The Impact of the Electronic Signatures Act on Plan Administration

By FREDRIC S. SINGERMAN

New law brings us one step closer to the reality of a paperless world by affording electronic signatures the same status as the traditional handwritten signature. Its impact on plan administration is both welcome and significant in allowing new paperless systems to be implemented with a much higher degree of confidence that they will hold up to legal challenges.

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On June 30, 2000, President Clinton signed into law the Electronic Signatures in Global and National Commerce Act (the Electronic Signatures Act) [Pub. L. No. 106-229 (2000)], in order to provide electronic transactions the same legal status as pen-and-paper transactions. To a large extent, the Electronic Signatures Act recognizes what already exists: An ever-growing proportion of the country already relies upon electronic technology for commercial transactions, from banking and investing to purchasing goods and services. In the employee benefits arena, 401(k) plan vendors routinely permit participants to access their accounts using interactive voice response (IVR) telephone systems or the Internet. The Electronic Signatures Act is intended not only to recognize the validity of these transactions, but to expand them "by providing a consistent national framework for electronic signatures and transactions." [S. Rep. No. 106-131, at 1 (1999)]

The Electronic Signatures Act will have a significant impact on the administration of employee benefit plans, bringing us closer to the holy grail of truly paperless plan administration. This article describes the three key areas addressed by the Electronic Signatures Act—the validity of electronic signatures; electronic disclosures to consumers; and electronic retention of records. It also reviews the current Internal Revenue Service (IRS) and Department of Labor (DOL) authority on paperless administration, to the extent they continue to be relevant, and addresses possible opportunities and pitfalls presented by the Act.

ELECTRONIC SIGNATURES ACT

Congress intended that the Electronic Signatures Act would have broad-reaching effects on electronic commerce. Thus, the Act applies "to any transaction in . . . interstate or foreign commerce." [§ 101(a)] The term "transaction" is defined broadly as any "action or set of actions relating to the conduct of business, consumer, or commercial affairs between two or more persons." [§ 106(13)]

The Act's expansive scope is reflected in its broad preemption of state law. Under Section 102(a) of the Act, a state law or regulation may modify, limit, or supercede the Act only if the state action either adopts the Uniform Electronic Transactions Act (as reported by the National Conference of Commissioners on Uniform State Laws in 1999) or provides alternative procedures for the use of electronic signatures and records consistent with the Act.

The Act will apply similarly broadly at the federal level, and to the Employee Retirement Income Security Act (ERISA) in particular. Section 514(d) of ERISA makes it clear that ERISA does not "alter, amend, modify, invalidate, impair, or supersede any law of the United States," including the Electronic Signatures Act. A colloquy between Senators Gramm and Abraham while the Act was under consideration specifically addresses how the Act may affect ERISA:

> SEN. GRAMM: "It is my understanding that [the Act] would cover all activities relating to employee benefit plans or any other type of tax-favored plan, annuity or account, such as an IRA, a 403(b) annuity, or an education savings program, including all related tax and other required filings and reports. Is this correct?"

> SEN. ABRAHAM: "Yes, and as a result, the act would apply to such activities as the execution of a prototype plan adoption agreement by an employer, the execution of an IRA application by an individual, and the waiver of a qualified joint and survivor annuity by a plan participant's spouse and the designation of any beneficiary in connection with any retirement, pension, or deferred compensation plan...." [146 Cong. Rec. S5283 (June 16, 2000)]

Certainly, the ability to elect a benefit option requiring *spousal consent* goes well beyond the array of employee benefit transactions currently permitted to be implemented electronically.

Electronic Signature

As noted above, the Act gives electronic signatures and online transactions the same legal force as those created or entered into with pen-and-paper. Section 101(a) of the Act provides that "a signature, contract, or other record ... may not be denied legal effect, validity, or enforceability solely because it is in electronic form." Further, "a contract ... may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation." [§ 101(a)(2)]

An important feature of the Act is that it is *technologically neutral*—that is, it does not dictate the type of technology the parties may use to create an electronic signature or to enter into a transaction. Thus, the term "electronic signature" is defined as "an electronic sound, symbol, or process attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record." [§ 106(5)] This could encompass pushing a specified number or code on a telephone key pad; pressing "I Accept" on a web page; or sending an e-mail indicating the acceptance of terms. The key is that the person executing the transaction intended to sign the contract. The Act does not explicitly address the possibility that an electronic signature may be forged. As with paper signatures, this is a matter of proof from a legal perspective.

Further, if a statute or regulation requires that a signature be notarized, made under oath, or otherwise verified, that too may be done electronically. [§ 101(g)] This provision is intended to permit notaries and other officers to perform their functions electronically so long as they provide all information required by law for notarization or authorization (which would presumably require that the notary and signatory be at the same terminal). The Act removes any requirement for a stamp, seal, or other embossing device that might otherwise preclude entering into the contract by electronic means.

Electronic Records

The Act also authorizes the use of electronic records in consumer transactions. Anywhere "a statute, regulation, or rule of law requires that information ... be provided or made available to a consumer in writing," an electronic record may be substituted. [§ 101(c)] However, the Act does not *require* a person to use or accept electronic records or electronic signatures. [§ 101(b)(2)] Among other things, Congress was worried that consumers might be "forced or tricked into receiving notices and disclosures in an electronic form that they cannot access or decipher." [146 Cong. Rec. S5220 (June 15, 2000) (statement of Sen. Leahey)] Thus, in order for the use of electronic records to be valid, the consumer must affirmatively consent to their use; and the consumer has the option of withdrawing that consent. Moreover, the Act does not affect either the required content or timing of consumer notices.

The Act imposes specific requirements regarding how consumers may "opt-in" to receiving electronic records. Under Section 101(c)(1)(B), the consumer must be provided, *prior to consenting*, with a "clear and conspicuous statement" (which may be delivered electronically) describing

1. Any right or option to have the record provided on paper;
2. The right of the consumer to withdraw consent to receiving records in electronic form, and whether any consequences or fees apply if consent is withdrawn;

3. Which transactions and/or records the consent applies to;
4. The procedures the consumer must use to withdraw consent; and
5. The hardware and software requirements needed to access and retain the electronic records.

Significantly, the consumer's consent must be given electronically, "in a manner that reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information." [§ 101(c)(1)(C)(ii)] This "reasonable demonstration" requirement would be satisfied, for example, if the consumer replies in a manner that indicates he or she has actually accessed the electronic record—by sending a reply e-mail, clicking on the appropriate icon at a website, or by pressing the appropriate telephone key when prompted by an IVR system.

Failure to comply with the opt-in requirements of the Act does not necessarily mean that the underlying contract is invalid. Rather, the same principles of contract law that apply to pen-and-paper contracts must be considered to determine if the particular transaction is valid. [§ 101(c)(3)] Thus, if the consumer saw the terms and conditions of the agreement before signing electronically, the underlying contract may still be enforceable. Similarly, if the consumer withdraws consent to receive documents electronically, the withdrawal will not affect the validity of prior transactions. [§ 101(c)(3)]

It is important to note that the Act's provisions regarding the use of electronic records applies only to "consumers." (This is not true of the Act's other provisions, relating to electronic signature and electronic recordkeeping.) Thus, a key issue that may affect the Act's impact on ERISA plan administration is whether, or when, a plan participant is a "consumer." Section 106(1) of the Act defines a "consumer" as "an individual who obtains, through a transaction, products or services which are used primarily for personal, family, or household purposes ...." This would appear to apply, for example, to a 401(k) plan participant making an investment decision or requesting a distribution or loan, because the participant is in a similar position to an investor accessing a bank or mutual fund account. It is less clear, however, whether a pension plan participant is similarly a "consumer" for purposes of the Act, although the legislative history quoted above suggests that he or she is. As of this writing, the DOL has not weighed in on the issue.

Retention of Records

Under Section 101(d) of the Act, if a statute or regulation requires that a contract or record be retained, this requirement is satisfied by the retention of an electronic record of the required information, provided that two conditions are met: First, the record must accurately reflect the information set forth in the contract or other record; and second, the record must remain accessible to all who are entitled to access it for the time required by law in a form capable of being reproduced. If these conditions are satisfied, even the requirement that a particular contract or other record be an *original document* (such as under a statute of frauds) will be satisfied. The Act also permits retention of an electronic record containing the information on the front and back of a check, in lieu of the original check (or a photocopy of the check).

Excluded Transactions

Although the Electronic Signatures Act was intended to apply broadly, certain transactions and records are specifically exempt. These include the following:

- Court orders and documents (which would include domestic relations orders);
- Wills and matters of family law;
- Notice of cancellation of utilities or repossession of a consumer's primary residence;
- Cancellation of health or life insurance benefits; and
- Product recalls

Effective Dates

The Act generally becomes effective on October 1, 2000. The record retention provisions, however, become effective March 1, 2001. A state or federal agency may delay the effective date of these provisions in order to propose rules regarding retention, but only to June 1, 2001.

PRIOR AUTHORITY REGARDING PAPERLESS ADMINISTRATION

The Electronic Signatures Act does not write on a clean slate (or blank computer screen) when it comes to employee benefit plan administration. Both the IRS and the DOL have previously weighed in with guidance in the area, and an important challenge to practitioners (and to the respective agencies) in the coming months will be to determine how the Act will affect the existing agency guidance.

DOL Authority

In 1999, the DOL proposed regulations permitting the electronic distribution of summary plan descriptions (SPDs), summaries of material modifications (SMMs), and summary annual reports (SARs) for employee benefit plans covered by ERISA. [Prop. DOL Reg. § 2520.104b-1(c)] The proposed regulations also address the use of electronic media for maintenance and retention of employee benefit plan records. [Prop. DOL Reg. § 2520.107-1]

Under the DOL guidance (which employers are currently entitled to rely on), electronic distribution of SPDs, SMMs, and SARs is permitted only for participants who have the ability to "effectively access" documents furnished in electronic form and convert them to paper form without charge. In addition, the following requirements apply:

- The administrator must take "appropriate and necessary measures" to ensure that the system results in actual receipt by participants of transmitted information and documents (e.g., using return-receipt electronic mail or conducting periodic reviews or surveys to confirm receipt of transmitted information).
- The electronically delivered documents must be prepared and furnished in a manner consistent with the applicable style, format, and content requirements for SPDs for the applicable "hard copy" documents.
- Each participant must be provided notice, through electronic means or in writing, apprising him or her of the documents to be furnished electronically, the significance of the document, and the right to request and receive a paper copy free of charge.
- Upon request of any participant, the plan administrator must furnish a paper copy of the document free of charge.

The DOL proposed regulations also address electronic record maintenance and retention. In general, the DOL takes the position that the record maintenance and retention requirements imposed by ERISA would be satisfied by using electronic media if the following requirements are met:

1. The electronic recordkeeping system has reasonable controls to ensure the integrity, accuracy, authenticity, and reliability of the electronic records;
2. The electronic records are maintained in a reasonable order and in a safe and accessible place, so that they may be readily examined (e.g., the system should provide for indexing, preserving, retrieving, and reproducing the electronic records);
3. The records are readily convertible into legible paper copy;
4. The electronic recordkeeping system is not subject to any agreement or restriction that would limit the ability to comply with any reporting and disclosure requirements of ERISA;
5. Adequate records management practices are implemented (e.g., procedures for labeling electronic records, providing a secure storage environment, creating back-ups, etc.); and
6. The electronic records must exhibit "a high degree of legibility and readability" when displayed on a computer terminal.

Although the requirements imposed by the DOL are arguably superceded by the Electronic Signatures Act, they are nonetheless significant because they provide reasonable guidelines a prudent fiduciary must consider in moving to electronic recordkeeping.

IRS Authority

In Notice 99-1, the IRS made it clear that the Internal Revenue Code does not bar participant enrollment, contribution elections, beneficiary designations (other than designations requiring spousal consent), direct rollover elections, and 401(k) elections from using electronic media. This notice, along with proposed regulations permitting the electronic delivery of distribution notices, acknowledged and accelerated the market shift to daily valuation 401(k) plans that permit participants to make contribution, investment, and distribution decisions on a largely paperless basis.

On February 8, 2000, the IRS finalized the proposed regulations regarding electronic delivery of notices required for benefit distributions, including notice of distribution options, the right to roll over benefits into an individual retirement account or another qualified retirement plan, notice of the right to defer distribution to normal retirement age, and notice concerning voluntary tax withholding. [Treas. Reg. §§ 1.402(f)-1, 1.411(a)-11, 35.3405-1] Examples in the IRS regulations make it clear that participant notice *and elections* may be processed via e-mail, through access to a website, or using a telephone menu system, with the participant's identity verified through a personal identification number (PIN). [Treas. Reg. §§ 1.402-1(g), A-5; 1.411(a)-11(f)]

Under the IRS regulations, distribution notices provided through electronic media must be provided under a system that meets the following requirements:

1. The system must be reasonably designed to provide the notice in a manner no less understandable than a written paper document; and
2. At the time the notice is provided, the participant must be advised that he or she may request and obtain a written copy of the document to be provided at no charge.

If a participant's consent to a distribution is obtained electronically (or by telephone), the following requirements apply:

- The electronic system must be reasonably designed to preclude any individual other than the participant from giving consent;
- It must provide the participant with a "reasonable opportunity" to review, modify, or rescind the terms of the distribution before the consent becomes effective; and
- It must provide for confirmation of the terms of the distribution, either on a written paper document or through electronic media, within a reasonable time after consent is given.

Certain of the notices addressed in the regulations require delivery within a fixed period (i.e., 30 to 90 days) before the distribution. The regulations permit this timing requirement to be met by delivering the full notice in writing before the required period, and providing a summary of the notice by telephone at the time of the election. The participant may also waive the requirement that distribution notices be provided at least 30 days in advance of distribution as part of the consent. [Treas. Reg. § 1.402(f), A-2] Thus, the regulations encourage paperless administration by cutting through the otherwise burdensome notice and timing requirements that apply to distribution notices. Because the Act does not affect the required content or timing of consumer notices, this guidance remains important.

(More recently, the IRS issued regulations permitting plan loans to be made electronically if requirements similar to those discussed above for distributions are not met. [Treas. Reg. § 1.72(p)-1, Q-3(b).] Again, no provision is made for loans requiring spousal consent.)

IMPLICATIONS OF THE ACT

The Electronic Signatures Act will have a major impact on the administration of employee benefits plans. Because of the Act's broad preemption of both federal and state laws that would otherwise require action in writing, plan administrators may design and implement systems for paperless administration and electronic recordkeeping with a much higher degree of confidence that these systems will stand up to legal challenge. (Although this article focuses on the interaction between plan and participant, the employer should not overlook the application of the Act to transactions—including claims processing—with vendors and providers .)

For example, many employers have been reluctant to move entirely to electronic enrollment in employee benefit plans requiring a participant contribution, because of uncertainty as to whether state wage payment laws requiring *written* authorization for withholdings will apply. Once the Act becomes effective, the legal status of electronic authorization will be clear. Employers have also been reluctant to use electronic enrollment for health insurance plans, where the potential exposure from a coverage dispute involving a catastrophic claim can be enormous. Because the Act gives the same legal status to signatures provided electronically as accorded to signatures on paper, this consideration also becomes less significant.

The Act also clears the way for the paperless processing of participant claims. Thus, the requirement of a *written* claims determination in DOL Regulations Section 2560.503-1 will be satisfied by an e-mail, to the extent the participant has "opted-in" to the Act's electronic records provisions. Similarly, a plan could permit an electronic request for a 401(k) plan hardship withdrawal, or a claim for flexible spending account benefits, even though the IRS currently requires written documentation for these claims. [*See*, Treas. Reg. § 1.401(k)-1(d)(2); Prop. Treas. Reg. § 1.125-2, A-7(b)(5)] Required third-party documentation in support of a claim may also be submitted electronically (e.g., attaching an e-mail from a child care provider in support of a dependent care assistance plan).

Once it becomes effective, the Electronic Signatures Act will permit the electronic distribution of a large array of other documents required to be distributed by ERISA, but not addressed by the DOL guidance. This would include the Section 204(h) notice of cessation of benefit accruals, COBRA notices, HIPAA certificates of coverage, and claims determinations. However, a key limitation on an employer's ability to deliver these notices electronically is the Act's requirement that the participant consent *in advance* to receiving notice electronically. The DOL guidance, although narrower in scope, is actually less restrictive than the Electronic Signatures Act with respect to a participant's opt-in rights. However, once the plan obtains a participant's agreement to electronic records, it should not be necessary to assure that the participant may "convert them to paper form without charge," as required by the DOL proposed regulation.

In evaluating the application of electronic systems to benefits at a particular employer, the driving force will be how "online" the employer is, and whether the employer can track those employees who are and are not online or who opt out of receiving documents electronically. (Although the Act does not permit an employer to force participants to perform transactions electronically, it should be possible to limit specified benefits only to individuals who consent to electronic administration, subject to the limitations in ERISA. However, as far as we know, neither the DOL nor the IRS has formally addressed the exclusion of participants on this basis.) An employer intending to move to electronic processing should consider making opt-in language a part of its open enrollment process.

One large benefit of the Act not dependent upon an online workforce is that it clarifies and makes uniform the rules governing electronic record retention. Because of the unclear (and apparently eroding) limits to ERISA preemption, employers generally retain paper records to document participant loans, beneficiary designations, COBRA elections, and other actions that may arguably fall within the realm of state consumer, family, or insurance law that might impose more burdensome writing or record retention requirements than ERISA. The Electronic Signatures Act will, upon becoming effective, preempt the field. This will permit employers and plan administrators to more fully implement electronic record retention.

It is important to keep in mind the limitations of the Electronic Signatures Act, however. Although the Act is intended to establish parity between written and electronic signatures, a participant or beneficiary may challenge a plan's reliance on an electronic signature (or electronic distribution of an important notice) based upon breach of fiduciary duty under ERISA. Because a judge may be wary of forgoing a pen-and-ink signature in favor of having the participant enter a PIN, it is important that the plan's e-systems be secure (or, as the IRS puts it, "be designed to preclude any individual other than the participant from giving consent" to an action) and be *demonstrably* reliable. Consistent with ERISA's duty of prudence, the employer should consider alternate technologies for executing plan transactions. Once selected, the employer must continue to monitor developments in the technology to assure that its paperless systems remain secure and reliable.