Morgan Lewis

webcast

Plan Sponsor Basics

Webinar 6 of 6

Fiduciary Responsibility and 401(k) Plans

Presenters:

Gregory L. Needles

Julie K. Stapel

Stuart P. Kasiske

September 19, 2012

www.morganlewis.com

Today’s Topics

- Statutory Framework
  - ERISA
  - Fiduciary Duties
- Plan Governance
  - Roles and Responsibilities
  - Governance Examples
- Managing Fiduciary Liability
  - Investment Options
  - Participant Disclosures and Other Considerations

Statutory Framework

- ERISA
- Who is a fiduciary?
- What are a fiduciary's duties?

ERISA and the Code

- ERISA
  - Reason for enactment
  - Sets forth a comprehensive scheme to protect employee benefits
  - Coverage
  - Are plan assets involved?

Who Is a Fiduciary?

- Functional test – a person is a fiduciary to the extent he or she:
  - exercises discretionary authority or discretionary control respecting management of the plan
  - exercises any authority or control respecting management or disposition of plan assets
  - renders investment advice for compensation with respect to plan assets
  - has any discretionary authority or discretionary responsibility for plan administration

Who Is a Fiduciary?

- A person becomes a fiduciary by:
  - being formally designated as a fiduciary
  - functioning as a de facto fiduciary
  - appointing other fiduciaries
  - default: if a plan administrator is not named, the plan sponsor (usually the employer) is considered to be the plan administrator

Morgan Lewis

What Are a Fiduciary's Duties?

- The exclusive purpose rule
- Avoidance of prohibited transactions
- The prudent investor standard – process is key
- Diversification
- Following the terms of the plan

Plan Governance

- Process, Process, Process
  - Clearly defined roles
  - Qualified people
  - Well-reasoned decisions

Plan Governance – Roles and Responsibilities

- Nonfiduciary Roles
  - Settlor (Plan Sponsor) Functions
    - *Plan/trust creation, amendment, termination, contributions*
    - *May wear "two hats"*
  - Ministerial Functions
    - *Nondiscretionary actions*

Plan Governance – Roles and Responsibilities

- Designated Fiduciaries
  - Plan Administrator (Administrative Fiduciary)
    - *Designated in the plan document and SPD*
    - *Responsible for discretionary aspects of day-to-day plan operation (e.g., loans, QDROs)*
  - Named Fiduciary (Investment Fiduciary)
    - *Designated in plan document or appointed via procedure in plan document*
    - *Primarily responsible for selection and monitoring of plan investment options*

Morgan Lewis

Plan Governance – Appointing and Monitoring Plan Fiduciaries

- Frequently targeted in litigation:
  - Broadens the scope of discovery
  - Provides access to deep pockets – executives, insurance coverage, employer indemnity
  - Perception that settlement is more likely
- Suggestions for managing risk:
  - Carefully evaluate roles and candidates
  - Document selection process
  - Provide initial and ongoing training

Plan Governance – Dealing with Plan Service Providers

- Fiduciary duties apply to selection, monitoring, and payment
- Suggestions for managing risk:
  - Initial due diligence
  - Proper allocation of responsibilities
  - Ongoing monitoring

Plan Governance – Communicating with Participants

- Plan fiduciaries have duty to:
  - Provide certain disclosures under ERISA
  - Not lie when asked
- Suggestions for managing risk:
  - Establish procedures for participant communications
  - Include discretion and reservation-of-rights clauses
  - Maintain records of all participant communications

Plan Governance – Claims Administration

- Benefit claims present heightened risk
- Suggestions for managing risk:
  - Good plan and SPD language
  - Full and fair review of initial decision
  - Meet all time deadlines
  - Draft denial letters carefully
  - Get deferential standard of review on appeal

Plan Governance – Investment Process

- Source of most fiduciary litigation
- Suggestions for managing risk:
  - Seek advice of independent professionals
  - Adopt and follow investment policy statement
  - Meet on regular basis
  - Document all decisions
  - Invoke available ERISA protections

Managing Fiduciary Liability

- Section 404(c) of ERISA
  - A significant fiduciary risk management tool for 401(k) plan fiduciaries
  - Protection from liability for investment decisions made by participants if certain conditions are met
  - DOL and some courts have taken the position that Section 404(c) does not protect from liability for imprudent selection of investment alternatives

Managing Fiduciary Liability

- Three Primary Components of Section 404(c) Compliance
  - Offer a broad range of investment alternatives
    - *At least three*
    - *Each must be diversified*
    - *Each must have materially different risk and return characteristics*
  - Offer each participant a reasonable opportunity to give investment instructions
  - Provide each participant with specified information about the investment alternatives to allow the participant to make informed choices
    - *Same information as required by the Section 404(a) participant disclosures*

Managing Fiduciary Liability

- Qualified Default Investment Alternatives (QDIAs)
  - Protection from liability for investments made in the absence of participant direction if certain conditions are met
  - Can be very helpful for plans with automatic enrollment or in fund mappings
  - Does not protect from liability for imprudent selection of the QDIA

Managing Fiduciary Liability

- Primary components of QDIA compliance
  - The investment alternative is a QDIA
    - *Life cycle or target date funds*
    - *Balanced funds*
    - *Managed accounts*
    - *<u>Not</u> stable value or money market (subject to some grandfathering)*
  - The participant had the opportunity to direct the investment, but did not
  - Notice (prior to first default investment and annually)

Participant Disclosures

- Recent 401(k) participant disclosures are a <u>fiduciary duty</u>
- Initial disclosures were required by August 30, 2012
- Three categories of disclosures
  - General plan information
  - Plan administrative expenses
  - Investment information
    - *Performance*
    - *Fees and expenses*
    - *Other investment-related disclosures*
- Some of the disclosures annually; others quarterly
- Differs from other reporting obligations under ERISA where the consequences for noncompliance are fines, penalties, etc.

Review of Fees and Expenses

- Monitoring, reviewing, and determining reasonableness of plan fees and expenses are fiduciary duties
- Section 408(b)(2) service provider disclosure requirements reflect DOL focus on fees and expenses
- Significant area of 401(k) plan litigation
- Importance of prudent process for fee and expense review
  - Periodic review of service providers
  - Benchmarking
  - RFPs

Company Stock Funds

- Company stock funds raise special fiduciary considerations
- “Hard wiring” into plan document
  - Establish a company stock fund as a plan design (or “settlor”) function, rather than a fiduciary function
- Procedures for voting company stock, tender offers, and other corporate actions

Managing Fiduciary Liability Process

- Use third-party service providers and select them carefully
- Hold regular meetings
- Take appropriate and detailed minutes
- Carefully consider all actions; document thought process details
- Monitor those whom you appoint
- Review all investment reports carefully
- Establish appropriate procedures for communicating with participants
- Engage independent fiduciaries when there are conflicted and prohibited transactions
- Document all claims carefully

Questions?

Presenters

- **Gregory L. Needles**, *Partner*
  - 202.739.5448
    - *gneedles@morganlewis.com*
- **Julie K. Stapel**, *Partner*
  - 312.324.1113
    - *jstapel@morganlewis.com*
- **Stuart P. Kasiske**, *Associate*
  - 202.739.6368
    - *skasiske@morganlewis.com*

Morgan Lewis

DISCLAIMER

- This communication is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship.

- **IRS Circular 230 Disclosure**
  To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein. For information about why we are required to include this legend, please see http://www.morganlewis.com/circular230.