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webcast

Overview of ERISA's Fiduciary Requirements: Retirement Plan Sponsor Considerations

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Introduction

- 2nd in series of retirement plan sponsor “Basics” webcasts
- Focus on fiduciary requirements and considerations
- Overview of fiduciary concepts (definition of fiduciary, description of fiduciary duties, standard of care, etc.)
- Managing fiduciary responsibilities
- Emphasis on participant-directed investments and discussion of ERISA section 404(c) compliance

ERISA Plans

- Fiduciary rules apply to any pension or welfare plan subject to ERISA and the Code
- Fiduciary rules do not apply to top-hat plans (nonqualified plans covering a select group of management or highly compensated employees) or to certain welfare plans that are exempt from ERISA

Who Is a Fiduciary?

- Origin in trust laws – a fiduciary is someone who stands in a special relation of trust, confidence, or responsibility in certain obligations to others (e.g., trustee, executor, guardian, etc.)
- In the ERISA context – a fiduciary is an individual or entity (trustee, plan administrator, investment committee, etc.) that:
 - Exercises ANY discretionary control over administration
 - Exercises ANY control over plan assets (whether or not discretionary)
 - Renders investment advice to a plan for a fee

Who Is a Fiduciary?

ERISA provides a functional test for fiduciary:

- You are a fiduciary when you are performing specified fiduciary functions under ERISA
- You are a fiduciary “to the extent” you are performing fiduciary functions
- ERISA permits fiduciaries to wear two hats **(but not at the same time)**
- It is possible to be a named fiduciary or a “de facto” fiduciary

Fiduciary vs. Settlor Activities

- Certain activities related to the plan are non-fiduciary – they are called “settlor” activities
- Settlor activities are unfettered by fiduciary responsibility (i.e., can be made based on company’s business interests and subject to the business-judgment rule)
- Settlor functions include things like:
 - Establishing a plan
 - Choosing plan design and plan features
 - Amending or terminating a plan

Types of Fiduciaries

- “Appointing fiduciaries” are fiduciaries with respect to appointment, monitoring, and removal of other fiduciaries
- Limited-purpose fiduciaries are appointed and monitored by named fiduciaries (trustee, investment managers, consultants who provide investment advice, etc.)
- Non-fiduciary service providers (e.g., record-keepers, auditors, benefits legal counsel, company personnel who work in benefits administration, etc.), as long as they stay within guidelines established by fiduciaries

Fiduciary Duties

- Duty of loyalty
 - Act solely in the interest of participants and beneficiaries
 - For the exclusive purpose of providing benefits
- Adherence to plan documents, unless contrary to applicable law
- No prohibited transactions
- Diversification of investments to reduce risk of loss (other than company stock in some circumstances)

Fiduciary Standard of Care

- Strict (and high) standard of care - fiduciaries must carry out their duties with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims
- This is the so-called prudent expert standard
- Flexible and evolving standard of care

Fiduciary Liability

- Personal liability for fiduciary breaches and losses stemming from breaches (no exculpatory provisions)
- Obligation to restore profits
- Other equitable and remedial relief (e.g., removal from fiduciary position)
- Additional penalties
 - Monetary penalties of 20% of recovery amount
 - Criminal penalties for willful violations of reporting requirements or fraud, force, or violence

Managing Fiduciary Responsibilities

- Engaging in procedural prudence
- Structure and operation of fiduciary committees
- Service provider relationships
- Indemnification of fiduciaries
- Securing fiduciary liability insurance
- Obtaining a fidelity bond
- ERISA section 404(c) compliance

Procedural Prudence

- No precise description of what is procedurally prudent under every circumstance
- Go back to standard of care definition:

“Fiduciaries must carry out their duties with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims...”

Procedural Prudence

Example: Monitoring Investment Funds

- Critically examine fund offerings against standards or benchmarks set out in any investment policy
- Set a regular review interval and stick to it
- Consider use of an independent investment consultant
- Predefine circumstances when a fund choice would be placed on a “watch list” and ultimately removed if performance lags
- Obtain full disclosure of fees and benchmark against peers

Fee and Expense Litigation

- Fee and expense litigation: an example of where procedural prudence matters
 - Wave of 401(k) plan fee and expense litigation initiated by certain plaintiffs' law firms
 - Claims of excessive or inappropriate fees (failing to understand, bargain for, obtain, etc. "revenue sharing"; offering mutual funds instead of separate accounts; offering retail instead of institutional share class funds; failure to disclose fees and revenue sharing; offering unitized stock fund without appropriate consideration)

Fee and Expense Litigation

- In a recent case, a court held that a fiduciary committee’s failure to inquire about a particular class of investment alternatives was, in and of itself, a violation of its fiduciary standard of care (even though the class of investments probably would not have been suitable for the plan). *Tibble v. Edison International* (C.D. Cal. 2010)
- In another case, the court held that fiduciaries of a 401(k) plan breached their fiduciary duty by electing to use a “unitized” company stock fund (which contained a cash float that resulted in a slight lag in performance as compared to actual company stock) without appropriately considering the issues. *George v. Kraft Foods Global, Inc.* (7th Cir. 2011)

Fee and Expense Litigation

- Considerations to manage litigation risk
 - Document review and negotiation of plan services agreements
 - Periodically review fee arrangements and investment alternatives
 - Consider both direct and indirect payments to plan service providers
 - Consider seeking assistance from a consultant who can help benchmark reasonable fees and expenses
 - Evaluate available share classes

Fiduciary Committee Structure and Operation

Committee Structure/Membership

- What sort of committees will be established and maintained (administrative, investment, settlor, etc.)?
- Who should be on the fiduciary committee?
 - Investment experts, human resources experts, benefits experts, representatives from business units?
 - Consider fiduciary training
- Consider who should be responsible for appointing fiduciary committee members and monitoring their activities
 - Board of Directors, CEO or other officers; designate committee members in the plan document by name or title?

Fiduciary Committee Structure and Operation

Committee Operation

- Documents governing committee actions:
 - Committee charter/operating rules; clarify how committee functions
 - Investment policy statement/guidelines; sets forth investment strategy, identifies what investments can and cannot be offered in the plan, describes how investments are evaluated, etc.
 - As important as it is to have good governance documents, critical to follow them; almost worse than not having them at all, since failure to follow will be prima facie evidence of imprudence

Fiduciary Committee Structure and Operation

- Conduct of meetings:
 - Agenda and list of topics to address
 - “Perennials” – reports from fund providers and investment managers, key vendors, consultants; review of fund and manager performance, including fees and expenses; review of legal/compliance issues; review of participant issues (usage/trends, complaints, claims/appeals)
 - Keep minutes to document activities and confirm exercise of procedural prudence
 - Avoid overlap of fiduciary and settlor activities

Service Provider Relationships

Service Provider Relationships

- Express delegation of fiduciary duties and responsibilities to fiduciary service providers
- Use of service providers to satisfy fiduciary standard of care and provide expert advice on issues
- Keep in mind that there is an ongoing obligation to monitor service providers
- Carefully review service provider agreements and watch out for limitation of liability provisions

Indemnification, Insurance, and Fidelity Bond

- Plan documents (and often corporate organizational documents) typically indemnify plan fiduciaries for actions taken in their fiduciary capacity, but no indemnification for willful misconduct, fraud, bad acts
- Corporate umbrella liability insurance policies often provide (directly or through a rider) liability insurance for fiduciary activities
- ERISA requires plans with plan assets to maintain a fidelity bond to cover fiduciaries and other individuals who “handle” plan assets

404(c) Relief – Overview

- Applies to defined contribution plans that permit participant-directed investments
- Upon satisfaction of procedural requirements, plan fiduciaries are relieved of fiduciary duty with respect to participant investment elections:

404(c): “In the case of a pension plan which provides for individual accounts and permits a participant or beneficiary to exercise control over the assets in his account:

...

no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant’s or beneficiary’s exercise of control.”

404(c) Relief – Requirements

- Basic 404(c) requirements:
 - Plan and SPD must say it's a 404(c) plan
 - Broad range of choices, so participants can diversify/limit risk (at least three choices, each diversified – range of risk/return characteristics)
 - Must be able to exercise control and make affirmative investment elections and changes freely (at least once a quarter; daily is clearly compliant)
 - Participants must be provided “sufficient information” regarding plan and investments (description of investments, fees, election procedures, prospectuses, etc.)

404(c) Relief – Scope

- Evolving area of the law – some recent court decisions suggest that scope of 404(c) relief may be relatively broad, while DOL takes the position that 404(c) relief is very narrow
 - One court concluded that compliance with 404(c) could serve as a defense in a fee and expense litigation case. *Hecker v. John Deere Co.* (7th Cir. 2009)
 - DOL in speeches and amicus curiae briefs takes position that 404(c) is relatively narrow

404(c) – Safe Harbors for Negative Elections

- 404(c) relief generally predicated on participants making an “affirmative” election and exerting control over their accounts
- 404(c) originally did not contemplate “negative” or “deemed” elections
- Pension Protection Act of 2006 added two safe harbors for negative elections – the “mapping” safe harbor and the “QDIA” default safe harbor

404(c) – Mapping Safe Harbor

- 404(c) relief preserved in situations where a plan is changing investment funds if:
 - Participants are provided notice within the 30-60 day period before the change
 - Notice must include information about the funds being added and eliminated
 - Notice explains the nature of the negative election
 - Replacement fund has investment characteristics that are “reasonably similar” to the investment fund being replaced; facts and circumstances analysis

404(c) – Mapping Safe Harbor

- Mapping safe harbor relatively easy to administer
- Facts and circumstances aspect of the mapping safe harbor can make 404(c) relief uncertain
- In some situations (e.g., phasing out a particular “sector” fund without a similar replacement), mapping safe harbor is not available
- Pre-safe harbor mapping legacy may lurk in plans

404(c) – QDIA Safe Harbor

- 404(c) relief preserved in situations where amounts are defaulted into a “qualified default investment alternative” (QDIA) - QDIA safe harbor is available if:
 - Participants receive 30 days’ advance notice and annual notice thereafter
 - Participants have an opportunity to make an election to avoid default
 - Plan provides a broad range of investment alternatives
 - Participants have opportunity to elect to transfer amounts into and out of QDIA fund at least quarterly
 - Any restrictions on transfer rights must be no more onerous than those that apply to individuals who affirmatively elected to invest in the QDIA
 - No unusual fees/expenses shall be imposed on such transfers

404(c) – QDIA Safe Harbor

- Amounts defaulted into a recognized QDIA (target or life-cycle fund, balanced fund, individually managed fund or, for grandfathered amounts, stable value fund)
- QDIA safe harbor is broader and more certain than mapping safe harbor, but potentially results in more significant investment change than mapping safe harbor
- In a recent case involving a QDIA default, the court concluded that the plan fiduciaries did not breach their duties in defaulting amounts into a QDIA even though participants experienced investment losses. *Bidwell v. University Medical Center, Inc.* (W.D. Ky. 2011)

Enhanced Disclosure Obligations

- Three-pronged disclosure initiative by the DOL
- Enhanced fee disclosures on Form 5500
- New service provider disclosure requirements
- Enhanced participant disclosure requirements
- June 29, 2011 Morgan Lewis webinar

Morgan Lewis: Executive Compensation and Employee Benefits Practice

- Morgan Lewis is a full-service law firm with more than 1,200 attorneys in a multitude of locations and practice areas
- One of the largest (if not the largest) employee benefits practices in the country with more than 75 full-time lawyer and nonlawyer professionals
- Significant contacts and experience with governmental agencies
- Additional group of 35 lawyers engaged solely or primarily in ERISA litigation
- ERISA litigators involved in cutting-edge “stock drop,” 401(k) fee litigation, retiree medical cases, etc.

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