United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

January 1989

PENSION PLANS

Labor and IRS Enforcement of the Employee Retirement Income Security Act

GAO/HRD-89-32

About Our New Cover...

The new color of our report covers represents the latest step in GAO's efforts to improve the presentation of our reports.

GAO

United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-232982

January 23, 1989

The Honorable J.J. Pickle
Chairman, Subcommittee
on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

This responds to your request for information on the efforts of the Department of Labor and the Internal Revenue Service (IRS) to enforce provisions of the Employee Retirement Income Security Act of 1974 (ERISA) that are related to pension plans. Specifically, you asked for information on the

- number of pension plans Labor and IRS review as part of their enforcement activities,
- number of plans cited for violations,
- number and types of violations found,
- results of actions taken against plans cited for violations, and
- average number of staff-hours spent on a pension plan review.

To obtain this information, we reviewed Labor and IRS records on ERISA enforcement activities completed in fiscal years 1985-87 and the first 8 months of fiscal year 1988.[1] We requested that Labor give us a specific report on its pension plan investigations because its records included the results of both welfare and pension plan investigations. Labor's enforcement efforts related to welfare plans, which provide such benefits as health insurance, were not covered by our review. We had to modify the information we obtained from IRS records because, in some instances, IRS counted a pension plan more than once when it had reviewed more than one tax return or other form filed by a plan.

In addition, we reviewed pertinent sections of ERISA and Labor's and IRS's ERISA enforcement policies to identify types of ERISA violations. Both agencies review plan activities as part of their ERISA enforcement efforts. However, information on such factors as the average time spent on reviews may not be comparable because differences in the agencies' responsibilities for reviewing plans affect the size and scope of their reviews.

[1] Labor refers to its reviews of employee benefit plans as "investigations," while IRS refers to its reviews as "examinations."

Our work was conducted at Labor and IRS headquarters between March and September 1988. We did not independently verify the information in the agencies' enforcement reports. The information we obtained is summarized below and presented in more detail in the tables in appendixes I and II.

As agreed with your office, we are continuing our efforts to evaluate Labor's and IRS's ERISA enforcement activities.

Background

According to the Department of Labor, in 1987 there were an estimated 870,350 private pension plans with over $1.6 trillion in assets covering about 76.6 million participants. ERISA was enacted to eliminate mismanagement and abuses of private pension plan assets and to ensure that participants of these plans receive the benefits to which they are entitled. To protect plan participants, ERISA established comprehensive minimum standards for how pension and welfare benefit plans are to be operated in the interests of participants (fiduciary standards). ERISA defines a fiduciary as anyone who exercises discretionary control or authority over the management of a plan or renders investment advice to a plan. For example, plan trustees and, in some cases, investment managers are plan fiduciaries.

ERISA also established minimum standards that concern what information pension and welfare benefit plans must report and disclose to the federal government and plan participants (reporting and disclosure standards). In addition, ERISA established certain standards applicable only to pension plans. These include how employees become eligible to participate in pension plans (participation standards), how employees earn a nonforfeitable right to pension benefits (vesting standards), and how plans are to be funded to ensure that promised benefits can be paid (funding standards).

Labor is primarily responsible for enforcing ERISA's fiduciary provisions and for ensuring that plan information is reported and disclosed to plan participants and other interested parties.

IRS is primarily responsible for administering and enforcing ERISA's participation, vesting, and funding standards. IRS is also responsible for determining whether plans qualify for favorable tax treatment under the Internal Revenue Code. Qualifying for favorable tax treatment means that business contributions to pension plans are generally tax deductible, earnings on the business contributions held by pension plans are not taxed, and employees do not pay taxes on their benefits until they are received.

Labor's Pension Plan Enforcement Efforts

Within Labor, the Pension and Welfare Benefits Administration (PWBA) is primarily responsible for ERISA enforcement activities. Labor focuses its enforcement on ensuring compliance with ERISA's fiduciary standards. Labor has an authorized enforcement staff of 266, located at 15 field offices, to carry out its ERISA enforcement efforts.

Labor's current ERISA enforcement strategy has been in effect since fiscal year 1987. The strategy allocates 50 percent of PWBA's investigative resources to investigations of welfare plan service providers and financial institutions that serve as pension plan fiduciaries. The other 50 percent is spent on investigations of individual plans. According to Labor, this strategy enables it to better use its limited investigative resources by reviewing organizations that deal with a substantial number of plans, rather than investigating only individual plans.

Labor can take several actions to correct fiduciary violations it identifies. First, it can obtain an agreement from plan fiduciaries to voluntarily correct a violation. Second, it can initiate civil litigation in federal district court to require plan fiduciaries to correct a fiduciary violation. Third, it can refer a violation to IRS for imposition of an excise tax against a plan. These actions can result in plan fiduciaries (1) being required to restore plan assets and reverse a prohibited transaction or (2) being removed. For example, if Labor finds that a plan fiduciary violated ERISA by loaning plan funds to the employer that sponsored the plan, the fiduciary may be required to rescind the loan, repay the loan balance, and reimburse the plan for any losses due to the prohibited transaction. Labor can also refer alleged criminal violations to the Department of Justice.

In response to your questions concerning Labor's ERISA enforcement activities, we found that:

1. From fiscal year 1985 through fiscal year 1987, the number of individual pension plan investigations closed by Labor increased slightly, from 1,259 to 1,323. During the first 8 months of fiscal year 1988, Labor closed 718 plan investigations. In fiscal year 1987, Labor also closed investigations of 78 financial institutions that provided services to almost 6,300 plans. Through the first 8 months of fiscal year 1988,

Labor closed investigations of 109 financial institutions serving about 5,500 plans.

2. About one out of four individual plans investigated in fiscal years 1985-87 were cited for ERISA violations. During the first 8 months of fiscal year 1988, the rate dropped to about one out of five plans.

3. Labor identified 573 fiduciary violations in fiscal year 1986 and 574 in 1987. The most common types of these violations were prohibited transactions and prudence violations.[2]

4. The value of plan assets restored and transactions reversed as a result of Labor's actions against plans with fiduciary violations increased from about $42 million in fiscal year 1985 to about $106 million in 1987. Through the first 8 months of fiscal year 1988, assets restored and transactions reversed totaled $59 million. Labor also removed about 20 plan fiduciaries per year in fiscal years 1986 and 1987.

5. The average number of staff-hours spent on a pension plan review has increased steadily over the past few years. About 85 hours were spent on each plan review in fiscal year 1985, compared to about 120 hours in fiscal year 1988. Financial institution reviews took longer—an average of 141 hours in fiscal year 1988.

Tables I.1 through I.5 in appendix I provide more detailed information on Labor's pension plan enforcement activities.

IRS's Pension Plan Enforcement Efforts

The Office of Assistant Commissioner (Employee Plans and Exempt Organizations) is primarily responsible for IRS's pension plan enforcement activities under ERISA. Its enforcement activities consist of (1) processing determination requests from plan administrators and (2) conducting plan examinations.

A determination is an IRS review of plan documents to ascertain whether a plan is designed in accordance with ERISA's requirements and thus qualifies for favorable tax treatment. Plans may request determinations when they are initiated, amended, or terminated. Pension plan examinations are conducted to ensure that plans are operated in accordance with

[2]Appendix III describes prohibited transactions and prudence violations.

ERISA in such areas as minimum funding, participation, vesting, and nondiscrimination in benefits.

When IRS identifies a violation, it can impose several types of sanctions, such as assessing excise taxes and penalties or revoking a plan's tax-qualified status. In fiscal year 1988, IRS was authorized 1,574 staff assigned to district offices nationwide to carry out its ERISA enforcement activities.

In response to your questions concerning IRS's ERISA enforcement activities, we found that:

1. The number of pension plans IRS has examined decreased from about 20,000 in fiscal year 1985 to about 5,300 in 1987. According to IRS, the decrease was due to the large increase in determination requests from plans amended to comply with changes in tax law. IRS's policy was to give priority to processing these determination requests. During the first 9 months of fiscal year 1988, IRS examined about 12,000 plans.

2. The proportion of plans examined that were cited for violations increased from 20.5 percent in fiscal year 1985 to 32 percent in 1987, but dropped to 22.3 percent during the first 9 months of fiscal year 1988. The number of plans IRS cited for violations dropped from 4,200 in fiscal year 1986 to 1,709 in fiscal year 1987.

3. The most often cited violations during fiscal years 1986 and 1987 concerned prohibited transactions,[3] minimum funding, and participation and coverage requirements.[4] Prohibited transactions made up about 40 percent of the violations found during these years.

4. The amount of excise taxes and penalties IRS assessed increased from $7.9 million in fiscal year 1985 to $12.5 million in 1987. For the first 9 months of fiscal year 1988, assessments totaled $3.4 million. Revocations of plans' tax-qualified status increased from 78 in fiscal year 1985 to 167 during fiscal year 1986 before declining to 45 in fiscal year 1987. During the first 9 months of fiscal year 1988, IRS revoked the tax-qualified status of 27 plans.

[3] Both Labor and IRS investigate or examine pension plans for prohibited transactions. Although they coordinate their efforts, only IRS has the authority to impose an excise tax on such transactions. Labor can seek to have a prohibited transaction reversed.

[4] Appendix III describes these ERISA violations.

5. The average number of hours spent on a pension plan examination declined from about 15 in fiscal year 1986 and 1987 to about 13.1 in 1988.

Tables II.1 through II.5 in appendix II provide more detailed information on IRS's pension plan examination activities. We have also provided additional information on IRS's processing of determination requests because that has been a major segment of its pension plan enforcement program. (See table II.5.)

As agreed with your office, we did not obtain written agency comments on this report. However, we discussed the contents of the report with Labor and IRS officials and considered their comments in preparing this document.

We also are sending copies of this report to the Department of Labor, IRS, and other interested parties. Copies will also be made available to others on request. The major contributors to this report are listed in appendix IV.

Sincerely yours,

Joseph F. Delfico

Joseph F. Delfico
Senior Associate Director

Contents

Abbreviations

ERISA	Employee Retirement Income Security Act of 1974
IRS	Internal Revenue Service
PWBA	Pension and Welfare Benefits Administration

Tables Providing Information on the Department of Labor's Pension Plan Enforcement Efforts

Table I.1:Number of Plans and Financial Institutions Investigated and Cited for Violations[a] (Fiscal Years 1985-88)

	Fiscal year			
	1985	**1986**	**1987**	**1988[b]**
Individual plans:				
Investigations closed	1,259	1,279	1,323	718
Plans with violations[c]	301	312	342	133
Percentage of plans cited for violations	23.9	24.4	25.9	18.5
Financial institutions:[d]				
Investigations closed[e]	•	•	78	109
Institutions with violations	•	•	12	22
Percentage of institutions cited for violations	•	•	15.4	20.2

[a]Includes only closed investigations.

[b]As of May 31, 1988.

[c]Plans in which fiduciary and other violations were found and corrective action was taken.

[d]Labor did not begin maintaining records on financial institution investigations until fiscal year 1987, when they became part of Labor's ERISA enforcement strategy.

[e]The 78 financial institutions provided services to 6,286 pension plans. The 109 financial institutions provided services to at least 5,494 pension plans. According to a Labor official, the number of pension plans included for fiscal year 1988 is understated due to missing plan data for certain institutions reviewed.

Table I.2: Number and Types of Violations[a] Found in Investigations of Individual Plans (Fiscal Years 1985-88)

	Fiscal year			
Types of violations	**1985**	**1986**	**1987**	**1988[b]**
Fiduciary violations:				
Not solely in interest of plan participants	73	79	110	46
Prudence	137	164	143	72
Diversification	24	37	44	20
Not in accordance with plan documents	25	49	32	20
Prohibited transactions	178	239	243	98
Unspecified	5	5	2	0
Total[c]	442	573	574	256
Other violations:				
Bonding	232	239	227	112
Reporting and disclosure	175	207	126	84
Criminal	9	5	3	5
Total	416	451	356	201
Total[d]	**858**	**1,024**	**930**	**457**

[a]Appendix III describes ERISA violations.

[b]As of May 31, 1988.

[c]According to a Labor official, these numbers may be understated because PWBA's case management system limits the number of fiduciary violations that can be reported for each investigation.

[d]The total number of violations exceeds the total number of plans cited for violations because some plans had more than one violation.

Table I.3: Number and Types of Violations Found in Investigations of Financial Institutions (Fiscal Years 1987-88)[a]

Types of violations	Fiscal year 1987	Fiscal year 1988[b]
Fiduciary violations:		
Not solely in interest of plan participants	3	4
Prudence	7	14
Diversification	0	3
Not in accordance with plan documents	1	4
Prohibited transactions	8	21
Unspecified	1	0
Total[c]	20	46
Other violations:		
Bonding	1	1
Reporting and disclosure	6	6
Total	7	7
Total[d]	**27**	**53**

[a]Labor did not begin maintaining records on financial institution investigations until fiscal year 1987, when they became part of Labor's ERISA enforcement strategy.

[b]As of May 31, 1988.

[c]According to a Labor official, these numbers may be understated because PWBA's case management system limits the number of fiduciary violations that can be reported for each investigation.

[d]The total number of violations exceeds the total number of financial institutions cited for violations because some institutions had more than one violation.

Table I.4: Results Taken Against Plans and Financial Institutions Cited for Fiduciary Violations (Fiscal Years 1985-88)

Dollars in millions

	Fiscal year			
	1985	**1986**	**1987**	**1988**[a]
Monetary recoveries:				
Individual plans	$41.98	$60.65	$93.18	$47.00
Financial institutions[b]	•	•	12.37	12.04
Total	**$41.98**	**$60.65**	**$105.55**	**$59.04**
Nonmonetary results:				
Number of plan fiduciaries removed	16	20	21[c]	5
Receiver/independent fiduciaries appointed	2	1	9	3

[a]As of May 31, 1988.

[b]Labor did not begin maintaining records on financial institution investigations until fiscal year 1987, when they became part of Labor's ERISA enforcement strategy.

[c]Five of the 21 involved fiduciaries in financial institution cases.

Table I.5: Average Staff-Hours Per Closed Investigation (Fiscal Years 1985-88)

Figures in hours

	Fiscal year			
Type of review	**1985**	**1986**	**1987**	**1988**[a]
Individual plans	84.7	99.2	107.1	119.8
Financial institutions[b]	•	•	166.9	141.2

[a]As of May 31, 1988.

[b]Labor did not begin maintaining records on financial institution investigations until fiscal year 1987, when they became part of Labor's ERISA enforcement strategy.

Tables Providing Information on IRS's Pension Plan Enforcement Efforts

Table II.1: Number of Plans Examined and Cited for Violations (Fiscal Years 1985-88)

	Fiscal year			
	1985	**1986**	**1987**	**1988**[a]
Plans examined[b]	19,969	14,538	5,342	11,975
Number of plans cited for violations	4,087	4,200	1,709	2,670
Percentage of plans examined with violations	20.5	28.9	32.0	22.3

[a]As of June 30, 1988.

[b]IRS records contain information on total returns examined, which may include more than one return per pension plan. To determine the number of pension plans reviewed, we excluded returns that were counted more than once.

Table II.2: Number and Types of Plan Violations (Fiscal Years 1985-87)[a]

	Fiscal year		
Type of violation[b]	**1985**	**1986**	**1987**
Minimum funding	1,522	2,012	814
Prohibited transactions	1,198	5,855	2,973
Coverage and participation	4,954	1,920	564
Vesting or benefit accruals	344	622	259
Discrimination of contributions or benefits	1,877	304	148
Deductibility of contributions (or credits)	1,465	1,350	595
Actuarial issues	2,128	341	211
Trust activities	1,358	1,482	556
Failure to file required statements or returns	2,910	103	62
Other[c]	281	753	227
Total[d]	**18,037**	**14,742**	**6,409**

[a]Information was not available for fiscal year 1988.

[b]Appendix III describes ERISA violations.

[c]Includes violations involving distribution of benefits, benefit and contribution limits, and the revocation of a plan's tax-qualified status for exclusive benefit rule violations.

[d]The total number of violations exceeds the total number of plans cited for violations because some plans had more than one violation.

Table II.3: Assessments[a] Imposed on Plans Cited for Violations (Fiscal Years 1985-88)

Dollars in millions

	Fiscal year			
	1985	1986	1987	1988[b]
Excise taxes assessed on:				
Prohibited transactions	$1.4	$3.7	$6.9	$2.0
Minimum funding standards	4.5	3.6	3.8	0.3
Other[c]	0.4	1.6	0.3	0.5
Total	6.3	8.9	11.0	2.8
Penalties assessed on:				
Prohibited transactions	0.2	0.6	0.3	0.2
Minimum funding standards	1.3	0.2	1.0	0.1
Failure to file required returns	0.1	0.5	0.2	0.3
Total	1.6	1.3	1.5	0.6
Total assessments	**$7.9**	**$10.2**	**$12.5**	**$3.4**

[a]Plans found to be in violation can be assessed excise taxes or penalties. They may also have their tax-qualified status revoked.

[b]As of June 30, 1988.

[c]Includes taxes on items such as disqualified and excess fringe benefits and unrelated business income.

Table II.4: Average Staff-Hours Per Plan Examination (Fiscal Years 1985-88)

	Fiscal Year			
	1985	1986	1987	1988[b]
Average staff-hours	12.4	15.7	15.2	13.1

[a]As of June 30, 1988.

Table II.5: Number of Determination Requests Processed, by Type of Request[a] (Fiscal Years 1985-88)

Type of request	Fiscal year 1985 Number	1985 Percent	1986 Number	1986 Percent	1987 Number	1987 Percent	1988[b] Number	1988[b] Percent
Initial	46,765	31.3	66,140	18.7	82,421	25.6	62,113	40.8
Amendment	76,226	51.0	262,673	74.2	207,186	64.4	67,655	44.4
Termination	26,460	17.7	25,240	7.1	32,232	10.0	22,624	14.8
Total	**149,451**	**100.0**	**354,053**	**100.0**	**321,839**	**100.0**	**152,392**	**100.0**

[a]Plan officials may apply for tax-qualified status when a plan is established, amended, or terminated.

[b]As of August 31, 1988.

Description of ERISA Violations

Actuarial Issues	Issues involving full funding limits or improper actuarial valuations.
Bonding	Failure of a fiduciary or person handling plan funds to be bonded as required by ERISA.
Criminal	Embezzlement of plan funds, false reporting, or willful violation of ERISA's reporting and disclosure requirements.
Deductibility of Contributions (or Credits)	Issues involving late contributions, improper carryovers, or fair market value of contributions.
Discrimination of Contributions or Benefits	Providing benefits or contributions that discriminate in favor of employees who are officers, shareholders, or highly compensated.
Diversification	Failure to diversify investments of plan assets (in various types of investments, such as stocks, bonds, real estate) to minimize the risk of large losses, unless it is prudent not to diversify.
Minimum Funding	Failure to make pension plan contributions sufficient to satisfy the minimum funding requirements.
Not in Accordance With Plan Documents	Failure of fiduciary to administer plan in accordance with terms of the plan's trust agreement, insofar as the agreement is consistent with ERISA.
Not Solely in Interest of Plan Participants	Failure of fiduciaries to discharge duties for the exclusive benefit of plan participants. For example, a fiduciary may not use plan assets for his own interest or account.
Participation and Coverage	Failure to include eligible persons in a plan or failure of plan to meet minimum coverage requirements. For example, at least 70 percent of the sponsoring employer's non-highly-compensated employees must be covered by the plan.

Prohibited Transaction

Transaction prohibited by ERISA to prevent conflicts of interest and self-dealing. For example, a fiduciary may not sell plan property or loan plan money to the employer or union that established the plan, unless exempted by Labor.

Prudence

Failure to discharge duties with care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use. Examples include making an inadequately secured loan and purchasing highly speculative or overpriced securities.

Reporting and Disclosure

Failure to file required annual report or to disclose certain material, including reports, statements, and documents to plan participants and beneficiaries.

Trust Activities

Issues concerning such matters as failure to carry out fiduciary duties in accordance with the trust agreement or failure to annually determine the fair market value of plan assets.

Vesting or Benefit Accruals

Failure to fully vest plan participants at normal retirement age or improper calculation of accrued benefits.

Major Contributors to This Report

Human Resources Division, Washington, D.C.

Joseph F. Delfico, Senior Associate Director, (202) 275-6193
Larry D. Wood, Group Director
John C. Hansen, Assignment Manager
Francis J. Kovalak, Evaluator-in-Charge
Lawrence R. Drewett, Evaluator

Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are $2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.

United States
General Accounting Office
Washington, D.C. 20548

Official Business
Penalty for Private Use $300

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100