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EMPLOYEE BENEFITS

Johnson & Johnson Highlights the Need to Revisit ERISA Responsibilities

This article should not be considered a comprehensive guide to the ERISA plan asset, fiduciary responsibility, trust or exclusive benefit requirements, or the requirements applicable to ERISA plan sponsors utilizing a trust. ERISA plan sponsors should consult with legal counsel regarding compliance with the fiduciary responsibilities of ERISA, Part 4, discussed in part below.

Introduction

A class action lawsuit was filed by and on behalf of participants of a group health plan sponsored by Johnson & Johnson (plaintiffs). The lawsuit, alleging mismanagement of the prescription drug benefit program, was filed against the following parties (defendants):

1) Johnson & Johnson as the plan sponsor
2) The pension and benefits committee of Johnson & Johnson and specific members of such committee

The complaint alleges, among other things, that defendants failed to act as prudent experts would have when selecting the plan's pharmacy benefit manager (PBM) and negotiating pricing for prescription drugs covered by the plan. A key factor underlying these allegations is Johnson & Johnson's plan is funded through a trust. As of this article's date (May 2024), this case is still in the initial stages of the litigation process (filed February 2024).

Considering this recent litigation, this article briefly describes some special considerations for plans with plan assets, including those utilizing a trust.

NOTE: This article is intended to be informational and does not comment on the soundness of any specific strategies for selecting a PBM or designing a plan's pharmacy benefits or on the merits of plaintiffs' (e.g., Johnson & Johnson plan participants') claims.

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ERISA Protection: The Big Picture

ERISA requires every employee benefit plan to be established and maintained pursuant to a written instrument that provides “for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan.” In most cases, employers who sponsor welfare benefit plans for their employees are considered fiduciaries of the plan.

Prudence and Undivided Loyalty

Fiduciary duty generally applies to “every act taken in a fiduciary capacity.” In addition, ERISA outlines specific fiduciary duties. This article discusses several, but not all, of the fiduciary duties required by ERISA.

Fiduciaries are expected to perform their duties with the care, skill, prudence, and diligence that a prudent expert would use and with like aims. ERISA also requires fiduciaries to act solely in the interests of participants and beneficiaries, commonly referred to as the duty of undivided loyalty.

ERISA was primarily enacted to protect pension plan participants. At the time, regulating welfare benefit plans was a secondary concern. However, since ERISA was enacted, employee welfare benefit plan requirements have significantly expanded. While ERISA claims alleging mismanagement of funds are not uncommon in the retirement plan landscape, this class action lawsuit against Johnson & Johnson could mark a shift in the welfare benefit plan landscape. As a result, plan sponsors should evaluate whether third party administrators and other vendors of their welfare benefit plans are chosen and monitored with the same care, skill, prudence, and diligence that an expert acting in the sole interest of participants and beneficiaries would use to choose and monitor third party administrators.

Plan Assets

Employee welfare benefit plan sponsors should consider taking a moment to assess whether they sponsor any plans that may be subject to the same level of scrutiny as the health plan in the Johnson & Johnson case due to holding plan assets in trust. In addition, this case highlights the importance of ensuring plans comply with ERISA’s fiduciary requirements specifically applicable when a plan is “in possession of plan assets.”

Sponsors of employee welfare benefit plans will likely possess plan assets while performing administrative functions if the plan collects participant contributions, as participant contributions become plan assets the moment they can reasonably be segregated from an employer's general assets (and in no event later than 90 days after being withheld or contributed). In addition, funds in possession of the plan sponsor in excess of what can be attributed to participant contributions, even those originating from the plan sponsor’s general assets, are at times considered plan assets under ERISA.

Examples of situations in which funds other than participant contributions can become plan assets include:

Formal Irrevocable Trust

Funds held in trust by ERISA welfare benefit plans are considered plan assets under ERISA. This includes plan sponsor contributions to the trust and investment returns on the trust assets.

Separate Accounts

If the sponsor of a self-insured welfare benefit plan establishes a separate account for paying claims instead of paying claims from their general assets, this could result in all amounts held in that separate account being considered plan assets.

In other words, this could result in employer contributions and any earned interest within the account being considered plan assets. A crucial factor to be considered in determining whether these additional amounts are considered plan assets is whether the plan has a beneficial interest in the account. This will depend on whether the relevant documents, actions, or representations show an intention that funds in the account belong to the plan.

Example 1: A plan sponsor utilizes a separate account to fund plan benefits. The account is in the plan sponsor's name and contains general assets of the plan sponsor. Typically, segregation of funds in this manner does not, on its own, result in additional funds being designated as plan assets.

Example 2: A plan sponsor utilizes a separate bank account in the plan's name to fund plan benefits. Typically, segregation of funds in this manner will result in additional funds being designated as plan assets.

It is not always clear if the segregation of funds will cause the additional funds to become plan assets. However, this is a common employer strategy, especially in administering health reimbursement arrangements (HRAs) and health flexible spending accounts (FSAs). A potential solution may be giving the TPA check writing authority over an account that otherwise belongs to and is for the benefit of the plan sponsor. Sponsors of employee welfare benefit plans are strongly encouraged to discuss the current funding structures of self-insured plans with legal counsel to determine if the strategies could lead to additional funds being treated as plan assets.

Exclusive Benefit Requirement

ERISA plan sponsors must use plan assets for the exclusive benefit of plan participants. In other words, plan assets may only be used to provide benefits to participants or to defray reasonable administrative expenses directly benefiting plan participants. Depending on the circumstance, returning plan assets to plan participants may be a plan sponsor's only option to comply with the exclusive benefit rule.

Plan assets may only be used to defray administrative expenses if permitted by the ERISA plan document and SPD. Administrative expenses for these purposes should only include "direct expenses properly and actually incurred in the performance of a fiduciary's duties to the plan."[1] The Department of Labor (DOL) does not consider expenses related to settlor functions of the plan, such as establishment, amendment and termination, to be considered administrative expenses. Expenses are only considered reasonable administrative expenses if they benefit the same participants from whom the plan assets were collected.

The following factors can lead to challenges for plan sponsors attempting to comply with the exclusive benefit requirement. They could cause a plan sponsor to possess funds considered plan assets. Plan sponsors should be prepared to comply with the exclusive benefit rule regarding these funds.

Surplus

If participant contributions to a self-insured plan exceed paid claims and reasonable administrative expenses, the surplus amounts are considered plan assets. Plan sponsors are not permitted to retain these surplus amounts. Self-insured plan sponsors should be aware that the exclusive benefit rule requires accounting of these excess funds.

[1] 29 CFR 2550.408c-2

Rebates

If the sponsor of a fully insured ERISA welfare benefit plan receives a rebate from an insurance carrier for a policy that is at least partially funded by participant contributions, all or a portion of that rebate may be considered plan assets. According to guidance applicable to MLR (Medical Loss Ratio) rebates, the same percentage of total premiums paid to the carrier attributable to participant contributions should be applied to the total rebate received by the plan sponsor and considered plan assets.[2] This general approach also applied to rebates plans received from carriers during the COVID-19 pandemic.

When determining how to utilize carrier rebates, a plan sponsor should assess if returning any rebates to past plan participants is feasible. Specifically, rebates should be returned to a former participant enrolled during the rebate coverage period. Proportionate sharing of rebates and other experience refunds with former participants may depend on whether the benefit payable to such participants is more than de minimis when considering the cost of administering the refund and associated tax on the payment. Plan sponsors could use the amount for current plan participants if it is not feasible. For more information about determining the appropriate use of plan assets resulting from MLR rebates, see Brown & Brown's FAQ.

READ FAQ →

FSA Experience Gains

Any health FSA participant contributions considered plan assets that are later forfeited back to the health plan will continue to be considered plan assets of the health FSA.

Specific concerns regarding the use of FSA experience gains for the exclusive benefit of FSA plan participants are as follows:

1) Plan sponsors that utilize a TPA or other service provider may use forfeited amounts to pay the associated costs of the TPA's administration (e.g., claims processing fees) if the costs are reasonable and not used to offset administration costs of a different plan.

2) Being paid from plan assets to offset a plan sponsor's in-house administrative expenses potentially violates ERISA's self-dealing prohibition.[3] Plan sponsors should only reimburse in-house administrative expenses with FSA experience gains with the guidance of legal counsel.

3) If returning experience gains to health FSA plan participants, the funds must be allocated uniformly and reasonably (e.g., on a per capita or weighted average based on coverage level). The plan sponsor cannot consider individual claims experience or individual forfeiture amounts.

For more information on appropriately utilizing health FSA experience gains, see our 2024 Health FSA Guide.

VIEW 2024 HEALTH FSA GUIDE →

[2] This is the method that should be used when both the employer and participants pay a fixed percentage of the premiums. However, separate rules apply if either: 1. the employer pays a fixed amount, and participants pay any additional costs; or 2. participants pay a fixed amount, and the employer pays any additional costs.
[3] DOL Information Letter to Gary E. Henderson (July 28, 1998).

Trust Requirement

Plans subject to ERISA are generally required to hold all plan assets in trust.

DOL Technical Release 1992-01

DOL Technical Release 92-01 may offer relief from enforcement of the requirement to hold plan assets in trust.[4] Note, however, the guidance provided in Technical Release 92-01 is not a formal exception to the statutory trust requirement, it is "a non-enforcement policy." It seems clear that the DOL will not actively enforce the trust requirement if the conditions of the non-enforcement policy are met. However, participants could still decide to assert a violation of the statutory trust requirement by a plan sponsor regardless of the sponsor's compliance with the requirements of DOL Technical Release 92-01.

That said, most employers rely on the Section 92-01 non-enforcement policy. Therefore, ERISA welfare benefit plan sponsors should review (with the assistance of legal counsel) the setup and function of their plans to determine whether DOL Technical Release 92-01 applies and whether the DOL will not enforce the ERISA requirement to hold plan assets in trust.

DOL Technical Release 1992-01 provides two separate non-enforcement policies, one for cafeteria plans and one for insured plans.

Cafeteria Plans

Technical Release 92-01 may offer relief from DOL enforcement of the requirement to hold plan assets in trust in cases where the following conditions apply:

1) Participant contributions are the sole plan assets
2) The participant contributions are made through salary reductions under the employer's cafeteria plan
3) The funds (participant contributions) remain part of the employer's general assets until used to pay benefits or plan expenses

Insured Plans

Technical Release 92-01 may also offer relief from DOL enforcement of the requirement to hold plan assets in trust in cases where the following conditions apply:

1) Benefits are provided exclusively through insurance contracts or through a qualified health maintenance organization (HMO)
2) Premiums are paid directly by the employer (or employee organization) from its general assets or partly from its general assets and partly from contributions from its employees (or members)
3) Contributions by participants are forwarded to the insurance carrier or HMO by the employer (or employee organization) within three months of receipt

The DOL has indicated collecting COBRA premiums on a post-tax basis will not jeopardize the DOL's non-enforcement of the trust requirement for a plan that otherwise complies with requirements of either non-enforcement policy (for cafeteria plans or insured plans). However, plan sponsors should know that the relief will only apply if all conditions of either non-enforcement policy apply.

[4] *Additional nonenforcement positions may apply in specific circumstances. For instance, in its guidance regarding MLR rebates discussed above, the DOL indicated that it would not enforce the trust requirement with respect to any portion of the MLR rebate that constitutes plan assets so long as those plan assets were returned to participants or used within three months of receipt*

Responsibilities of Plans Utilizing a Benefits Trust

Plan sponsors should discuss with legal counsel whether they satisfy the typically heightened obligations applicable to plans holding plan assets in trust. One of the fiduciary duties imposed by ERISA on plan sponsors is to diversify "the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so." Typically, ERISA welfare benefit plan sponsors only have plan investments if a trust is utilized.

While determining whether a plan's investments are sufficiently diversified, plan sponsors should consider the following factors[5]:

(A) The composition of the portfolio with regard to diversification

(B) The liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan

(C) The projected return of the portfolio relative to the funding objectives of the plan

Johnson & Johnson

The Johnson & Johnson case has not established a new avenue for ERISA welfare benefit plan participants to enforce their rights. However, the outcome of the case may help inform whether welfare benefit plan participants will deem claims alleging violations by fiduciaries in the maintenance and utilization of plan assets an effective use of time and attention moving forward. Regardless of the outcome, plan sponsors and fiduciaries can take this opportunity to reexamine their compliance with ERISA's fiduciary and plan asset requirements.

Action Items / Key Take-Aways

- Plan sponsors should evaluate whether third party administrators and other vendors of their welfare benefit plans are chosen and monitored with the same care, skill, prudence, and diligence that an expert acting in the sole interest of participants and beneficiaries would use to choose and monitor third party administrators.
- Sponsors of employee welfare benefit plans should consider taking a moment to assess whether they sponsor any plans that may be subject to the same level of scrutiny as the health plan in the Johnson & Johnson case due to holding plan assets in trust.
- Sponsors of employee welfare benefit plans will likely possess plan assets while performing administrative functions of the plan if the plan collects participant contributions, as participant contributions become plan assets the moment they can reasonably be segregated from an employer's general assets.
- Sponsors of employee welfare benefit plans are strongly encouraged to discuss the current funding structures of self-insured plans with legal counsel to determine if the strategies could lead to additional funds being categorized as plan assets.
- If participant contributions to a self-insured plan exceed paid claims and reasonable administrative expenses, the surplus amounts are considered plan assets. Plan sponsors are not permitted to retain these surplus amounts.
- If the sponsor of a fully insured ERISA welfare benefit plan receives a rebate from an insurance carrier for a policy that is at least partially funded by participant contributions, all or a portion of that rebate may be considered plan assets.
- Any health FSA participant contributions that are forfeited by the participant will continue to be considered plan assets of the health FSA.
- Plans subject to ERISA and in possession of plan assets are generally required to hold the assets in trust.
- ERISA welfare benefit plan sponsors should review the setup and function of their plans to determine whether DOL Technical Release 92-01 applies. If so, the DOL will not enforce the ERISA requirement to hold plan assets in trust.
- Plan sponsors should discuss with legal counsel whether they satisfy the typically heightened obligations specifically applicable to plans holding plan assets in trust.

[5] https://www.federalregister.gov/documents/2020/11/13/2020-24515/financial-factors-in-selecting-plan-investments

How Brown & Brown Can Help

Connect with your Brown & Brown service team to learn more about how we can help find solutions to fit your unique needs.

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