

Understanding Your Fiduciary Role

Legal Aspects of Fiduciary Duties
Under ERISA for
Tax-Exempt Plan Sponsors

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January 26, 2012

I. ERISA

- ERISA imposes various technical and complex rules with respect to benefit plans.
 - Plan must be established and maintained pursuant to a written instrument.
 - Contents of plan must meet ERISA requirements.
 - “Fiduciaries” must meet certain duties.
- Most 403(b) arrangements sponsored by tax-exempt organizations are ERISA plans.

- A 403(b) arrangement is exempt from ERISA if:
 - Participation is completely voluntary;
 - Participants may enforce their rights under the plan without the employer's participation;
 - The employer receives no compensation other than reimbursement for offering the plan; and

– Employer involvement is limited to:

- Permitting annuity contractors to publicize their products to employees;
- Requesting information concerning proposed funding media, products, or annuity contractors, and summarizing such information to facilitate review by employees;
- Collecting and remitting salary reductions and maintaining records of such payments; and
- Holding in the employer's name group annuity contracts.

- Discretionary determinations by the employer may result in an ERISA plan:
 - Authorizing plan-to-plan transfers,
 - Processing distributions,
 - Satisfying applicable QJSA/QPSA requirements,
 - Making determinations regarding hardship distributions, QDROs, or loans, or
 - Negotiating with vendors, except to fix conflicting provisions or facilitate tax compliance.

- IRS regulations generally effective in 2009 require 403(b) plans to operate much like 401(k) plans
 - The greater employer involvement required to comply with the regulations has subjected many previously exempt 403(b) programs to ERISA.
 - The DOL maintains that it is possible to comply with the regulations and remain exempt from ERISA.
 - As a practical matter, ERISA classification is now very difficult to avoid.

- Form 5500 Reporting Requirement

- “Large” (100+ participant) ERISA-covered 403(b) plans must now file audited financial statements with their Form 5500s.
- “Small” ERISA-covered plans can use Form 5500-SF, but must still report aggregate financial information.
- Certain contracts or accounts issued before 2009 do not need to be included in plan assets.

- If ERISA does not apply, state law applies instead.
 - Many states impose fiduciary duties similar to the duties imposed by ERISA.
 - State law (rather than ERISA § 404(c)) governs whether and how a plan fiduciary may avoid liability for participants' investment decisions.

II. ERISA Fiduciaries

- Any person who exercises discretionary control over the management of the plan or its assets is a fiduciary.
- Named Fiduciaries
 - ERISA requires that the plan provide for one or more “named fiduciaries.”
 - Purpose is to let employees know who is responsible for operating the plan.

■ Other Fiduciaries

- A person is an ERISA fiduciary to the extent he or she:
 - Exercises discretionary authority or control over the disposition of plan assets;
 - Renders direct or indirect investment advice with respect to plan assets for a fee or other compensation; and/or
 - Has power to make decisions concerning plan management, administration or interpretation.

- Certain functions are non-fiduciary:
 - Establishing the plan
 - Determining the group of covered employees
 - Choosing benefits to be provided
 - Amending or terminating the plan
- A person is a fiduciary only “to the extent” he or she performs a fiduciary activity.

- ERISA imposes personal liability on fiduciaries who breach their duties.
 - Fiduciaries are personally liable to the plan for losses resulting from a breach and profits made through use of plan assets.
 - No liability for breaches occurring while not a fiduciary
 - But there is an obligation to take reasonable steps to correct a predecessor fiduciary's breach.

III. ERISA Fiduciary Duties

- Duty of Loyalty
 - Fiduciaries must deal fairly and honestly with participants.
 - Plan assets held in trust for the benefit of participants and beneficiaries.
- Duty of Disclosure
 - Fiduciaries must communicate material facts about the plan.
 - Loyalty may require speaking without being asked.

- Electronic disclosures are permitted, but only in certain circumstances:
 - For employees who have computer access as an “integral part” of their duties, communication/disclosure by e-mail or website posting is fine.
 - ♦ Access to a computer kiosk is not sufficient.
 - For employees who don’t have such access, paper copies must be distributed unless affirmative consent to electronic distribution is obtained.

- Exclusive Benefit Rule

- An ERISA fiduciary must act solely in the interest of plan participants and beneficiaries and for the exclusive purpose of providing benefits and paying reasonable plan expenses.
- Fiduciaries are not prohibited from taking actions that incidentally benefit the employer.

■ Duty of Prudence

- Standard for prudence depends on the circumstances
 - Consider the factors and circumstances that a prudent person having similar duties and familiar with such matters would consider relevant, e.g., obligation to assure plan is, and remains, tax qualified
- Affirmative duty to seek advice and counsel from independent experts when fiduciary's own ability is not sufficient under the circumstances

■ Duty to Monitor

- Adopt and adhere to an investment policy
- Conduct regular, formal reviews of service providers
 - Read reports
 - Review fees
 - Review complaints

- Duty to Diversify Plan Investments
 - ERISA § 404(c) provides some relief from liability.
- Adherence to Plan Documents
 - Congress wanted participants and beneficiaries to know their rights and be able to enforce them.
 - Documents should be up-to-date; oral modifications are not permitted.

IV. Fulfilling Your Fiduciary Duties

- Establishing an Administrative Committee
 - The Board of Directors should delegate the authority to manage the plan to a committee.
 - Committee members are fiduciaries.
 - The committee should meet regularly and keep minutes.
 - Minutes provide evidence of a reasoned and careful decision-making process.

■ Selecting Vendors

- The committee should compare multiple options, considering:
 - Fees
 - Investment options
 - Compliance assistance
 - Recordkeeping capacity
 - Institutional stability
- Selection process should be carefully documented.

■ Selecting Plan Investments

– Draft an Investment Policy Statement

- An IPS is a written statement that provides the fiduciaries responsible for plan investments with guidelines or general instructions concerning investments.
- Maintenance of an IPS does not relieve the named fiduciary of its obligations under ERISA with respect to monitoring of vendors/investments.

– Provide a menu of investment choices

- Fulfilling the requirements of ERISA § 404(c) provides relief from liability for participants' investment losses.
 - ♦ Participants must:
 - » Be able to choose from a “broad range” of at least three investment alternatives;
 - » Receive enough information to make informed investment decisions; and
 - » Have the right to change investments at least once per quarter.

- ♦ Plan fiduciaries remain responsible for the selection and monitoring of a menu of investment choices.
 - » “Socially responsible” investments may be included only on the basis of investment analysis – fiduciaries must not consider unrelated facts in evaluating the quality and expense of an investment or service provider.
- Establishing a QDIA (e.g., target date retirement fund) provides certain fiduciary relief from liability for participant investment in a default investment option.
 - ♦ A QDIA must allow participants to transfer funds at least once every three months.
 - ♦ Initial and annual QDIA disclosure requirements.

- Special considerations apply to selecting a guaranteed income option:

- ◆ Cost of the guarantee
- ◆ Quality of the underlying investments
- ◆ Option for retirees to roll over
- ◆ Financial viability of the provider

– Focus on procedure

- Hire professionals to evaluate the investment
- Exercise independent judgment
- Follow investment policy guidelines
- Document the process carefully.

■ Monitoring Vendors and Investments

- To establish procedural due diligence, review annually:
 - Quarterly reports
 - Benchmarks
 - Fees and expenses
 - Management, investment style, and capital structure
- Consider retaining an independent firm to review investment performance.
- Periodically conduct a request for proposal (RFP) process (e.g., every 3-5 years), unless circumstances would require this process sooner.

V. Fees

- Fees are an increasingly important consideration in selecting and monitoring vendors and investments.
- 403(b) participants pay higher fees
 - By one estimate, 403(b) participants pay 30% to 50% more for investment management than 401(k) participants.
 - 401(k) plans may allow almost any kind of investment, but 403(b) plans are limited to mutual funds and annuities, which are more expensive investment structures.

- Insurance carriers frequently charge special fees upon termination of group annuity contracts.
 - Fiduciaries should ask specific questions regarding these “surrender” or “contingent deferred sales” charges.

■ Disclosures by Service Providers

- DOL regulations effective April 1, 2012 require service providers to disclose to fiduciaries:
 - Compensation for services, contract terminations and recordkeeping
 - Investment fees
 - Operating and ongoing expenses
- Plan fiduciaries should review new disclosures when assessing reasonableness of fees.

■ Disclosures to Participants

- Under regulations the DOL issued in the Fall of 2010, plan fiduciaries will be required to make a number of new fee disclosures to participants.
- The final rule is applicable to covered individual account plans for plan years beginning on or after November 1, 2011, although the DOL has generally extended the initial compliance date to May 31, 2012 (for calendar year plans).

■ Fee Litigation

- A number of class action suits regarding 401(k) plan fees have been brought in recent years, claiming that:
 - Fiduciaries failed to negotiate lower fees or consider cheaper investment options.
 - Revenue sharing payments between plan sponsors and service providers were not properly disclosed.
- 403(b) plans have not yet been targeted, but logic of 401(k) suits is applicable.

VII. Exculpation/Insurance/ Indemnification

- Plan may not release a fiduciary from liability
 - Fiduciary may delegate duties to other individuals but must monitor delegate's activities.
 - Committee must monitor the activities of any subcommittee.
 - Indemnification by employer/sponsor of a plan for a fiduciary breach is generally permitted under ERISA.

- Indemnification

- Indemnification does not apply in cases of gross negligence or willful misconduct.

- Fiduciary Insurance Policies

- Protects the organization and plan managers and administrators from lawsuits alleging breaches of their duties under ERISA.

VIII. Best Practices

- Identify and define roles of all plan fiduciaries
- Develop and maintain a written investment policy for each plan
- Select investment vehicles consistent with the plan's investment policy
- Select service providers prudently
- Review fees

- Evaluate total costs of plan services: transaction fees, recordkeeping, administration, trustee services, advice/education
- Communicate fees and investment returns to participants
- Review ERISA fiduciary and D&O policies
- Document everything