Church Plans compared with ERISA Plans

How do church retirement and welfare plans, such as the Clergy Retirement Security Program, the Comprehensive Protection Plan and HealthFlex, differ from benefit plans subject to ERISA?

Church Plans Generally
Most U.S. employee benefit plans are governed by the Employee Retirement Income Security Act of 1974 (ERISA). ERISA covers both retirement plans (ERISA §3(2)), including both defined benefit and defined contribution plans, and welfare benefit plans (ERISA §3(1)), including, but not limited to, health plans, disability plans and life insurance plans. Church plans are defined in ERISA §3(33) and in §414(e) of the Internal Revenue Code (Code). In general, a church plan is a plan established and maintained by a church or by a convention or association of churches that is exempt from tax under Code §501.

ERISA §4(b)(2) exempts church plans from Title I (Protection of Employee Benefits Rights) and Title IV (Plan Termination Insurance) of ERISA and the regulations issued by the Department of Labor (DOL) thereunder. These two Titles contain most of the ERISA regulations of benefit plans. A church plan can elect to become subject to ERISA under Code §410(d). Such an election is irrevocable.

ERISA Requirements
Title I of ERISA imposes certain restrictions and obligations on employer-sponsored plans, including reporting, disclosure and fiduciary requirements. ERISA §§103 and 104 require plans to file Form 5500 (Annual Return/Report of Employee Benefit Plan) annually with the DOL. ERISA §§102 and 104 require plans to provide participants with summary plan descriptions (SPDs) for each plan, summaries of material modifications (SMMs) and summary annual reports (SARs). The minimum content of these notices is established in regulations, and includes a statement of ERISA rights with the address of the DOL for participants to submit grievances. ERISA requires that plans have a written plan document. ERISA and DOL regulations require plans to have claim and appeal rules with specific time limits for decisions and responses.

ERISA §§401 through 414 set certain standards for plan fiduciaries, including requirements that the plan be in writing, employer and employee contributions be timely deposited and the assets of a plan be held in trust. Fiduciaries must follow a “prudent expert” standard of care, and may be held liable for the acts of a co-fiduciary. ERISA prohibits certain transactions between a plan and a party in interest (and excise taxes may apply when they occur), and requires that certain plan officials be bonded. Church plans, though exempt from ERISA’s fiduciary rules, are often subject to state fiduciary laws (under state trust law), which parallel ERISA standards in many ways, but can be more flexible than ERISA.

ERISA Advantages
ERISA preempts (supersedes) state laws governing employee benefits to permit uniform administration of benefits for multistate employers. ERISA §503 requires claimants to follow the plan’s claims and appeals process and exhaust those procedures before being allowed to file a lawsuit. Lawsuits are heard in federal court rather than state court. State causes of action, such as misrepresentation, fraud and breach of contract, generally will not be heard. ERISA limits remedies for plan claimants to the value of the benefit—i.e., no extra-contractual or punitive damages. Claimants may be awarded attorney’s fees. Jury trials generally are
not available to claimants. Decisions by the plan are subject to the more favorable “arbitrary and capricious” standard of judicial review in federal court.

**Retirement Plans**

Title IV requires that defined benefit retirement plans pay annual premiums to the Pension Benefit Guarantee Corporation (PBGC) to insure a certain level of benefit coverage in the event the plan terminates without sufficient assets. If a defined benefit plan terminates, the plan must comply with PBGC notice and filing requirements. The PBGC does not necessarily guarantee the payment of a pension participant’s full accrued benefit. However, the PBGC does provide basic pension benefits (subject to a maximum benefit) to participants when underfunded plans are terminated. Title IV also requires pension plans to notify participants of their PBGC protections. The PBGC per-participant annual premium in 2010 is $35 (with added amounts for underfunded plans). Church plans are not insured by the PBGC under Title IV of ERISA. Church retirement plans save significant amounts of money by not paying PBGC premiums, dollars that are used instead for participant benefits, mission and ministry.

In addition, ERISA §4010 requires a defined benefit plan that is less than 80% funded (when the underfunding is more than $15 million) to submit audited financial statements to the PBGC for the contributing sponsor (e.g., the annual conference) and each member of its controlled group, as well as actuarial information on the sponsor’s other plans.

ERISA also applies minimum vesting, benefit accrual and anti-cutback rules. It also mandates minimum funding rules. Church plans are generally exempt from these requirements (though they are subject to a few less-restrictive pre-ERISA rules in the Code that are similar in some cases). ERISA’s anti-cutback provision would prohibit church plans from reducing current retirees’ benefits (or the accrued benefits of active participants). ERISA has coverage and participation rules (nondiscrimination), from which church plans are exempt. This exemption makes clergy-only plans possible; otherwise, lay employees would be entitled to the same benefits.

**Church Retirement Plans Under the Code**

Even with the exemption from ERISA, church plans are subject to many of the same rules and regulations as other pension plans under the Code, and to oversight by the Internal Revenue Service (IRS). However, certain accommodations exist in the Code that recognize the unique structures of denominations.

Church plans are not subject to requirements relating to the following: qualified joint and survivor annuities under Code §§401(a)(11) and 417; preservation of accrued benefits during a plan merger or transfer of plan assets under Code §§401(a)(12) and 414(l); anti-alienation rules of Code §§401(a)(13); benefit commencement requirements of Code §401(a)(14) (i.e., 60 days after occurrence of normal retirement, 10th anniversary of plan participation or termination); the prohibition on reducing retiree vested benefits due to Social Security increases under Code §401(a)(15); and the prohibition on forfeiture of accrued benefits from employer contributions due to withdrawal of employee contributions under Code §401(a)(19), if the employee is 50% vested.

Church plans are exempt from typical minimum participation standards, minimum vesting standards and minimum funding standards under Code §§410(c)(2)(B), 411(e)(2) and 412(e)(2). Church plans also have relaxed standards for defining a highly compensated employee under Code §414(q)(9). There are also specialized or relaxed rules pertaining to churches in computing the limits on employee contributions under Code §§401(a)(17), 402(g)(7) and 415(c)(7).

For Code §403(b) plans, the nondiscrimination provisions of Code §403(b)(12) do not apply to qualified church-controlled organizations (including local churches). And the IRS’s 403(b) regulations provide that
church 403(b) plan assets may be commingled in a common fund with other church assets and that the church 403(b) plan may pay benefits in the form of a life annuity provided the plan sponsor guarantees such annuity benefits if they exceed the participant’s account balance. Moreover, 403(b) defined benefit plans, limited to certain grandfathered church plans, are exempt from many Code §401(a) rules, giving them considerable flexibility in plan eligibility, nondiscrimination, funding and payments options.

The application of ERISA to church retirement plans would negate some of these special rules.

Health Plans
Church health plans used to be significantly less regulated than they are today. Typical denominational health plans were exempt from ERISA, and, because they usually are self-funded (self-insured), they were not regulated as health insurance issuers by state departments of insurance. In addition, there were few requirements of health plans in the Code until 1996.

Federal Law
When the Health Insurance Portability and Accountability Act (HIPAA) was enacted in 1996, Code §9801 was added, which subjected church health plans to most of HIPAA’s provisions. Since 1996, when Congress enacts reforms for group health plans, it typically amends the Code and the Public Health Services Act (PHSA) (which applies to health insurance issuers) at the same time it amends ERISA. Consequently, church health plans have become subject to more and more of the regulations that apply to health plans under ERISA.

Because they are exempt from ERISA, church health plans are not required to file Forms 5500 with the DOL or provide SPDs or SMMs to participants. Church plans are also exempt from the accelerated claims procedures in ERISA. The Women’s Health and Cancer Rights Act applies to health plans only through ERISA, so it generally does not apply to church health plans. However, most church plans offer such coverage anyway.

Through Code §§9811 and 9812, church health plans are subject to the following federal health plan laws: Newborns’ and Mothers’ Health Protection Act (requiring hospital stays of certain length for childbirth); Michelle’s Law (requiring extension of coverage for certain student dependents in cases of injury of illness); Children’s Health Insurance Program Renewal Act of 2009 (requiring notice of certain state CHIP programs); and Mental Health Parity and Addiction Equity Act of 2008 (requiring equal treatment of mental health and substance abuse benefits).

Church plans are exempt under Code §4980B(d)(3) from the federal continuation coverage requirements (COBRA) applicable to group health plans. Those requirements involve substantial notice and other administrative obligations. Though church plans are exempt from COBRA under the Code, were a church plan to be subject to ERISA, COBRA would then apply.

State Laws
Because they are generally exempt from ERISA, state insurance departments from time to time have asserted jurisdiction over self-insured church plans. Because church plans are often operationally multiple employer plans, states have asserted in the past that they are multiple employer welfare arrangements (MEWA) subject to state regulations. MEWAs are subject to state law even under ERISA through an exception.

In 1999, Congress enacted the Church Plan Parity and Entanglement Prevention Act (Parity Act) (P.L. 106-244), which amended the definition of church plan under ERISA §3(33). The Parity Act clarifies that, under state law, church welfare plans are deemed to be sponsored by a single employer that reimburses
costs from general church assets or purchases insurance coverage with general church assets—i.e., church health plans are not MEWAs. The Parity Act also exempts church health plans from state licensing, solvency and insolvency requirements.

**Health Care Reform**
The Patient Protection and Affordable Care Act (PPACA) has changed the regulation of church health plans even more. The PPACA did not include any church plan exemptions. The PPACA amended both ERISA and the Code (and thereby the rules applicable to church plans) to subject all group health plans to a host of new rules and requirements. Furthermore, if a church health plan loses grandfathered plan status under the PPACA, it becomes subject to even greater regulation by the federal government (grandfathered plans are exempt from many requirements of the PPACA). Non-grandfathered church health plans must provide coverage, notices, appeals rights and reports to the federal government to nearly the same degree as plans subject to ERISA.

**Welfare Plans**
Welfare plans that are not health plans can also be church plans. Church welfare benefit plans are also exempt from Title I of ERISA, relieving plan sponsors of the notice requirements, claims procedures and fiduciary standards thereunder. As with church health plans, church welfare plans may be subject to state laws in some circumstances because they lack ERISA’s preemption provisions.

**Death Benefits**
Death benefit plans (group term life insurance), such as CPP, UMLifeOptions and discretionary supplemental life insurance plans maintained by annual conferences, are not subject to the nondiscrimination in coverage requirements of Code §79(d)(7), meaning that death benefits do not have to cover all employees. Code §7702(j) treats death benefits from a self-funded church plan, for tax purposes, as life insurance proceeds under Code §101, meaning the benefits are generally not subject to income tax. The favorable tax treatment does not cause the sponsor to be taxed as an insurance company.

**Disability Benefits**
Similarly, disability benefit plans can be church plans and are not subject to ERISA. Plan sponsors are not required to provide SPDs and other notices annually, and are not subject to the ERISA fiduciary standards. In addition, church disability plans, because they are exempt from ERISA, have greater autonomy and flexibility in designing their claims and appeals procedures, free from the constraints of the DOL’s regulations under ERISA.

**Securities Laws**
Church plans and the investment pools maintained by church benefit programs in connection with such plans are generally exempt from federal and state securities laws, including the Investment Company Act of 1940 (§80a-3(c)(14)) and the Securities Act Of 1933 (§77c(a)(2)). Church plans are not required to register or report as investment companies, register securities held or disclose information about the securities they hold. Church plans, like other pension plans, are subject to the anti-fraud provisions of federal securities laws. Church plans using these securities laws exemptions are required to inform plan participants that they will not be afforded the protection of these securities laws. This notice is to be given to new participants as soon as practicable after beginning participation and to all participants annually.

Congress has also “blessed” the unique funding and administration of church plans and church benefit boards by authorizing the commingling by church benefit boards of plan and non-plan church assets for investment purposes.
Conclusions
The ERISA exemption for church plans remains as necessary today as when it was included in ERISA to avoid unnecessary government entanglement in the financial affairs of churches under the First Amendment. In addition, the exemption remains important as a matter of practicality—many of the ERISA rules that apply to secular benefit programs simply would not work in the decentralized context of a denominationally-offered church plan. Notwithstanding the ERISA exemption, most church plans voluntarily adopt many ERISA standards.

Church plan exemptions, though they may reduce certain participant protections under federal law, were created over time to recognize the special needs of denominational benefit plans. Clergy, who are self-employed for Social Security purposes, are able to participate in denominational benefit plans, because the denomination is deemed to be the employer. Any organization controlled by or associated with the denomination can participate. Application of ERISA nondiscrimination rules would be difficult for churches, because there is no centralized payroll system for denominations to test pay and benefits. And many denominations have separate clergy and lay worker retirement arrangements, reflective of church governance structures (i.e., denominational control over clergy benefits and local control for lay benefits), which could make compliance with ERISA’s coverage rules problematic, if not impossible.

Many denominations impose limitations on investments in certain industries or securities as a matter of religious conviction, and some require some level of socially targeted investments. These requirements, based on religious tenets, would be problematic under ERISA’s investment and fiduciary rules. Denominations and church organizations often finance benefit plans in creative ways, sometimes directly billing each local church employer, but sometimes blending contributions and cross-subsidizing among participating employers, which could be prohibited under ERISA. ERISA also has specific deadlines for plan sponsors to remit contributions to a plan and penalties for failing to do so. With their lack of central employment offices, and often volunteer support staff, churches can have trouble satisfying these rules.