improperly managing your ERISA-governed plan. But most importantly, none of these mitigation tools is of any use to you if you don't even know you have a plan in the first place.

Do thousands of dollars in daily fines, or years' worth of retirement benefits going out the door all at once, make you nervous? If so, just give us a call. We'll make sure your business is protecting its most valuable asset - its people - without getting the company on the losing end of an expensive, potentially ruinous ERISA lawsuit, over a "retirement plan" that you might not even know you already have!

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